2010 Economics

Higher

Finalised Marking Instructions

Economics 2010

Higher

SECTION A

ITEM A

			Marks
(a)	**(i)**	The group of countries which collectively attempt to affect the world price of oil by controlling production. If not related to OPEC: 1 mark.	**2**
	(ii)	A situation in which two or more companies each try to increase their own share of the market by lowering prices.	**2**
(b)		The cut in the output (supply) of oil was outweighed by a bigger decrease in the demand for oil: 2 marks. The diagram should show a leftwards shift in supply (1 mark), a bigger shift to the left in demand (1 mark) and a fall in the price (1 mark).	**4**
(c)	**(i)**	Their real income has risen (1 mark) because, when they buy their usual amount of petrol, they will now have some income left over (1 mark).	**2**
	(ii)	The fall in oil prices will reduce the costs of airline companies (1 mark). This fall in costs might result in cheaper air flights (1 mark).	**2**
(d)		The relationship is a direct one ie when the price of oil rises, the revenue of oil producers rises and vice versa (1 mark). This means that, when the price rises, producers gain more from the rise in price than they lose from the resultant fall in the quantity demanded (1 mark). This is because the (%) increase in price is greater than the (%) decrease in quantity demand. (1 mark). Therefore the demand for oil must be price inelastic (1 mark). One mark for defining Price Elasticity demand <u>or</u> the formula.	**4**
(e)		As oil is priced in dollars, a fall in the value of sterling against the dollar will increase the sterling price of oil (1 mark). This means that those people who are buying oil with sterling will have to pay more for their oil (1 mark). This will negate, for them, the fall in the price of oil (1 mark).	**3**
(f)		Look for an understanding that the intense competition between supermarkets means that when one of them reduces the price of eg oil, the others will rapidly follow suit to prevent them losing customers. Consumers will therefore benefit from the prices. Price wars.	**2**
(g)		The reason is because the recession/fall in AMD/slow down in growth (1 mark) is causing oil consumers to cut back their demand (1 mark). Also credit environmental reasons eg developed countries are consuming less oil (or using it more efficiently) to protect the environment (or reduce climate change).	**2**
(h)		It will result in a fall in tax revenue (1 mark). Credit references to a fall in PRT, the tax on petrol etc (1 mark).	**2**
		The resultant increase in the demand for oil (1 mark) could increase environmental damage (1 mark).	

ITEM B

			Marks
(a)	**(i)**	The official (and largely meaningless) definition is two successive quarters of negative growth − and this is all that is required for full marks, But also credit definitions which imply a significant decline in general economic activity over a period of time.	**2**
	(ii)	The Eurozone consists of fifteen European Union member states that have adopted the Euro as their official currency. 1 mark for mentioning the euro and 1 mark for development.	**2**
(b)	2		**1**
(c)	**(i)**	Inflation is well above target and a rise in interest rates might bring it down.	**2**
	(ii)	The UK economy is in recession and fall in interest rates might stimulate growth. Do not have to mention both interest and borrowing.	**2**
(d)	Credit any answer which explains why the demand for houses could have decreased or why the supply of houses could have increased eg the recession has reduced average income levels which will reduce the demand for houses; the credit crunch has reduced the willingness of banks to grant mortgages; the increase in the number of house re-possessions (because of the recession) has increased the supply of houses.		**2**
(e)	The advantage is that it makes our exports more competitive (credit explanations) and our imports less competitive (credit explanations). Either point, fully explained can gain 2 marks. The disadvantage is that it will increase inflationary pressure (1 mark) as it increases the price of imported finished goods, raw materials etc (1 mark).		**4**
(f)	Look for an explanation of export led growth eg as exports create an injection of income into the circular flow, (1 mark) an increase in them will increase AMD and boost growth (1 mark). Tax reductions will increase the disposable (or real) income of taxpayers (1 mark) which should lead to increased spending and growth (1 mark).		**4**
(g)	Look for an explanation of how an increase in government spending (1 mark) will increase the level of income/money in the economy (1 mark) which will increase the level of demand/spending (1 mark) which will increase economic growth (1 mark).		**3**
(h)	The UK Balance of Payments will worsen (1 mark) because the slowdown will reduce the level of AMD/income in the eurozone (1 mark) which will reduce their demand for our exports (1 mark).		**3**

SECTION B

Marks

1 **(a)** **Scarcity** − although the wants for goods and services are unlimited (credit reasons) the resources required to produce the goods and services are limited. This means that no country in the world has enough resources to produce enough goods to completely satisfy all the wants of its people. Credit references to the fact that scarcity is the basic economic problem and is the reason why we all have to economise. Also credit candidates who explain how scarcity leads to choice and that the basic aim of economics is to show how we can make the best (ie most efficient) use of our limited resources. <u>Maximum 4 marks</u>.

Shortage − occurs when the demand for a good is greater than the supply of it. In a market economy, shortages usually do not last for long and will be cured by a rise in price and/or an increase in supply. Credit candidates who state that demand is not the same as wants (demand = wants backed up by the ability to pay). Demand is limited by income and, in a market economy will be nearly always fully satisfied. Wants are unlimited so can never be fully satisfied.
Maximum 4 marks. **6**

(b) **Capital equipment** − given directly or by loans/grants. An invaluable source of aid, especially when the equipment is intermediate and not state-of-the-art which can help a country reach its take-off point.
However, unless the loans are 'soft', they can create huge debt problems for the developing country. Can include roads, housing, drainage, water supplies, the infrastructure etc.

Technical assistance − eg technical experts to give advice and training to local technicians on the best way to use existing Capital equipment − helps increase productivity and enables the developing country to make full use of their capital equipment. This can be very effective as a form of aid.

Educational support − literacy programmes and basic education for all are essential requirements for economic growth.

Charities − often used in emergencies to prevent famine but is more often used to finance long term development schemes, therefore more effective.

Cheap drugs and medicines − have always been important but are even more so now because of the Aids epidemic and the increase of Malaria in Africa.

Debt relief − essential and effective as it allows developing countries to spend more on their infrastructure; health care etc instead of spending money on servicing the debt.

Liberal trade policies − ie free and fair trade. Economic growth follows increases in trade therefore developed countries must allow the exports of developing countries free access to their markets and must abolish subsidies they give to their domestic producers (sugar, cotton, steel etc) which artificially reduces prices on world market. Very effective as a form of aid especially when included as part of a long term aid programme.

Max 3 marks per type of aid provided description is related to growth.
No credit for bilateral and multilateral aid.

Military aid − can stabilise government and therefore encourage growth, however it can divert resources from goods into armaments and can help keep dictators in power.

1 mark for each form of aid ***and*** *2 marks for its effectiveness.*
If candidates describe the various forms of aid ***only****, maximum 6 marks.*
If candidates merely list the types of aid − Maximum 3 marks. **10**

(c) **Advantages** − Faster growth in less developed countries eg debt reduction will increase their ability to buy UK goods.

The increase in our exports will increase our output, employment and economic growth rate.

Cheaper goods for UK consumers increasing disposable income.

Increased/improved quality brought about by greater specialisation.

Maximises world output: increased variety and choice; reduces danger of home monopolies.

The bigger market will create greater opportunities for firms in the UK to benefit from economies of scale.

Disadvantages − Cheaper products from developing countries will compete with more expensive goods produced in the developed countries.

Greater use of import restrictions to restrict imports coming out of the developing countries − goes against the economic benefits of free trade.

Can lead to some firms in developed countries going out of business.

Increase in pollution/damage to the global environment.

Natural resources become more expensive due to increased demand from developing countries.

One well explained advantage/disadvantage − maximum 2 marks.
Maximum 5 marks − ***only*** *advantages* ***or*** *disadvantages described.* **9**

Marks

2 **(a)** Textbook definitions can vary but look for a definition of technical efficiency that describes the situation where the maximum output is being obtained from a given set of inputs ie when a firm is producing at minimum ATC. Credit references to maximising productivity and producing on the PPC. Maximum 2 marks.

Economy efficiency occurs when resources are being allocated in a way which maximises society's welfare ie the situation where some people cannot be made better-off by reallocating resources, without making others worse-off. As far as society is concerned, the good is being neither under nor over-produced. Credit references to allocative efficiency and Pareto optimum. Maximum 2 marks.

The relationship is the technical efficiency is a necessary but insufficient condition for economic efficiency − or words to that affect. That is all that is necessary for 2 marks but credit candidates who explain the relationship differently eg economic efficiency requires that production is technical efficient and that the goods being produced are the ones that society wants the most. **6**

(b) **(i)** Market failure is the situation where the market (demand and supply) fails to allocate resources efficiently/equitably (1 mark). Look for an explanation of how the market can lead to:

- the creation of monopolies − credit result possible problems
- the under-production of merit goods − credit examples
- the under-production of public goods − credit examples
- the under-production of unprofitable goods − credit examples
- the over-production of de-merit goods − credit examples
- inequality of incomes
- externalities − credit examples
- booms and slumps.

Two marks per explanation, with a maximum of 8. **9**

(ii) Look for a straightforward description of how the government can use taxation revenue to fund the NHS, state education, the Competition Commission, reduce pollution, provide public and merit goods and reduce income inequality.
Three descriptions for full marks. **6**

(c) Look for a straightforward explanation of how State Planning works.
Mark according to overall quality. **4**

Marks

3 **(a)** Candidates must make an attempt to compare and contrast eg

- In a monopoly there is only one firm, in perfect competition there are many (1 mark).
- Monopolists tend to be large firms, firms in PC are small (1 mark).
- In a monopoly there are strong entry barriers, in perfect competition there are none (1 mark + 1 for examples of entry barriers).
- Monopolists are price makers, firm in PC are price takers (1 mark +1 for an explanation).
- Monopolists can make long run abnormal profits, firm in PC can only make long run normal profits (1 mark + 1 for an explanation or definition of normal/abnormal profit).
- Monopolists can benefit from economies of scale, firms in PC cannot (1 mark + 1 for examples of economies of scale).
- Monopolists are faced with a downward sloping demand curve, firms in PC are faced with a perfectly price elastic demand curve (1 mark + 1 for explanation).
- Monopolists can adopt price discrimination; firms in PC cannot (1 mark + 1 for definition of price discrimination).
- No attempts to make a comparison − zero marks.

If the candidate simply lists the characteristics and makes no attempt to compare maximum of 2 marks. **10**

(b) **(i)** PES is the extent to which the quantity supplied of a product will change in response to a change in its price (1 mark). Credit the formula (1 mark). The diagrams should show supply curves which are price elastic (ie cutting the price axis), price inelastic (ie cutting the quantity axis) and unitary price elastic (ie any straight line supply curve starting at the origin). One mark per diagram. Also credit correctly drawn perfectly elastic/inelastic supply curves (1 mark).
The maximum for (b) (i) is therefore 6.

(ii) The determinants include:

- the time period − supply is usually more elastic in the long run
- the existence (or non-existence) of spare capacity − the more spare capacity, the more elastic
- the cost and ease of storing stocks − the cheaper and easier, the more elastic
- the length of the production process − the longer, the more inelastic
- factor mobility − the more mobile the factors, the more elastic.

Two marks per determinant − maximum of 6. **10**

(c) The main importance of price elasticity of supply is that it determines the extent to which the price of good will change when there is a change in its demand. If this is then explained by using diagrams − full marks. Credit highly answers which relate the problems of developing countries to the inelastic supply of their main exports. Also credit candidates who talk about prolonged shortages and permanent price rises caused by inelastic supply.

Max 2 marks for diagrams. **5**

4 **(a)** Most candidates will simply give definitions of both policies − and that is all that is necessary for full marks − but credit highly candidates who explain the differences eg Monetary policy is typically implemented by a central bank, while fiscal policy decisions are set by the national government. However, both monetary and fiscal policy may be used to influence the performance of the economy in the short run. Maximum 3.

Fiscal policy involves the Government changing the levels of Taxation and Government Spending in order to influence Aggregate Demand (AD) and therefore the level of economy activity. Fiscal policy aims to stabilise economic growth and avoid the boom and bust of the trade cycle. Credit references to budget deficits and surpluses. Maximum 3.

Monetary policy is when the monetary authorities vary the supply or price of money (R) with the aim of achieving stable prices. However, most candidates will relate this to the UK − monetary policy involves the MPC of the B of E setting interest rates to achieve the government inflation target (2% CPI).
Maximum 3.

1 mark for explaining how monetary policy works.
1 mark for explaining how fiscal policy works. **6**

(b) **(i)**

- Rising world commodity prices − increased cost-push pressure.
- Rising global oil prices.
- Increased demand from China − no longer 'exporting deflation'.
- The weaker £ against the Euro has increased the price of imported finished goods, raw materials and components coming from the EU.
- Higher inflationary expectations increasing the need to go out and buy.
- Reduce interest rates.
- Budget deficits.
- Consumer boom.
- Accept descriptions of demand pull, cost push and monetary inflation. **4**

(ii)

- UK goods are less competitive at home and abroad (therefore lower economic growth, causing a trade deficit and increased unemployment).
- Reluctance of firms and individuals to engage in long-term planning and investment decisions are difficult; the economy is less stable.
- Disadvantage to savers; a redistribution of income from savers to lenders.
- A loss in income for those people on fixed incomes, real wages are falling.
- Pressure to use anti-inflation measures such as higher interest rates; budget surpluses etc will reduce the level of aggregate monetary demand in the economy.
- Increased shoe leather costs.

Maximum 3 marks for a well explained point. **7**

(c) Credit any measure aimed at improving the productive capacity of the economy. Increased emphasis on education and training.

Reduce TU powers:

Make planning permission easier to obtain reducing the level of bureaucracy faced by firms.

Tax reforms/tax incentives.

Privatisation and deregulation.

If candidates merely lists measures, a maximum of 2 marks. Candidates must explain each measure to gain 2 marks per measure. **8**

Marks

5 **(a)** Look for an explanation of why money flows from firms to households and back again. Maximum 3. NY equilibrium is when the NY is not changing and occurs when the total level of injections equal the total level of withdrawals/leakages. Maximum 2. The diagram should show all injections and withdrawals and all forms of income (if not already mentioned) as well as firms, households and flow of expenditure. Maximum 5.

Firms and households − 1 mark.
Injections − 1 mark.
Withdrawals − 1 mark.
Expenditure and income − 1 mark.
Expenditure and all four returns − 2 marks.
Expenditure and 1 return wrong − 1 mark.
Arrows the wrong way round − 0 marks. **10**

(b) **(i)** Look for an understanding of how a fall in AMD (NY) can cause fiscal deficits. Government spending on welfare benefits (JSA) rises and government taxation revenue from (income tax, VAT, corporation tax) falls. Maximum 3.

(ii) Can become unemployed (credit references to the demand for labour being derived), less job security, fall in (real) wages etc. Maximum 3. **6**

(c) **(i)** The multiplier describes the situation where an increase in spending leads to an increase in national income that is greater than the initial increase in spending. Maximum 2. Candidates may then explain how the multiplier works or they may do this in their answer to part (ii). Either approach is valid, but the explanation must be given somewhere, to gain full marks.

(ii) The multiplier rests on the fact that income and spending are interdependent ie when those who receive an increase in income spend it, it becomes income for someone else (one person's spending is another person's income). This process will continue indefinitely although the amounts will become smaller because of savings. Credit examples eg the London Olympics. Maximum 4. The MPC is the amount of any extra income that is spent (on consumption) − credit formula. As the size of the multiplier depends on the amount of any extra income which is spent (the more that is spent, the greater the multiplier), the higher the MPC, the bigger the multiplier. Credit the formula. Maximum 4. **9**

Marks

6 (a) (i) Various methods include; embargoes, tariffs, quotas, subsidies, exchange controls and import licensing.

- Tariffs can be used to raise the price of imports in order to prevent competition for ailing domestic industries.
- To prevent foreign countries dumping large quantities of goods which have been produced with lower production costs.
- To protect newly established industries.
- To protect industries which are essential to the economy of certain areas of the country.
- To safeguard jobs.
- To improve the balance of trade by reducing imports.
- Retaliation.

(ii) Free trade is trade between countries without any form of restrictions ie no tariffs, quotas etc.

- Encourage countries to specialise in the goods in which they have the greatest comparative advantage.
- Increased competition as imports may stimulate greater efficiency.
- Imports of many products became cheaper.
- It is beneficial for countries to specialise in industries where economies of scale can be gained.
- The range and variety of goods is greater.
- The removal of tariffs reveals the true cost relationships and increases the differences in comparative costs.
- Removes the threat of retaliation.
- The removal of trade barriers increases the probability of an increase in world trade.
- Removes possible inefficiency of companies which would otherwise hide behind a tariff wall.
- International specialisation and the level of world output are increased. **15**

(b) (i) Long run average total costs are the costs of producing one good over a period of time when the producer is able to alter the amount of every factor ie no factor is fixed, all are variable. A long run ATC curve is made up to a series of short run ATC curves.

(ii) In the long run average total costs fall as output increases because of economies of scale (increasing returns to scale) − when the % increase in costs is less than the % increase in output.

Look for an explanation of how economies of scale lead to falling average total costs and how diseconomies of scale lead to rising average total costs, eg

Financial Economies eg cheaper loans.

Managerial Economies eg employing experts.

Technological Economies eg specialised machinery, bulk buying, economies of increased dimensions.

Marketing Economies.

Management Problems eg more difficult to keep control of activities.

Geography may lead to higher average costs. **10**

Parts A (i) and (ii) max 8 for each section.

(b) (i) Definition of − long run total cost − 2 marks.
(ii) Max 8 marks
(ii) Must describe at least 2 economics and diseconomies of scale and explain why they lead to following average total costs to gain max 8 marks.

(25)

[END OF MARKING INSTRUCTIONS]