2012 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

1. Explain what is meant by the following as used in the passage.

(a) double- dip recession.

Recession- Definition (1 mark)

GDP growth slides back to negative after a period of positive growth. A recession followed by a short-lived recovery followed by another recession. **2**

(b) squeeze on real incomes

1 mark – definition of real incomes

1 mark to explain “squeeze” a lower standard of living, lower spending power. **2**

2. Explain how the 50p rate of tax may harm the UK economy’s rate of economic growth. Up to 3 marks for one well explained point.

Deters enterprise

Brain drain

Lower disposable income due to higher tax

Growth of shadow economy

Disincentive for philanthropy

Disincentive to work

Companies relocating abroad

Less inward investment

Points must be related to economic growth.

No marks for restating points in the passage. **3**

3. Justify the UK Government's belief that its tough fiscal approach is necessary in the current economic climate.

Size of Budget Deficit

Improve investor confidence

AAA rating

Sovereign debt crises

Interest burden

Intergenerational unfairness

Ideology eg reducing the size of the state

Mark according to the overall quality of the answer. Development marks can be awarded. **4**

4. (a) Other than rieking fuel duty, explain 2 reasons why petrol prices have been rising.

Demand reasons include: rising global demand especially BRICs, speculative activity, economic recovery (?), weak £, Threat of tanker strike – panic buying

Supply reasons include: Middle East instability, lack of refining capacity, depleting non-renewable resource

Firms protecting profit margins

OPEC cartel **4**

(b) Use a diagram to show the effect of an increase in fuel duty on the market for petrol

Diagram should illustrate upward shift in the supply curve and a new equilibrium. Only 1 mark if PED or PES is not inelastic **2**

5. Discuss whether the 50p tax rate fulfils the principles of good taxation.

Based on ability to pay

Cost of collection

Certainty

Convenience

Should not create disincentives to work

Mark according to the overall quality of discussion. Note – must be some form of discussion. For full marks. **4**

6. If the UK government were to scrap the 50p tax rate, suggest and justify an alternative option for raising tax revenue.

Mansion tax

Higher VAT

Green taxes

Higher petrol duties

Bankers' bonuses

Higher inheritance tax

Any other credible tax rise

1 mark for suggesting the option and 3 marks for justification **4**

[END OF SECTION A]

Section B

Essay 1

(a) Compare the characteristics of perfect competition and monopolistic competition.

The following characteristics apply to perfect competition and monopolistic competition.

Many buyers and sellers in the marketplace, none of whom are large enough to influence the price.

There is freedom of entry and exit into the market ie low or no barriers to entry. Firms must be able to establish themselves quickly in the marketplace.

Buyers and sellers have perfect knowledge; economic agents are fully informed of prices and output in the industry.

However, in perfect competition firms produce a homogenous product whereas monopolistic firms produce a non-homogenous (differentiated) product. These create scope for brand loyalty.

Perfect competition – price takers; monopolistic – limited price makers.

Shape of demand curves – perfect competition – perfectly elastic
monopolistic competition – Downward sloping + elastic

If only one correct market type – max 3 marks.

If no attempt at comparison max 5 marks. **6**

(b) Using diagrams to support your answers

(i) explain why a firm in perfect competition may make abnormal profits in the short run;

In the SR a firm in perfect competition can gain a competitive advantage by finding a lower cost production process (1 mark).

Where AR>ATC at profit maximising output. (1 mark).

In the long run new firms can enter the industry to compete away the abnormal profit. (1 mark).

Up to 3 marks for the diagram.

3:2 2:3

1 mark – correct curves

1 mark – profit maximising output

1 mark – abnormal profit

(ii) explain why a firm in monopolistic competition can make only normal profits in the long run;

Lack of significant barriers to entry ensures that only normal profits are made in the long run (1 mark). Short-run abnormal profits will induce new entry (1 mark). As new firms enter the market, the demand curve shifts until it's tangential to the AC curve (1 mark). At this point only normal profits are earned and there is no incentive for further firms to enter the industry (1 mark).

1 mark for downward sloping demand curve

1 mark for equilibrium output where MC=MR

1 mark for showing normal profits where AC=AR

3:2 2:3 **10**

(c) Explain why a few large firms can dominate some markets whilst small firms thrive in other markets.

Large firms dominate because of barriers to entry including patents and copyrights, economies of scale, control of raw materials, advertising, sunk costs, etc.

Small firms thrive because of the demand for variety, lack of capital to enable growth, personal service, geographical position, limited market for luxury goods, firms in their infancy because they are establishing in markets, ability to respond to market changes/uncertainty, self-interest and profit motive, government incentives for small firms, economies of scale through co-operation, scope for innovation, niche marketing, etc.

Minimum efficient scale of production is low in some industries so no/little cost disadvantage of being small.

No significant economies of scale for firms with low fixed costs. Large firms contract out to small businesses.

Family businesses choose to stay small to retain family control.

Maximum 5 marks if only 1 part of the question is covered.

5:4 4:5 **9**

Essay 2

Despite CPI inflation hitting a peak of 5.2% in 2011, the Monetary policy Committee (MPC0introduced a second round of quantitive easing.

(a) (i) Explain the term quantitative easing

(Quantitive easing is the purchasing of assets(mainly government bonds) 1 mark (by the central bank) using new electronically created money) 1 mark. Total 2 marks **2**

(ii) Explain how quantitative easing is expected to influence the level of economic activity.

QE works to increase the availability of credit in the banking system, lower LIBOR, lowers yields on government bonds and hence long run interest rates throughout the economy, lowers the £, improves funds flowing into capital markets and hence makes it easier for firms to raise affordable finance. It might also raise inflation. The first round of QE is believed to have raised Economic Growth by 1.5% → 2% GDP but inflation by between 0.75-1.5%. Total QE - £325 bn. Credit any relevant points. **8**

(b) Explain the reasons for the MPC deciding to undertake a second round of quantitative easing.

despite inflation being above target. Risk of a double dip recession. Interest rates at a historic low (Keyensian Liquidity Trap) and ineffective due to financial crisis. Risk of 2nd credit crunch due to Eurozone crisis, future growth prospects weak- eurozone crisis, austerity programme, real money supply falling throughout 2011. Bank lending still too weak. Low business and consumer confidence. No other option given government policies. Long term fears of deflation.

Credit reference to 3rd round £50bn Feb 2012. **8**

(c) Discuss why some economists believe that quantitative easing may be ineffective or even harmful.

Banks will hoard the cash and not lend it out. The bonds may be sold by foreign institutions and the money will flow out of the UK, it leads to asset bubbles and does not help real economy. It could lead to higher inflation. Long time lags make it inappropriate given the risk of double dip imminently. Measure of last resort. Credit Easing is not contemplated by MPC but government.

Risk of hyperinflation. Savers lose out.

A minimum of 3 points must be discussed. **7**

Essay 3

Youth unemployment in the UK passed the one million mark in 2011.

(a) Explain why the rate of youth unemployment in the UK is higher than the national average.
Credit accurate statistics – 20% approximately.

Human capital – a sizeable number of students leave school without qualifications.
Experience – employers may decide to employ someone with a proven track record.
Training costs – employers do not want the additional costs.
Apprenticeships – long term decline in the number available.
Benefit reforms – youth unemployment is a result of the benefits systems; Can't work v won't work and issues of reliability.
Priced out of the market by the minimum wage.
'Older' workers have accepted pay freezes or even pay cuts so employers have kept existing workers therefore not hiring anyone new.
Regional – more youngsters unemployed in areas of declining economic activity e.g. North East.
Graduates taking lower skilled jobs pushing out lower skilled applicants.
At least 3 points must be covered. Max 3 marks per point. **7**

(b) Describe the economic costs of youth unemployment to the individual and the UK economy.

"Lost generation"
Loss of income
Falling tax revenues
Increased government spending e.g. JSA
Lost output
Negative multiplier
Psychological, social and health consequences
Demoralisation / Despair

For full marks both the individual and UK economy should be covered **8**

4:4 5:3 3:5

(c) Discuss policies which the UK government might introduce to address the issue of youth unemployment.

Benefit reform – if you don't take the job, you won't get any benefits. Principle of conditionality. – Credit reference to controversy over "involuntary work" experience scheme. Gov work youth schemes.

Lower NI contributions for businesses which take on and train younger workers.

Abolishing the minimum wage or placing a moratorium on it.

Raising the school leaving age.

Providing training.

More school based vocational training – curriculum review?

Subsidised work and training placements/work experience placements.

More apprenticeships.

Reduce payroll and other taxes.

Reduce the burden of red tape for businesses.

Persuade banks to lend to businesses at lower rates of interest.

Policies to encourage geographical mobility.

Policies to restrict immigration.

Polices of economic growth.

10

Increased government spending.(targeted)

Essay 4

. In 2011, sovereign debt crises continued to impose strains on the eurozone.

(a) Explain why these sovereign debt crises continue to impose strains on the Eurozone.
Lack of clear system to bail out deficit countries, inherent flaws in structure and institutions of euro have been exposed, fear of contagion, unwillingness of Germany to bail out countries-moral hazard. Different countries do not agree on role of ECB.
Impact of default

Credit relevant points plus development, including examples of 2011 crises. **7**

(b) Explain why a country might consider abandoning the Euro and the consequences for its economy.
Countries failing in the eurozone are unable to compete against other eurozone countries because their productivity is lower whilst wages have risen. They cannot compete externally to the eurozone because the euro is strong relative to many other currencies which makes their exports less competitive in other markets. Faced with the lack of international competitiveness countries can either attempt to reduce their internal price and wage levels which would require very painful readjustments requiring years of falling wages and output or devalue their currency to restore international competitiveness. This can only be done for a country like Greece if they leave the euro and reintroduce the drachma which would be much weaker.
Eurozone is not an optimal currency area.
Regain control over monetary policy.

There would be many problems. The Maastricht Treaty did not include any mechanism for a country to leave. There would be problems of capital flight, the country would still have euro-denominated debt which would be even less affordable and would be even more likely to default. Business would still have euro dominated contracts which would take time to unravel. Banks may go bust if money is removed prior to the new currency being introduced. However there could be benefits-the country would be able to gain an advantage for its exports and regain control over its monetary policy although it would lose shelter of ESF and ECB.
Argentina benefitted from freeing its currency and has achieved better rates of growth in recent years since default.

Credit any relevant point plus development – up to 3 marks per fully explained point.

5:4 4:5 **9**

(c) Discuss measures which could be taken to ensure the survival of the Eurozone.

Two-tier euro.

Weaker countries could leave.

Higher wage inflation in German to equalise competitiveness.

Closer Fiscal Harmonisation-closer monitoring and oversight of countries' budgets and fiscal transfers.

ECB acting as lender of last resort.

Eurobonds being issued by ECB on behalf of all countries.

United States of Europe-economic and political union.

Labour market mobility.

At least 3 ideas well-explained for full marks. **9**

Essay 5

Rates of economic growth vary widely across the globe.

. (a) Explain why economists fear that the UK economy will experience low or negative rates of economic growth in the coming years.

Real incomes falling.
Less consumer spending – job insecurity.
New credit crunch.
Eurozone crisis.
Lack of confidence.
Oil prices.
Rising unemployment.
Austerity measures – more cuts on public spending.
Housing market and mortgage costs.
High levels of debt.

At least 3 points must be covered for full marks. **8**

(b) Discuss why the BRIC countries are maintaining higher rates of economic growth than the UK.

Political stability.
Export-led growth.
Economies of scale.
Speed of industrialisation.
Availability of resources e.g. raw materials.
Human capital – education levels and attitude to work.
Levels of inward investment from developed economies.
Government initiatives to encourage entrepreneurship.
Increased size and spending power of middle classes.
Relatively cheap labour.
High savings ratio.
Lack of regulation.
Currency manipulation – Yuan

At least 3 points for full marks. **9**

(c) Explain why rates of economic growth remain so low in some developing countries.

Low productivity
Lack of developed financial system.
Trade barriers.
Corruption.
Dependency on primary production such as agriculture.
Political instability.
Lack of resources.
Natural disasters.
Lack of developed infrastructure.
Lack of human capital.

At least 3 points must be covered.
Max 5 marks if ID only. **8**

Essay 6

. There is much debate about the future of pensions in the UK and some economists consider a pensions crisis imminent.

(a) Explain why many economists consider a pensions crisis to be imminent in the UK.

Ageing population-life increased life expectancy, increased cost of pensions to state, employers etc. Poor stock market performance has made it harder to meet final salary pension commitments. Many people do not make any provision for their old age age and think the state pension will be adequate. Higher dependency ratio as smaller working population will impose greater strains **9**

(b) Describe the proposals that have been made by the UK Government to reduce the cost of public sector pensions.

Raising retiral age from 60 to 65 to 67 earlier than previously and likely to rise to 70.

Contributions raised by 50%.

Pension calculated on average rather than final salary.

Pension increases linked to CPI not RPI. **7**

(c) Apart from the issue of pensions, discuss the consequences for the UK economy of an ageing population.

Pressures on health service.

Changing of pattern of demand.

Changing work patterns especially.

Rising poverty-pensioners experience lower incomes.

Implications for Government finances

Up to 3 marks for each fully explained point. **9**

[END OF SECTION B]

[END OF MARKING INSTRUCTIONS]