

X038/301

NATIONAL
QUALIFICATIONS
2011

MONDAY, 23 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.

The Governor, the Markets and the Tumbling Pound

It started with a harmless-sounding article in the Bank of England's Quarterly Bulletin. The article looked at why the value of the pound had fallen so much during the previous two years. One reason was that the UK economy had been more seriously affected by the **global financial crisis** than the economies of other countries. Another reason was that the UK has had a large and growing deficit on its **Trade in Goods**. (Although its Trade in Services continues to be in surplus.) This was fine as long as capital flowed into the UK from other countries.

As a result of the problems highlighted in the article, sterling fell against the euro. It staged a small recovery when the Bank's Monetary Policy Committee (MPC) agreed not to cut interest rates.

In the short-run the fall in the value of the pound boosts exports but it also puts upward pressure on the rate of inflation. A weak pound will also increase the price of food grown in the UK as it increases the incentive for UK farmers to sell abroad rather than in the UK.

The fall in the value of sterling is also causing problems for Nick James, whose company imports expensive French champagne. During the boom, champagne consumption soared. However, the good times ended last year. He said, "It was extremely difficult. We have had to increase our price and, as a result, our total revenue has fallen".

- (a) Explain what is meant by a “global financial crisis”. 2
- (b) Explain **one** reason why the UK economy could be more seriously affected by the financial crisis than the economies of other countries. 2
- (c) (i) Explain what is meant by a “deficit on Trade in Goods”. 2
(ii) Explain **one** reason for the UK’s Trade in Goods being in deficit. 2
(iii) Explain **one** reason for the UK’s Trade in Services being in surplus. 2
- (d) (i) Explain what would have happened to the value of sterling if the Bank’s MPC had cut interest rates. 3
(ii) State **one** reason why the MPC might increase the interest rate. 1
- (e) Explain why a fall in the value of sterling:
(i) boosts exports;
(ii) puts upward pressure on the rate of inflation. 4
- (f) Draw a diagram to show how the weak pound will increase the price of food grown in the UK. 2
- (g) (i) What evidence is there in the passage to suggest that the demand for Nick James’ champagne is income elastic? 3
(ii) State whether the demand for Nick James’ champagne is price elastic or price inelastic. Explain your answer. 2
- (25)**

[Turn over

ITEM B

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

Car Scrappage: Winners and Losers

For many car manufacturers worldwide, car scrappage schemes were a runaway success. Consumers were offered, on average, £2000 to scrap their 9+ year old vehicle for a new one. This gave an artificial boost to a depressed **car market** and increased the demand for new cars. Ford, for example, was in big trouble when sales plummeted during 2008. The “cash for clunkers” US scrappage scheme came at just the right time. In August 2009, Ford car sales jumped 17% from the same month in 2008.

Car manufacturers in **emerging economies** also saw a significant increase in demand due to motorists targeting small cars with their scrappage discounts. Hyundai, for example, saw their US car sales rocket 47%. In previous economic downturns the bottom end of the market was hit hardest. This time around it was the top end. Sales of BMWs fell by 18% in August 2009 in the US compared to the previous year. Second-hand car dealers have seen thousands of potential customers enticed away by large discounts on shiny new motors. Why buy a second-hand car when you can buy a new car for a similar price?

Some economic analysts are convinced that scrappage schemes will reduce environmental damage (a negative externality). They argue that the benefits of the reduced emissions from new cars is greater than the environmental cost of producing them. The UK scheme was extended until early in 2010 by which time it is hoped the recession will end.

- (a) Explain the meaning of the following terms as used in the passage:
- (i) car market; 2
 - (ii) emerging economies. 2
- (b) Explain **one** possible reason for the fall in Ford car sales in 2008. 3
- (c) Explain why the car scrappage scheme benefited the bottom rather than the top end of the market. 2
- (d) Explain, using a diagram, how the car scrappage scheme has affected the market for second-hand cars. 4
- (e) Give **one** argument for and **one** argument against extending the UK car scrappage scheme. 4
- (f) (i) Describe what is meant by an externality. 2
- (ii) State why environmental damage is considered to be a negative externality. 1
- (iii) Explain why negative externalities are often neglected when firms calculate the costs of producing a good or service. 2
- (g) Negative externalities are an example of market failure. Describe other forms of market failure. 3
- (25)**

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

SECTION B

Attempt any TWO questions.

1. A basic cause of inflation is the demand for goods rising faster than the supply of goods.
 - (a) Explain, using examples, the difference between:
 - (i) economic goods and free goods;
 - (ii) private goods and public goods. 8
 - (b) Explain how the Retail Price Index is calculated and how it differs from the Consumer Price Index. 5
 - (c) Describe **3** advantages of a low rate of inflation. 6
 - (d) Other than low inflation describe **3** economic aims of governments. 6

(25)
2. The existence of barriers to entry enables firms to charge a price well above the average total cost.
 - (a) Explain, using examples, what is meant by “barriers to entry”. 8
 - (b) Describe and account for the shape of an average fixed cost curve and an average variable cost curve. 7
 - (c) Explain why a firm might continue to produce when its price (average revenue) is well below its average total cost. 10

(25)
3. During 2009 the highest rate of Value Added Tax (VAT) was reduced from 17·5% to 15%.
 - (a) Explain why, in 2009, VAT was cut from 17·5% to 15%. 4
 - (b) Discuss the effects of a shift in the burden of taxation from direct to indirect taxes. 6
 - (c) Explain how the Budget can be used to reduce income inequalities in the UK. 7
 - (d) Explain why Budget deficits are almost inevitable during a recession. 8

(25)

4. Foreign Direct Investment is worth about £41 billion to the Scottish economy and accounts for more than half of all economic growth in Scotland.
- (a) Explain what is meant by economic growth. 3
 - (b) Explain why foreign firms may wish to locate in Scotland. 6
 - (c) Describe some of the costs and benefits of Foreign Direct Investment for the Scottish economy. 8
 - (d) Explain the main economic benefits that could arise for the Scottish economy of the UK joining the Eurozone. 8
- (25)
5. Less developed countries (LDCs) faced problems during the recession of 2009 partly because the demand for many of their exports is price inelastic but income elastic.
- (a) Describe some other economic problems facing LDCs. 8
 - (b) Explain, using an example and a formula, what is meant by price inelastic demand. 6
 - (c) Explain why the income elasticity of demand for some goods is positive and for other goods is negative. 5
 - (d) Describe 3 factors which can affect the price elasticity of demand for a product. 6
- (25)
6. During 2009 the UK experienced negative growth, rising unemployment and a fall in the value of its currency.
- (a) Describe 2 ways of measuring unemployment. 4
 - (b) Explain how negative growth results in rising unemployment. 5
 - (c) Describe 3 causes of unemployment other than negative growth. 6
 - (d) Discuss the advantages and disadvantages of a floating exchange rate. 10
- (25)

[END OF QUESTION PAPER]

[BLANK PAGE]