2010 Economics

Advanced Higher

Finalised Marking Instructions

Marking Instructions
Economics Advanced Higher

Detailed marking instructions/guidelines

These are not solutions

1. The appended marking instructions are guidelines only. Candidates will adopt different ways of tackling particular questions.
2. Differences of interpretation will be resolved at the Markers' meetings in May and June.
3. In essay or extended answers it is not necessary for candidates to include all the points listed in the enclosed mark schemes.
4. Candidates are expected to demonstrate a full appreciation of the topic and a sound understanding of the economic issues under discussion.
5. Marks should not be allocated on a rigid points scoring basis, but on the overall quality of the answer.

Advanced Higher: Marking Scheme

Marks

Section A

				Marks
1.	(a)	(i)	"Automatic stabilisers" − The automatic adjustments in the level of government spending and taxation which occur which smooth out the peaks and troughs of the trade cycle. Credit examples of JSA rising and tax receipts falling during a recession and the understanding that these would occur without any change in government policy.	**2**
		(ii)	"Structural deficit" − that part of the budget deficit which is not related to the trade cycle/recession but was caused by government spending rising at a faster rate that tax receipts before the recession and will continue thereafter.	**2**
	(b)	(i)	Credit examples of the cut in VAT, capital expenditure being brought forward, the car scrappage scheme etc to explain how the practical policies introduced as part of the fiscal stimulus might work. Also credit candidates who mention the difficulty of evaluating the success of fiscal policy.	
		(ii)	In theory an expansionary fiscal policy of increased government spending and falls in taxation will lead to higher AD. Mention could be made of a positive multiplier effect.	**5**
	(c)		Higher taxes and lower government spending in the future. The burden of Debt Interest and Opportunity cost in terms of government spending priorities. Lower AD in the future because of the contractionary effects on AD of lower government spending and higher taxation.	**4**
	(d)		£ might fall because of lower confidence in the UK economy. UK may have lower rates of growth than other major developed economies and may have lower interest rates because monetary policy will need to stay loose to counterbalance the contractionary fiscal policy.	**3**
	(e)		Loss of prestige for the UK government if UK government debt downgraded. Credit understanding of the term and the role of Credit Rating Agencies. Interest rates might rise because the government would have to pay more to borrow in international markets because of the higher perceived risk of the UK government defaulting. Credit reference to the Greek crisis.	**3**

Marks

(f) Credit a discussion of the negative implications for the UK economy and society of:

- Cuts in government spending − if frontline services are hit and the difficulty of achieving efficiency gains in the public sector. Unemployment would rise if job cuts occur. Effect on vulnerable groups. Rising inequality?

- Rises in taxation − difficulty of raising income tax. Would increasing VAT to 20% be a good idea? Progressive vs regressive issues. Disincentives to work caused by increasing higher MRTs. Environmental taxes and their significance. Political problems of raising taxes.

- Asset sales − only a one off but least painful in the short run but does not solve the underlying structure issue. **6**

Credit an appreciation that achieving this is not going to be painless or easy.
Knowledge of £6.2bn cuts and other details.
Very comprehensive answers may secure full marks without mention of assets sales.

[END OF SECTION A]

Section B

Marks

1. (a)

- Regulation was shared between the Bank of England, the Financial Services Authority (FSA) and the Treasury.
- The FSA was responsible for day to day control of individual institutions.
- The policy was essentially based on laissez faire, leaving the banks to make their own arrangements on the assumption that they knew best. **7**

(b)

- Candidates expected to comment on the unsatisfactory state of affairs contributing to the banking crises in which there was no responsibility for the systemic effects − those actions which make sense to any single institution but when aggregated can create immense problems.
- Banks need to hold more of their reserves in capital.
- Tougher liquidity requirements (hold higher stock of government bonds).
- Deposit insurance schemes and asset protection scheme.
- Should capital holdings be varied according to the state of the economic cycle?
- Clear division between the retail and investment functions of the major banks and the application of more stringent rules to speculative activity.
- FSA took over role of policing retail banking in November 2009. **8**

(c)

- Division between investment and retail banking likely to be effective.
- In investment banking the problem of the securitisation of loans not tackled; the creation of money through leveraged lending is an underling cause of instability. The problem that emerged after 1997 has not been addressed and is a global banking issue.
- Since the UK government owns several major banks it is in a strong position to impose tighter control.
- Questions remain. Who controls the bankers? Do they understand the instruments at their disposal? Can a repeat of the 2008/2009 crisis be averted? **10**

			Marks
2.	(a)	• Diagrams must be given to show the main differences. • Differences include pricing, ability to earn long run profits, entry and exit to the industry, the shape of revenue curves and the efficient allocation of resources. • Candidates who choose to analyse oligopoly instead of or in addition to 'pure' monopoly should be credited. If oligopoly is discussed product differentiation, price discrimination, the kinked demand curve and price wars should be considered.	**8**
	(b)	• The basis of the question is that efficiency requires price to equal marginal cost. • Benefits of monopolistic markets include rationalisation of the supply of goods and services, economies of scale, stability in times of economic depression, ability to compete in international markets and greater innovation opportunities for firms. • Costs include inefficient production, higher prices, limited choice and poorer consumer service. It may be difficult for government to monitor and control the behaviour of large firms.	**9**
	(c)	• This is about price discrimination. • Reasons include different consumer markets (with differing income and price elasticity), the timing of ticket purchase, the type of service or class purchased, the impossibility of reselling tickets to other consumers, the absence of consumer choice on many routes and whether or not the ticket is purchased as part of a package including things like accommodation and car hire. • Candidates should be credited for relevant examples.	**8**

Marks

3. (a) **Prosperity threatened by**

- A smaller working population to produce goods and services and to support the dependent population.
- Declining skill levels in the population.
- Marked increase in the dependent population requiring pensions and medical services.
- Higher levels of taxation for the working population reducing disposable income and consumer demand with consequent negative multiplier effects. **8**

(b) **Measures include:**

- Increasing the retirement age or even abolishing it.
- Increase in the activity rate especially the number of women between 16 and 65.
- Increase in National Insurance Contributions (NIC) to fund pensions and medical services.
- Abolition or reduction of the real value of the state pension.
- Greater emphasis on private pension arrangements.
- Immigration encouraged from those in the working age.
- More part time work for senior citizens.
- Encourage larger families. **8**

(c)

- Increasing retirement age already happening (to 68) and certain to be a key policy.
- Sustained increase in activity rates difficult to maintain in the longer term because a high percentage of the working age population is already in employment.
- NIC already rising and likely to be increased further.
- State pension may disappear eventually to be replaced by (compulsory?) private pension arrangements.
- Immigration controversial because of social considerations and perceived threat to domestic jobs.
- Larger families only effective in the very long term and may be difficult to induce. **9**

Marks

4. (a) **Brief definition of an economic recession, two successive quarters of negative growth.**
- Failing demand in global markets.
- The impact of the banking crisis leading to declining liquidity.
- Loss of consumer confidence.
- Collapse in asset prices.
- Inevitability after many years of sustained expansion.
- Interrelatedness of the world economy. **7**

(b) **Indication of the extent of the recession expected.**
- Disproportionate size of the UK banking sector.
- The UK fiscal injection lower than in most other countries.
- Extent of debt; government, personal and corporate.
- Difficulty of obtaining credit for firms.
- General implication that the UK had been financing expansion for many years on unsustainable bubbles based on easy, dubious credit sources. **8**

(c) **Demand side – Factors include:**
- For the economy; lack of demand leading to rising unemployment and multiplier effects.
- For the government; a vast budget deficit that must be financed (eventually), pressure to increase taxation and cut public services, leading to consumer welfare loss (health, education, transport etc.) and further job losses. Danger that this may prolong or renew recessionary conditions.
- Some areas and sectors of the economy suffer more than others leading to greater inequality for different parts of the UK and wider variations in per capita income.
- Lower business investment leading to a fall in aggregate demand can achieve long-term economic growth
- Lower living standards and impact on individuals and firms.

Supply side – Factors include:
- Deskilling. Rise in long-term unemployment.
- Inward shift in productive potential of economy.
- Fall in aggregate supply.
- Lower investment reducing productive potential.

Allocation of marks to depend on overall quality of answer, but both sides must be addressed for high marks. **10**

Marks

5. (a)

- Candidates expected to give information about meaning, timing and amounts of Quantitative Easing.
- Aim to meet MPC's inflation target of 2% CPI.
- Monetary policy impossible because interest rates cuts no longer an option because rates at 0.5% could be cut no further.
- Monetary transmission mechanism ineffective because of credit crunch.
- Fiscal stimulus difficult to countenance at a time of high public sector borrowing.
- To create demand in the economy in time of recession.
- NB candidates should avoid stating that governments were just printing money ('Like Zimbabwe leading to hyperinflation'). **8**

(b)

- Higher levels of demand leading to economic recovery.
- Banks more able to lend to firms and house purchasers.
- To reduce inter bank borrowing rates (LIBOR) and encourage greater confidence in the inter bank lending market.
- To encourage recovery in the financial markets.
- To create 'a feel good factor' when confidence was very low.
- Reduce long-term interest rates. **9**

(c)

- Inflation may result if the policy gets out of control.
- Danger of bubbles, for example in the stock market which may not be justified by economic conditions.
- Increasing levels of potential government debt.
- What happens if the policy does not work and how much extra money should be injected − it is above the original target and a matter of contention.
- Banks may become complacent and be encouraged to return to policies that led to the banking crisis.
- When to end the policy and reversing of £200bn injection of QE. **8**

Marks

6. (a)

- A clear statement of the type of market failure is necessary − costs of economic activity are not borne privately but by society.
- In many activities CO2 and other substances are emitted into the atmosphere, rivers, seas etc at no cost to the firm or individual creating them.
- Global warming is thought to be a consequence of market failure imposing burdens on the world and its citizens.
- Higher temperatures, rising sea levels, climate change, damage to the flora and fauna, levels of population can all be stated. **8**

(b) (i)

- Kyoto protocol to reduce emissions by 5% may be achieved, but targets considered too modest and largely achieved by switching polluting industrial activity to emerging and developing countries.
- Copenhagen. No legally binding agreement. Undertaking to cut CO_2 emissions by 2025 by 25% and to limit temperature rise to a maximum of 2°C. Fund of £100bn to assist developing countries to reduce emissions. **4**

(ii)

- Environmental taxes.
- Subsidies of green technology.
- Regulation of deforestation.
- CAP and trade schemes.
- Energy efficiency measures.
- Education
- Advances in technology.
- Carbon capture
- Power stations.
- Reducing rates of economic growth etc. **6**

(c)

- China and India object to the fact that they are expected to adhere to major reductions in CO2 emissions whilst undergoing expansion, which did not apply the western industrialised nations when they were industrialised, causing most of the environmental damage to date.
- Alternative energy supplies are much more expensive and poorer countries will be more seriously affected.
- Emerging economies expect less draconian limits to be applied to them.
- Emerging and developing economies expect substantial financial aid from the developed world.
- Some suggest that the cost of proposed CO2 limits will have a more than proportionate affect on living standards of poorer countries than permitting global warming to take place (eg Lord Lawson). **7**

[END OF SECTION B]

[END OF MARKING INSTRUCTIONS]