

X038/301

NATIONAL
QUALIFICATIONS
2010

FRIDAY, 28 MAY
9.00 AM – 11.30 AM

ECONOMICS
HIGHER

INSTRUCTIONS TO CANDIDATES

Candidates must attempt **both** items in Section A and any **two** questions in Section B.



SECTION A

ITEM A

Read the passage below and then answer the questions which follow.

Emergency Meeting of the Organisation of Petroleum Exporting Countries (OPEC)

Oil consumption in developed countries was more than 1 million barrels a day lower in September 2008 than in September 2007. World oil prices fell, despite the efforts of OPEC (the oil **cartel**) to steady them by cutting output by 1·5 million barrels a day. The decision to cut total daily output by 5% came after an emergency OPEC meeting. However, the move did not prevent the slide in the price of oil.

Motorists and air passengers have benefited from the drop in oil prices. One side effect of the fall in oil prices was that it started a **price war** among supermarkets. Asda and Morrisons led the race to get petrol prices down to £1 a litre, rapidly followed by Tesco. Other petrol retailers have had to react quickly.

However, not everyone benefited from the fall in oil prices. The revenues of oil producers, which were at a record high when the price of oil peaked at \$147 a barrel, fell as the price of oil fell. Oil is priced in dollars. The fall in the value of sterling against the dollar meant that those buying oil with sterling did not fully benefit from the fall in the price of oil.

The fall in consumption, plus the fall in the price of oil, created problems for the UK government.

- (a) Define the following terms, **as used in the passage**:
- (i) “cartel”; 2
 - (ii) “price war”. 2
- (b) Explain why the cut in the output of oil did not prevent the price of oil falling. Your explanation must include a diagram. 4
- (c) (i) Explain the way a fall in petrol prices affects the real income of motorists. 2
- (ii) Explain the way air passengers benefit from a fall in oil prices. 2
- (d) What does the relationship between the price of oil and the revenues of oil producers indicate about the price elasticity of demand for oil? Explain your answer. 4
- (e) Explain why the fall in the value of sterling prevents some people from fully benefiting from a fall in the price of oil. 3
- (f) Using information in the passage explain how consumers can benefit from competition in a market. 2
- (g) Explain **one** reason for the fall in oil consumption in developed countries. 2
- (h) Describe **one** problem for the UK government of a fall in the price of oil. 2
- (25)**

[Turn over

ITEM B

Read the passage below and then answer the questions which follow.

Which way forward for the Monetary Policy Committee?

If anyone needed proof of the difficulties facing the Bank of England's Monetary Policy Committee, it emerged in the third quarter of 2008. Official figures showed that the economy was grinding to a halt for the first time since the previous **recession** in the early 1990s. In addition inflation had risen to a 16-year high of 4.4 per cent, well above the government's target. There was a three-way voting split in the nine-member committee as Professor Besley pressed his case for an interest rate rise and Professor Blanchflower voted for an interest rate cut.

UK economic growth slowed between April and the end of June 2008 and gloomy news from the manufacturing and services sectors indicated that there was little chance of a turnaround in the third quarter. Retailers reported weak trading conditions in August and the deterioration in the housing market picked up pace, with prices in August dropping at the fastest rate in 18 years. The rise in electricity prices and the continuing weakness of sterling, which fell to a two-year low against the dollar on Friday, made the situation worse.

However, the US economy rallied in the second quarter of 2008 because of rising exports and a \$100 billion package of tax reductions. Although GDP growth in the USA was 3.3 per cent in the second quarter of 2008, analysts said that output could fall in the near future. There was also mounting evidence of a slowdown in the **eurozone**, but it was expected to perform better than the UK.

- (a) Define the following terms, **as used in the passage**:
- (i) “recession”; 2
 - (ii) “eurozone”. 2
- (b) What is the UK government’s current percentage target for inflation? 1
- (c) Using information from the passage explain the case for:
- (i) a rise in interest rates; 2
 - (ii) a fall in interest rates. 2
- (d) Give **one** explanation for the fall in house prices. 2
- (e) Explain **one** advantage and **one** disadvantage for the UK economy of a fall in the exchange rate of sterling. 4
- (f) Explain how booming exports and tax reductions helped increase the growth rate in the US. 4
- (g) Apart from reducing taxes, explain how Fiscal Policy can be used to stimulate recovery from a recession. 3
- (h) Explain how a slowdown in the eurozone is likely to affect the UK Balance of Payments. 3
- (25)**

[Turn over for Section B on Pages six and seven]

SECTION B

Attempt any TWO questions.

1. One problem facing all economies is how best to tackle scarcity. Developing countries are not very well-equipped to tackle scarcity.
 - (a) Explain the difference between scarcity and shortages. 6
 - (b) Describe ways in which developed countries can help increase the growth rates of developing economies. 10
 - (c) Discuss the advantages and disadvantages for the UK of increased growth rates in developing countries. 9

(25)
2. The price mechanism uses market forces to achieve an efficient allocation of resources. However, governments often intervene to try to correct market failure.
 - (a) Define technical and economic efficiency and explain the relationship between them. 6
 - (b) (i) Explain, using examples, what is meant by market failure. 9
 - (ii) Describe ways in which governments intervene to try to correct market failure. 6
 - (c) Identify **one** method of allocating resources, other than the price mechanism, and briefly explain how it works. 4

(25)
3. Firms in all markets have a greater control over supply than over demand.
 - (a) Compare the characteristics of monopoly with those of perfect competition. 10
 - (b) (i) Explain, using diagrams, what is meant by price elasticity of supply. 10
 - (ii) Describe the factors which influence price elasticity of supply. 10
 - (c) Explain the importance of price elasticity of supply. 5

(25)
4. In August 2008 the rate of inflation reached 4.4%, well above the government's target. In order to control inflation, a government may use monetary, fiscal and supply-side policies.
 - (a) Explain the difference between monetary policy and fiscal policy. 6
 - (b) (i) Describe **2** factors which could cause the rate of inflation to increase. 4
 - (ii) Explain how a high rate of inflation can create problems for an economy. 7
 - (c) Describe supply-side measures a government could take to reduce the rate of inflation and explain how they would work. 8

(25)

5. Falls in the level of our National Income have affected the government, individuals and the value of our marginal propensity to consume (MPC).
- (a) Explain what is meant by the circular flow of income and National Income equilibrium. Your explanations must include a diagram. **10**
- (b) Explain how a fall in the level of National Income can create problems for:
- (i) a government;
- (ii) an individual. **6**
- (c) (i) Describe what is meant by the multiplier.
- (ii) Explain the relationship between the MPC and the multiplier. **9**
- (25)**
6. One argument used for imposing import controls on Chinese goods is that average production costs in the UK are higher than average production costs in China.
- (a) (i) Describe some arguments for imposing import controls, other than cost differences.
- (ii) Describe some arguments against imposing import controls. **15**
- (b) (i) Explain what is meant by long run average costs.
- (ii) Describe the reasons why a long run average cost curve falls and then rises. **10**
- (25)**

[END OF QUESTION PAPER]

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