

[CO38/SQP164]

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Advanced Higher  
Economics  
Specimen Question Paper

Time: 2 hours 15 minutes

NATIONAL  
QUALIFICATIONS

You should answer Section A, and **two** questions from Section B.

The marks for each question are shown in the margin.

## SECTION A

Read the following passage, and then answer the questions which follow on **page three**.

### The price is wrong

Most western economies are **market economies**. It is assumed that market forces will lead to greater competition, growing efficiency, lower prices, better products and higher living standards. Indeed the collapse of the command economies in Eastern Europe was caused, at least in part, by their poor economic performance.

- 5 However, concern has been expressed in the UK about the power of oligopolistic firms. Such firms can withstand the forces of competition and continue earning substantial profits. In some industries, such as petrol retailing and newspaper publication, these firms have been accused of **predatory pricing**. Despite the existence of bodies to promote competition, it has been difficult to prove the existence
- 10 of monopolistic practices and the punishment for firms found guilty of such practices has been minute in comparison to the potential gains.

- In some markets, retailers have not been able to sell the products below the manufacturer's recommended price. Despite the abolition of resale price maintenance in 1964, large retailers, because of their market power, have been able to compel
- 15 manufacturers to block supplies to price-cutting retailers. It seems most manufacturers have been quite ready to co-operate. A newspaper survey (Sunday Times, 17 November 1996) found that a leading brand of television sold for exactly £700 in many UK electrical stores but for only £361 in the USA. In the grocery trade, another retailer sold all its fruit and vegetables at substantial discount in
- 20 comparison to its prices in other nearby stores, thus forcing specialist fruit and vegetable shops out of business. There were over 180 000 shops in the grocery trade in the 1950s, but today over 60% of the market is controlled by the four largest firms.

- Recently, because of increasing pressure from the UK government, the European Commission and the greater **price transparency** in European markets, UK car prices
- 25 have started to fall nearer to those on offer in other EU states. However, despite the drive to cut supermarket prices following the take-over of ASDA by the American firm Walmart, a newspaper survey (Sunday Times, 8 October 2000) found that an average basket of goods in the UK cost over £40 compared to £34 in France and Germany. Competition between large firms can benefit the consumer especially if
- 30 some market leaders are prepared to sell products below market price.

Rumours of various **monopolistic practices** persist. It appears that the benefits of market forces, in which prices allocate economic resources in the most efficient way, can be denied because "the price is wrong".

1. Explain the meaning of the following terms:
  - market economies (line 1);
  - predatory pricing (line 8);
  - price transparency (line 24);
  - monopolistic practices (line 31).

4
2. (a) What are oligopolistic firms? 2  
 (b) How and why are oligopolistic firms able to withstand competition? 4
3. In what ways might consumers lose out because of the practices of electrical suppliers, supermarkets and car firms? 3
4. Why are firms sometimes prepared to sell their products below market prices? 3
5. Discuss some reasons, unrelated to competition, why UK prices may be higher than those charged in France and Germany. 3
6. The assumption of the article is that “the price is wrong”.
  - (a) Explain the economic justification for claiming that “the price is wrong”. 2
  - (b) Identify and discuss **two** measures which might lead to more appropriate price levels. 4

(25)

## SECTION B

**Attempt TWO of the six questions set.**

**Each question carries 25 marks.**

	<i>Marks</i>
1. "Rising oil prices cast a shadow on the development of the world economy."	
(a) Why did the price of oil rise sharply after January 1999?	6
(b) Discuss the consequences of higher oil prices for the UK economy.	9
(c) Discuss the case for and against a reduction in the amount of excise duty levied on petrol and diesel in the UK.	10
2. Silicon Glen is a symbol of the restructuring of the Scottish economy after the decline of coal, shipbuilding, steel and textiles.	
(a) Why does Scotland attract a high proportion of foreign direct investment (FDI)?	8
(b) Discuss the benefits for Scotland of these high rates of FDI.	9
(c) With reference to particular cases and circumstances, what dangers might there be from being too dependent on FDI?	8
3. (a) Why has the level of state pensions become a major economic issue in recent years?	10
(b) Given the size of the surplus in the UK budget, why is the UK government reluctant to introduce higher state pensions?	9
(c) Discuss some other ways by which pensions might be financed without increasing UK public expenditure.	6
4. At present there are fifteen members of the European Union (EU); however, if all the current applicants join there could be almost thirty members by 2010.	
(a) What plans exist to expand the membership of the EU?	5
(b) What benefits will be gained from expanding the EU by: <ul style="list-style-type: none"><li>• existing member countries?</li><li>• new member countries?</li></ul>	12
(c) Discuss the difficulties which current members of the EU may face if new countries are admitted to membership of the organisation.	8
5. In the past, inflation was regarded as "public enemy number one", but in the last decade in the UK and in many other countries inflation seems to have been conquered and in the eyes of some "inflation is dead".	
(a) Why was inflation regarded as "public enemy number one"?	7
(b) Explain why the threat of inflation has declined.	10
(c) Discuss arguments in favour of and against the view that "inflation is dead".	8

6. The UK introduced a National Minimum Wage in 1999, which was increased from £3·60 to £3·70 per hour from October 2000. However, many people feared that its introduction would lead to a rise in the levels of unemployment.
- (a) Outline the arguments in favour of a National Minimum Wage. **8**
- (b) How would you account for the fact that, despite the introduction of the minimum wage, UK unemployment is at its lowest rate for over twenty years? **10**
- (c) How has the introduction of a National Minimum Wage affected other aspects of the UK's economic performance? **7**

*[END OF QUESTION PAPER]*



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Advanced Higher  
Economics  
Specimen Marking Instructions

NATIONAL  
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The appended marking instructions are guidelines only; candidates will adopt different ways of tackling particular questions. (Differences of interpretation would be resolved at a markers meeting.)

In the essay questions it is not necessary for candidates to include all the points listed. What is expected is a full appreciation of the topic and a sound understanding of the economic issues under discussion. Marks should not be allocated on a rigid point-scoring basis, but on the overall quality of the answer. It may not be possible to discuss all the relevant points in the marking scheme to obtain full marks in a given question or sub-question.



## SECTION A

1. **Market economies**—arrangement in which the forces of demand and supply operate with little or no government interference and in which price remains supreme in the allocation process.  
**Predatory pricing**—deliberately setting prices below cost price to drive competitors out of business.  
**Price transparency**—ability to compare prices more easily because of freer and more open trading arrangements.  
**Monopolistic practices**—business activities preventing effective competition, for example collective boycotting and price fixing.
2. (a) When a few large firms dominate the supply in a given industry.  
(b) How and why?
  - Substantial resources (reserves) in difficult times.
  - Maintain low loss making prices in the short run.
  - Prevent entry of new firms to an industry by financial, technical and legal barriers.
  - Price, market or output agreements with other oligopolistic firms.
  - Economies of scale make prices lower than competitors.
3. Prices are higher because of lack of competition.  
Choice and product range may be restricted.  
Quality of product and service may suffer.  
Number of outlets limited.
4. Able to subsidise losses from profits made on other business ventures.  
Aim to establish product in the mind of the consumer.  
Use of loss leaders to attract custom.  
To drive out competitors with the intention of putting up prices later!
5. Impact of exchange rate fluctuations, which are used when making comparisons.  
Tax system in other countries focuses on direct rather than indirect taxation.  
Higher costs because of climate, soils and remoteness.  
Other business costs, for example diesel duty and compliance with government legislation.
6. (a) Prices should reflect the true cost of supply (factor cost) plus the level of profit in competition with other firms—which is also, strictly speaking, a factor cost. Price fixing yields abnormal profit for participating firms.  
(b) Many possibilities here.
  - Improve the powers of official bodies and their resources to investigate monopolistic practices.
  - Increase the penalties for firms “guilty” of price fixing.
  - Governments intervene to fix price levels, limit monopoly profits or use specific “windfall taxes”.
  - Create a more open system revealing financial details, rewarding “whistle blowers” and registering all information agreements and similar arrangements.
  - Learn lessons from other countries, for example the USA, by introducing measures strengthening consumer rights.

## SECTION B

1. (a) Reasons include:
  - OPEC restricting output by about 8%;
  - booming world economy and hence demand for oil;
  - activities of speculators;
  - concern about the long term supply of oil.
- (b) Consequences include:
  - benefits to the balance of payments, the exchequer and to the green lobby;
  - costs to the individual in products, motoring, holidays and employment prospects;
  - increased costs of raw materials and distribution for business;
  - loss of competitiveness and possible closure of some firms;
  - government under pressure and may lose popularity—but inflation may rise and economic growth suffer with negative effects on the budget.
- (c) Discussion will include:

**For:** as above will reduce inflation, lower business costs, improve business competitiveness and maintain economic growth without the threat of inflation or unemployment. With a large budget surplus they can afford it!

**Against:** environmental impact, increased congestion and accidents, depletion of oil reserves, loss of government revenue and related opportunity costs.
2. (a) Some background information expected on output, employment and the proportion of UK and EU levels of FDI.

Labour skill, education, training and experience.  
Government assistance.  
Cost of land and labour.  
Attractiveness of Scotland.  
Access to the EU market.  
English language and culture.  
Magnet attraction after early FDI successes.
- (b) These will involve personal judgements.

Lower levels of unemployment.  
Diversification of labour skills and opportunities.  
Multiplier effects in the central belt upstream and downstream.  
Benefit to balance of payments.  
Increased levels of economic activity and higher standard of living.  
Improved infrastructure especially communications and educational provision.
- (c) Reference to examples eg Hyundai essential.

Low wage levels.  
“Screwdriver Glen” based on assembly not innovation and development?  
Dependent on economic conditions in other parts of world, as in 1997/1998 Asian crisis.  
Domestic industry is unfairly treated.  
Multinationals may remit profits or withdraw with little notice and no means of government control.  
Decision making outwith Scotland.  
Conceals Scotland’s poor record in establishing new businesses.

3. (a) Factors include:
    - people living longer;
    - falling birth rate;
    - the growth cost of health care and sheltered housing;
    - impact of higher education and early retirement on the size of the working population;
    - massive cost implications for government expenditure and the tax burden for those in employment;
    - removal of link between average earnings and the state pension.
  - (b) Budget surplus the product of current growth rates, which can change very quickly. Government commitments to other areas such as NHS and education. The rapid increase in the pensioner population (15·8% and rising). Desire for greater levels of personal provision by Government. Political pressures to restore the link with average earnings may prove too great in the end.
  - (c) Various approaches are possible, including greater contributions to personal pensions from an early age, higher NIC, schemes to release assets tied up in property and removing some of the tax and saving restrictions on the elderly. Also ideas about hypothecating funds from the sale of mobile phone licences and the like and increased general taxation.
4. (a) “Early birds”—Slovenia, Estonia, Czech Republic, Poland, Hungary and Cyprus by 2004. Based on economic readiness (market driven economies) and the development of democracy. Later—Malta, Latvia, Lithuania, Slovakia, Romania, Bulgaria and eventually Turkey.
  - (b) Points include:
    - creation of a larger market permitting specialisation and greater economies of scale, greater efficiency; sources of cheaper products—especially food and raw materials; political expediency; integrated Europe economically and politically.
    - access to farm and industry support; access to new markets; rising living standards; better pay levels and lower unemployment; greater “voice” in Europe’s future.
  - (c) Budget pressure—already funds are inadequate to finance agriculture; most of these countries have large sectors that will benefit. Regional funds under pressure; some areas eg Highlands and Islands will lose aid. Competition for member firms leading to business closures and job losses. New enterprises and inward investment will move “east” to cheaper locations. Problems with control, decision-making and democracy with so many diffuse members. Mafia and the “black market” activities spreading into western Europe.

5. (a) An analysis of the costs of inflation expected to cover all the major effects including loss of competitiveness, inefficiency, unfair distribution of income, disincentives, the menu and shoe leather costs and the undermining of business confidence and enterprise.
- (b) The marked success of current monetary policy used in many countries. The role of interest rates and the independence of monetary authorities should be discussed fully.  
Improved International co-operation.  
More flexible markets, especially the labour market.  
A rapid and sustained period of economic growth.  
Growth in productivity related to supply-side efficiency.  
More compliant trade unions.  
Changing attitudes towards pay claims and unemployment.
- (c) **In favour:** the high rates of economic growth and the falling rates of unemployment which have not led to wage inflation; the new attitudes created by successful monetary policies and the development of the “new paradigm” emanating from the USA.  
**Against:** the boom in the economy cannot last forever, the effect of rising oil prices, the temptation for governments to embark on deficit financing in times of difficulty and the prospect of a wages explosion.
6. (a) It is fairer protecting those with little “clout” or union strength thus guaranteeing all a decent basic wage.  
Productivity may increase because incentives have improved.  
Prevents exploitation (NMW is favoured by many of the “better” employers) and it is in keeping with the policies practised in most western democracies.  
The level of aggregate demand will be much higher leading to better living standards for all.
- (b) The rate is so low that it makes little impact, some loopholes exist in the legislation and employers can ignore the NMW.  
Unemployment figures are misleading because of the differences in counting the numbers and because of globalisation workers are very aware of the consequences of being uncompetitive.  
The growth of part-time work and temporary contracts limits the ambitions of many people.  
The UK economy has grown rapidly in recent years, above its long-term trend, and created many new job opportunities.
- (c) Business costs have increased slightly and some inflationary effects will have occurred.  
Firms have increased productivity to retain their competitiveness.  
The UK Government has received higher revenue from direct and indirect taxation but the balance of payments may have gone into greater deficit.  
In general the introduction of the NMW has had little effect on the UK’s economic performance.

[END OF MARKING SCHEME]