

X038/301

NATIONAL
QUALIFICATIONS
2008

FRIDAY, 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.

OIL PRICES

The prices of many raw materials have risen sharply in recent years. Oil, in particular, has seen dramatic changes in its price. In 2002, oil prices were \$20 a barrel, however, in 2005, they reached a record high of \$78 a barrel.

One reason for the increase in price is that oil is particularly vulnerable to supply side shocks. These include severe weather and the decision of the oil producing cartel (OPEC) to lower **production quotas**. In addition, high rates of economic growth in the US and China have caused the demand for oil to increase rapidly. The impact of the above events was to push the price of oil up to a record high. However, there was some relief when the US Government released 700 million barrels of oil from its reserves.

Although high oil prices cause a variety of economic problems, they may be good news for environmentalists who want people to reduce energy consumption. They also encourage the search for renewable sources of energy which, if successful, can lead to reduction in **negative externalities** such as global warming and pollution. However, high energy prices push up **variable costs** for many firms and, therefore, affect the competitiveness of their products.

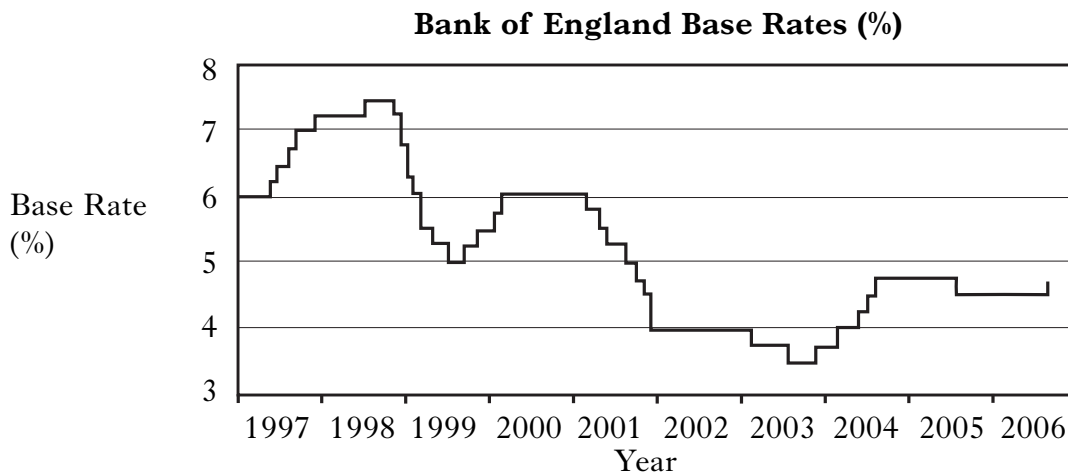
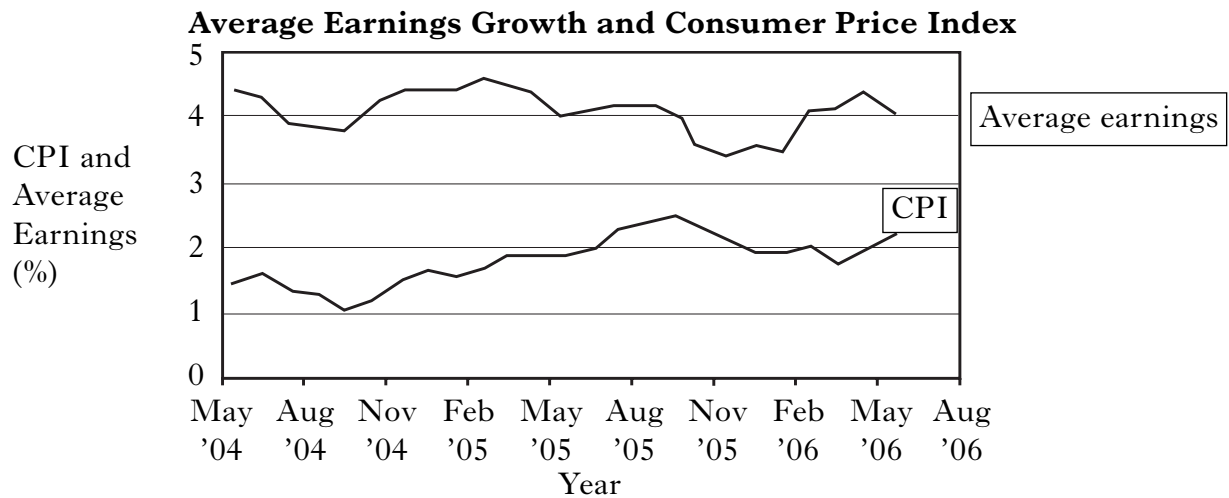
With experts predicting that global demand for oil may rise by as much as 50% by 2020, it is crucial that more energy efficient methods of production and transport are developed.

- (a) Explain the meaning of the following terms, **as used in the passage**:
- (i) “production quotas”; 2
 - (ii) “variable costs”. 2
- (b) Draw **one** diagram to show how supply side shocks and high rates of economic growth in the US and China could cause an increase in the price of oil. 3
- (c) Explain why there was some relief when the US Government released 700 million barrels of oil from its reserves. Your explanation must include a diagram. 3
- (d) (i) Suggest and explain **one** reason for the high rate of economic growth in China. 2
- (ii) Explain how the UK might benefit from a high rate of economic growth in the US. 2
- (e) Explain the effect a rise in the price of oil might have on the foreign exchange value of sterling. 2
- (f) Explain, in your own words, why high oil prices may be good news for environmentalists. 2
- (g) (i) What is meant by “negative externalities”? 2
- (ii) Describe **one** measure a government could take to reduce negative externalities, and explain how it would work. 3
- (h) Describe **one** way in which transport might be made more energy efficient. 2
- (25)**

[Turn over

ITEM B

The following diagrams refer to the UK economy.



Unemployment rose to its highest level for 6 years in May 2006, reaching 5.4%. However, the number of people in employment in May 2006 rose to 28.9 million.

In 2006/2007 Government expenditure was £552 billion and Government revenue was £516 billion.

- | | | |
|-----|---|-------------|
| (a) | Did real earnings rise or fall between May 2004 and May 2006? Explain your answer. | 2 |
| (b) | (i) Suggest and explain one reason for the change in interest rates during 2004. | 2 |
| | (ii) Explain how an increase in interest rates is likely to affect the exchange rate of sterling. | 3 |
| (c) | Explain how unemployment and employment can both increase at the same time. | 2 |
| (d) | Explain how an increase in unemployment is likely to affect: | |
| | (i) the growth of average earnings; | 2 |
| | (ii) government finances. | 4 |
| (e) | Explain how the budget situation in 2006/2007 is likely to affect: | |
| | (i) the level of unemployment; | |
| | (ii) the rate of inflation. | 4 |
| (f) | (i) Suggest and explain 2 reasons for the UK's relatively low rate of inflation. | 4 |
| | (ii) Describe one advantage for the UK of a relatively low rate of inflation. | 2 |
| | | (25) |

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

SECTION B

Attempt any TWO questions.

Marks

1. Economics involves the study of costs, the most important one being opportunity cost.
 - (a) Explain the concept of opportunity cost. Your explanation should include a production possibility diagram. **9**
 - (b) Explain the relationship between marginal cost and average total cost. Your explanation should include a diagram. **6**
 - (c) Explain why firms may continue to produce when their total revenue is less than their total costs. **10****(25)**
2. Economics explains how countries can make the most efficient use of their resources.
 - (a) Explain the relationship between technical and economic efficiency. **6**
 - (b) Explain why governments sometimes intervene in the allocation of resources. **10**
 - (c) Explain how developed countries can help to increase the economic growth rates of developing countries. **9****(25)**
3. The slow down in the growth of UK National Income in 2005 was partly caused by the increased deficit on trade in goods and services.
 - (a) Suggest and explain reasons why the UK usually has a deficit on trade in goods and services. **8**
 - (b) Explain, using a circular flow of income diagram, how a deficit on trade in goods and services can slow down the growth of National Income. **8**
 - (c) Suggest and explain measures the government could take to reduce deficits on trade in goods and services in the future. **9****(25)**
4. Despite the UK's reluctance to join the Eurozone, a 2006 report stated that "Britain remained the favourite European destination for foreign investment projects".
 - (a) Suggest and explain reasons for the UK's reluctance to join the Eurozone. **8**
 - (b) Explain why foreign firms might wish to locate in the UK. **8**
 - (c) Explain the advantages and disadvantages for the UK economy of foreign direct investment. **9****(25)**

5. One effect of the growth of world competitiveness has been to make the demand for internationally traded goods more price elastic.
- (a) Suggest and explain reasons for the increased competitiveness in world markets. 8
 - (b) (i) Explain the meaning and importance of price elasticity of demand. 10
 - (ii) Describe what producers can do to make the demand for their products more price inelastic. 7
- (25)
6. One reason why Romania and Bulgaria joined the EU in 2007 was to increase their rates of economic growth.
- (a) Explain the advantages and disadvantages for the UK economy of EU enlargement. 12
 - (b) (i) Explain why economic growth is an aim of governments. 6
 - (ii) Describe some of the disadvantages of high rates of economic growth. 7
- (25)

[END OF QUESTION PAPER]

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