



# **2009 Economics**

## **Higher**

### **Finalised Marking Instructions**

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## Economics 2009

### Higher

#### SECTION A

#### ITEM A

	<i>Marks</i>
(a) Derived demand is when the demand for one good arises from the demand for another. The demand for timber is derived from the demand for fences (or decking or sheds).	2
(b) The diagram should show: <ul style="list-style-type: none"><li>• A decrease in supply</li><li>• An increase in demand</li><li>• An increase in the equilibrium price.</li></ul>	3
(c) Look for an explanation of how supply can be increased by dipping into stocks or cutting down more trees. Credit references to Germany and S America.	2
(d) If consumers think that the price of a good is going to rise, they may be panicked into buying more of it. This will increase the demand for it and push up its price.	2
(e) (i) As the UK is a net importer of timber, the increase in its price will increase our import bill for timber and worsen our trade balance. Credit references to PED and the price of exports.	2
(ii) The increased expenditure on imported timber will increase the supply of sterling which will reduce its value. Look out for a consequential error.	2
(f) Look for a description of how they could settle for lower profit margins or cut some of their other costs or find alternative suppliers.	4
(g) The increase in the price of timber will increase the price of sheds which will reduce the demand for them. If the demand for sheds is price elastic, the % fall in demand will be greater than the % rise in price and therefore the TR from the sale of the sheds will fall.	3
(h) (i) Look for a simple explanation of how the increased growth rates in some developing countries has led to an increase in average incomes which has increased the demand for houses, factories etc. Maximum 3 marks	
(ii) The price of sheds will rise because the increase in world demand will increase the price of timber for UK producers. There will also be a reduction in the supply of timber available for UK producers (competitive supply). Maximum 3 marks	5

## ITEM B

### Marks

- (a) (i) The official definition is “an international agency which encourages trade between member nations, administers global trade agreements and resolves disputes when they arise” but the key elements are the promotion of free trade and the settling of disputes among members – 1 mark each. However, if the candidate correctly develops the promotion of free trade, they should be given full marks. 2
- (ii) The facilities within a country that make business activity possible. These include roads, rail, ports, airports, financial institutions, energy and water supplies, sewerage etc. One mark for the definition and one for the examples. 2
- (b) (i) Look for an understanding that money rates of economic growth include inflation whereas real rates of economic growth are adjusted for inflation. Also credit definitions of the rate of economic growth eg the percentage increase in the productive capacity of a country over a period of time. 2
- (ii) Membership increased China’s volume of trade with member countries. Trade is the engine room of growth (especially for China), therefore China’s economic growth rate increased as a result. 2
- (c) (i) A reduction in the general level of prices. 1
- (ii) Three clear points. 3
- The price of many of China’s exports was lower than their world price.
  - This made the rate of inflation throughout the world (or, at least in those countries which imported goods from China) lower than it otherwise would have been.
  - Central banks could therefore cut interest rates without the fear of increasing inflation above the desired level.
- (d) (i) It is likely to fall (1 mark – if explanation is correct) because of ‘Hot Money’ outflows (1 mark) or lower interest rates will increase AMD and therefore increase the demand for imports. 2
- (ii) It is likely to rise (1 mark – if explanation is correct) because it is now cheaper for firms to borrow money (1 mark). Also credit references to the fact that marginal investment projects might now become viable and that the increased demand (because of the increased real income of mortgage holders) could also stimulate demand. 2
- (e) They increased (1 mark – if explanation is correct) because of the shortage of (skilled) labour (1 mark). 2

- (f) Three clear points.
- The US balance of trade should improve.
  - US exports to China will now be cheaper (credit reason) so more will be sold.
  - US imports from China will now be dearer (credit reason) so fewer will be bought.
- 3**
- (g) The economic problems include:
- Increased unemployment in industries which compete with China's exports.
  - Increased price of world commodities because of the increase in China's demand for them.
  - Increased global warming because of China's reliance on fossil fuels and resultant high levels of pollution.
  - Increased trade deficits (with China)
- Also credit any other plausible economic problem.
- 4**

## SECTION B

### Marks

- 1 (a) Look for a straightforward explanation of economic scarcity. Although our wants for goods and services are unlimited (credit reasons) the resources needed to produce the goods and services (credit examples) are limited. Therefore no country has enough resources to produce enough goods to completely satisfy all its people. That is why resources are scarce. 5
- (b) Candidates should describe how (in market economy) changes in demand bring about changes in supply.  
Price acts as a signal to producers. An increase in the demand for a good will cause a shortage of it in the market. This shortage will push up its price. The increase in price will increase the profit the producer is making on the good and, as the producer is motivated by profit, he/she will produce more of it by re-allocating resources from another good.  
If consumer demand for a good falls, the resultant glut/surplus will cause its price to fall resulting in a fall in the profit made on the good. Producers will then move resources out of the production of that good and use them to produce those goods that are now relatively more profitable.  
Candidates need only describe the increase in demand or the decrease, for full marks. 6
- (c) Look for an explanation of how the price mechanism can best achieve an efficient allocation of resources: resources are allocated on the basis of demand (consumer sovereignty); competition and profit maximisation result in goods being produced at lowest average cost; consumers get what they want at the lowest possible price; incentive for producers to cut costs, increase productivity and develop new products because of the chance of extra profit; the system is flexible as changes in demand quickly bring about changes in supply (shortages and gluts do not last long); no regulation is required.  
Three well described advantages for full marks but also credit candidates who devote part of their answers to describing the disadvantages of state planning. 6
- (d) The problems include: a lack of merit goods, public goods and unprofitable goods; over-production of demerit goods; externalities; monopolies; income inequality. Three well described problems for full marks. 8

- 2 (a)** The main reason was the high and growing level of AMD due to our prolonged period of non-inflationary growth. Explanations of this could gain up to 4 marks. Other reasons include: low interest rates; increase in part-time work; increase in the tertiary sector – especially financial services; growth of the public sector; government policies; the growth of China. Two well explained reasons for full marks. **6**
- (b)** The advantages include: increased revenue for the government; reduced government spending on welfare benefits; citizens can benefit from possibility of tax reductions and increased government capital spending; less waste of a scarce resource; increased living standards; less crime. **6**
- (c)** Monetary policy is when interest rates (or the money supply) are changed to influence the economy – specifically to control the rate of inflation. Credit references to the MPC and the 2% CPI target. Maximum 2 marks.  
Fiscal policy is when the government (the Chancellor) deliberately alters the balance between government spending and tax revenue in order to influence the economy. Credit references to the Budget and AMD. Maximum 2 marks.  
Look for a clear explanation of how interest rate cuts and budget deficits can increase AMD (maximum 4 marks each) and how increases in AMD can increase employment (maximum 3 marks).  
Maximum of 8 marks for each. **13**

- 3 (a)** The relevant points include:
- economic growth is an increase in the productive capacity of an economy
  - it can only occur in the long run
  - it is usually measured by increases in GNP/GDP
  - a sustainable growth rate is the rate a country can achieve without causing rising (or falling) inflation
  - it is also called the trend rate of growth
  - for the UK, it is around 3%
- Some candidates might write about sustainable development, which although not the same as a sustainable growth rate, is close enough to warrant credit. Therefore, if a candidate defines and develops the concept of economic growth and then explains sustainable development (ie a rate and type of economic growth which meets the needs of the present without compromising the ability of future generations to meet their own needs), they can gain full marks. **8**
- (b)** The diagram should show a movement of actual production towards the curve and an outward shift of the curve. One mark for correctly drawing and labelling the curve, and one mark for each of the movements ie a maximum of 3 marks for the diagram.
- A movement towards the curve is an increase in economic activity and will occur if there has been an increase in efficiency or a reduction in unemployment ie a more efficient use of existing resources. Maximum 3 marks.
- Economic growth is shown by an outward shift of the curve and means that the economy/firm, in the long run, is capable of producing more of both goods. Maximum 3 marks. **7**
- (c) (i)** Straightforward question but look for a description eg
- A low rate of inflation – 2% as measured by the CPI.
  - A low rate of unemployment – around 3%. Credit references to full employment, the natural rate of unemployment and the NAIRU.
  - Balanced Payments ie when the value of our exports equals the value of our imports.
  - Greater equality of income – closing the gap between rich and poor.
  - Reducing climate change/global warming – reductions in the UKs carbon emissions.
- If no description, maximum 3 marks. **6**
- (ii)** Candidates should give an explanation of possible trade-offs eg between inflation and unemployment, growth and inflation, inflation and balanced payments, etc. Mark according to how well the candidate has explained the conflict. **4**

- 4 (a) (i)** The Law states that the extra satisfaction gained from consuming one more of a good declines as more of it is consumed (in a given time period). Maximum 2 marks.

This means that the more we have consumed the less we are willing to pay for one more. Therefore we will only buy more of a good (*ceteris paribus*) if its price falls. If the price falls, we will be getting the same amount of utility for less money ie the good has become a better buy. We can now increase our total utility (according to the theory of equi-marginal utility) by buying more of this good and less of other goods. A normal demand curve will therefore slope downwards from left to right (a negative slope) showing that more is demanded as price falls. A demand curve is therefore a curve that joins or plots marginal utility. Credit highly, answers based on the theory of equi-marginal utility. Maximum 6 marks.

Not necessary to make all the above points for full marks.

**7**

- (ii)** Look for explanations of:

- speculative buying eg stocks and shares
- Veblen goods eg designer clothing, diamonds
- price related to quality eg fresh fruit, watches
- Giffen goods eg bread, rice.

Two marks for the explanation, one for the example.

**8**

- (b)** The Law only applies in the short run as all factors are variable in the long run (one mark). The Law states that, as increasing amounts of a variable factor are added to a fixed factor, the rate of increase in total output may rise (increasing marginal returns) but, after a while, the rate of increase in total output will fall (diminishing marginal returns). Maximum 4 marks.

If the marginal returns to the variable factor are increasing this means that producing one more unit of output is costing less and less in variable inputs. If all the variable factors are paid the same, the marginal cost (ie the cost of producing one more good) must be falling.

However, when diminishing (marginal) returns set in, producing one more unit of output is costing more and more in variable inputs. When this happens, marginal cost will rise. One mark for a correctly drawn marginal cost curve.

The key point to look for is that when returns are increasing, MC is falling and vice versa.

**10**



- 5**    **(a)**       Reasons include: increased manufacturing productivity has made Scottish exports more competitive; high rates of growth in China and India have increased the demand for our exports; low rates of price and wage inflation have made our exports more competitive; the increases in investment made by Scottish whisky have boosted foreign sales. Credit any plausible reason eg falls in the value of sterling – making exports cheaper. Two well explained reasons for full marks. **6**
- (b)**       Look for a description of trade in services with examples (max 2 marks), IPD with examples (max 4 marks); transfers with examples (max 2 marks) and the Capital Account with examples (maximum of 6 marks for Current Account and 6 for Capital Account). One mark for a definition of the B of P. **9**
- (c)**       The main measures are aid, debt relief and free trade. Descriptions of these can gain 6 marks. Candidates should then explain how some forms of aid (education, training, capital, micro-lending etc) can lead to increased growth (max 3 marks) and do the same with debt cancellation and the extension of free trade – maximum 2 marks each. **10**

- 6 (a)** The main reason is to reduce production costs – especially labour costs and rent. However, other reasons include: less red tape; closer to markets; nearer suppliers; EU enlargement; easier labour laws. Explanations of any 3 for full marks. **7**
- (b)** A negative multiplier effect occurs when the multiplier works in reverse ie when a fall in AMD (due to a decrease in an injection) causes a greater fall in national income. The explanation can refer to a normal multiplier effect but should centre on the fact that spending and income are inter-related. The examples can be hypothetical or related to the stem of the question eg the loss of 700 jobs will create a fall in AMD/spending which will have a knock-on negative effect on local shops, pubs, restaurants etc. Credit the multiplier formula and definitions of the MPC and the MPS. **8**
- (c)** Arguments for include:
- stable exchange rates – trade less risky
  - no transaction costs – could lead to increased investment throughout the EU
  - should help to maintain the high level of FDI into the UK – if UK does not join might lose some FDI to countries in the eurozone
  - price transparency – easier to compare prices in different countries – could create a downward pressure on prices
  - would help maintain London’s position as a leading financial centre.
- Arguments against include:
- loss of monetary independence – UK would no longer determine its interest rate
  - one European interest rate will not suit all member countries eg the UK is often at a different stage of the economic cycle
  - the UK is more sensitive to changes in interest rates – it has a higher percentage of variable rate mortgage holders
  - high menu costs – changing vending machines, ATMs etc
  - exogenous shocks unlikely to impact all members the same – eg changes in oil prices. Could result in divergence after convergence.
- Two marks per argument but can mark 6:4, 5:5 or 4:6. **10**

[END OF MARKING INSTRUCTIONS]