

**2004 Economics**

**Higher**

**Finalised Marking Instructions**

## 2004 HIGHER ECONOMICS

### MARKING SCHEME

#### ITEM A

	<i>Marks</i>
(a) (i) Total cost divided by output (or AFC + AVC) – one mark. In the passage it can mean either the cost of running one train or train costs per passenger mile – either will gain full marks.	2
(ii) Long term spending on fixed assets – one mark. In the passage it means spending on rolling stock (or rail tracks, stations etc) – full marks.	2
(b) Increased punctuality, cleaner trains, more regular services, newer trains, safer trains etc – accept any plausible possible benefit. Half a mark per benefit and half a mark per description.	2
(c) (i) The only firm in an industry (pure monopoly), a firm which dominates an industry or a firm which has at least 25% share of a market – any of these will gain full marks. Also credit references to monopoly power ie the ability to fix either price or output.	2
(ii) Through legislative bodies. Look for some description of the Competition Commission, or the OFT or government watchdogs.	2
(d) (i) Look for a straightforward description of: time wasted in traffic jams, increased pollution, road rage, increased transport costs etc.	3
(ii) Look for an understanding of the idea that a subsidy should reduce rail fares, and this might persuade some road users to travel by rail instead.	2
(iii) Possible measures include: motorway tolls which will increase the cost of road journeys and therefore reduce demand; road pricing in cities which will persuade some car users to switch to public transport; increased petrol tax which will make some people use their cars less; incentives to encourage car sharing; increased road building and motorway extensions to increase the supply of roads.	4
	(Mark 2:2)
(e) To provide a service to eg remote areas of Scotland, to promote tourism in these areas, as part of overall regional policy – credit any plausible answer.	2
(f) (i) Look for some understanding of the problem of time lags. Although the costs of capital investment are incurred in the short term, its benefits accrue in the long term. As short term contracts might not be renewed, train companies might incur the costs of investment but not experience the benefits.	2
(ii) Look for a description of some of the problems of not renewing rolling stock, rail tracks and stations ie delays, increased breakdowns, more accidents etc.	2
	(25)

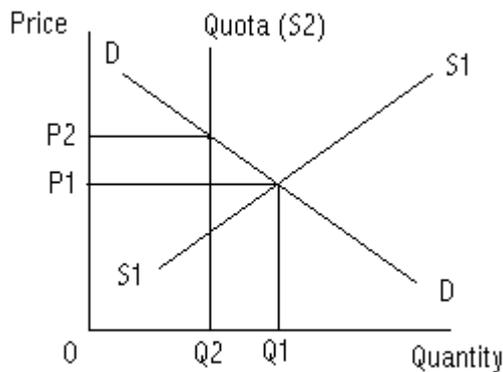
ITEM B

	<i>Marks</i>
(a) (i) The value of the output of goods and services produced by all firms in the Ukraine. No need to define ‘Gross’, but credit candidates who do.	2
(ii) Not an official term, so credit any explanation that refers to short term speculative flows of funds (or some equivalent term) between countries.	2
(b) Ukraine.	1
(c) Prices rose, but the rate at which they rose, fell. If candidate simply describes the graph, half a mark.	2
(d) (i) Look for a simple explanation of how budget deficits increase AMD. $G > T$ , therefore government injecting more money into the economy through spending than they are taking out through taxation. AMD will therefore increase which will increase inflationary pressure.	2
(ii) Reductions on interest rates will encourage borrowing (and investment) discourage saving, both of which will increase spending and therefore inflation. Credit references to the increase in the real incomes (and therefore the demand) of (variable interest) mortgage holders.	2
(e) (i) Explanation can involve imports or exports – not necessary to mention both for full marks. Import prices will fall (credit explanation) therefore imported raw materials, components etc will be cheaper. This will reduce cost-push inflation. The price of finished imports will also fall. Exports will be less competitive (credit explanation) and the resultant fall in AMD will reduce demand-pull inflation.	2
(ii) Look for a straightforward description of some the problems of either cheaper imports or dearer exports (trade deficits, unemployment, slower growth).	2
(f) The diagram should show an increase in supply and a fall in equilibrium price.	2
(g) As much of UK industry is ‘oil-based’, an <b>increase</b> in oil prices will increase industry fuel and transport costs and therefore increase cost-push inflationary pressure. Also credit references to the increased cost of motoring.	3
(h) Difficult question – the answer is found in the statements made in the second last paragraph. As many services are non-traded ie not bought and sold internationally, any increase in demand for them must be met by increases in domestic production (an unlikely situation). As demand is rising faster in eastern Europe, it will experience larger shortages in services and therefore faster rising prices. Credit highly answers along these lines.	3
(i) Variety of answers possible; reasons include: <ul style="list-style-type: none"> <li>• They can sell to and buy from a huge market free of any trade barriers</li> <li>• They should experience increased employment as firms re-locate to take advantage of lower wage rates</li> <li>• The level of FDI should increase – should lead to higher output and incomes</li> <li>• They will (eventually) receive large amounts of money from the EU regional fund and the CAP.</li> </ul>	2

SECTION B

Marks

- 1 (a) Look for a straightforward explanation of relative scarcity eg although the wants for goods and services are unlimited (credit reasons) the resources (land etc) required to produce the goods and services are limited. This combination of unlimited wants and limited resources creates the basic economic problem of scarcity. As this is true for every country, all countries are affected by scarcity. Although scarcity may be more obvious in poor countries, where many are starving, even rich countries do not have enough resources to produce enough goods to fully satisfy all their people 8
- (b) As little can be done to reduce peoples wants, measures to reduce scarcity must aim at making more efficient use of resources. Therefore look for explanations of how technical (or economic) efficiency can be increased eg greater specialisation, capital investment, more research and development, better training and education, improved management techniques etc. Three measures, well explained can gain full marks. Credit candidates who refer to the government's role in promoting economic growth and who state that although scarcity can be reduced, it can never be eliminated. 10
- (c) Straightforward question but look for some attempt at comparing and contrasting growth rates, levels of capital and capital investment, spending on education and training, types of exports and the volume of exports, levels of debt, importance of aid etc. 7
- 2 (a) PED is the responsiveness of the demand for a good to a small change in its price ie it measures the extent to which the quantity demanded changes when price changes.  
Credit the formula and references to PED being  $>1$ ,  $<1$  and  $=1$ .  
Maximum of 5 marks for the definition.  
Look for a simple description of at least three determinants (degree of necessity or habit, closeness and availability of substitutes, price relative to income, frequency of purchase, a small but vital part of something else etc) and how they affect PED. Credit examples and diagrams. A maximum of 8 marks for the descriptions with a maximum of 2 marks for each description. 10
- (b) The diagram should show a (price elastic) demand curve, a supply curve and the original equilibrium price and quantity (one mark). Most candidates will then show a decrease in supply (because of the quota) resulting in an increase in price and a decrease in quantity. Maximum 3 marks. However if the candidate draws the new supply curve being perfectly price inelastic at the quota, maximum 4 marks.



The explanation should mention that the quotas will reduce the supply of fish and therefore increase the price. As the demand is price elastic, the increase in price will reduce the total revenue of the industry – the extra revenue gained from the increase in price will be less than the revenue lost from the decrease in quantity. Maximum 4 marks.

8

- (c) Straightforward question but credit highly candidates who convey the idea (they do not have to mention it by name) of the downward multiplier.

The quotas will reduce the incomes of fishermen and some will go out of business. This will reduce incomes and employment in fishing related industries (credit examples). As the Scottish fishing industry is heavily localised, many people in the fishing communities will suffer a loss of income eg shopkeepers, hotel owners, banks etc.

7

- 3 (a) The uses include: to enable the government to plan future economic policy; to measure growth rates and changes in the standard of living; to compare the S of L over time and between countries; to calculate the level of contributions to international organisations and to identify the countries in need of aid. Max 5

The main limitations are that the figures are only estimates and can be misleading indicators of economic welfare as they ignore many of the variables that add to or detract from the quality of life eg clean air, peace, religious freedom etc. They also do not indicate how any increases have been distributed.

Although the question asks about limitations, credit candidates who show that the problems of calculating the National Income (double counting, transfer payments, the shadow economy, non monetary transactions etc) can limit its usefulness. Also credit references to the difficulties of comparing countries (different currencies, work rates, leisure time, conditions of employment etc) and comparing years (inflation, population changes, changes in work habits, demand patterns etc). Also credit candidates who state that the most useful measure is real GDP per capita. Max 5.

9

- (b) Unemployment is a waste of a scarce resource therefore the lower it is, the less waste there is. The goods that an unemployed worker could have produced are gone forever. Falling unemployment reduces the output gap and means that the economy is closer to reaching its potential output. More people in work increases average income and the standard of living. This should increase spending, AMD and growth. Low unemployment therefore reduces government spending on JSA and increases government taxation revenue. This creates more scope for increased state spending on public services. Credit reference to the fact that low unemployment can also lead to fewer social problems.

Three well explained reasons for full marks.

7

- (c) Look for a straightforward description of how budget deficits and lower interest rates can increase AMD and therefore reduce unemployment.

An increase in G will increase the level of income in the economy and boost spending. To meet this increase in demand, firms may take on more workers. A reduction in income tax will increase disposable income which will lead to greater spending and so on. Reductions in interest rates will encourage borrowing discourage saving – again leading to an increase in spending and so on. It will also make investment cheaper (any increase in I will increase AMD) and increase the real income, and therefore the spending of mortgage holders.

Credit highly candidates who describe direct government measures to reduce unemployment eg the New Deal, from welfare to work, job clubs, help for new firms, regional policy etc.

Three well explained measures for full marks; maximum of 3 marks per measure.

9

- 4 (a) Reasons include: government incentives (credit examples); skilled labour force; quality universities and science parks; relatively cheap land; to get inside ‘fortress Europe’; efficient infrastructure; stable economy; common language (if American); scenery; golf courses. At least 3 reasons, with some development, for full marks.

7

- (b) The costs include: can be expensive for the government to entice these firms into the UK; the money could have been used to help domestic firms; no guarantee that the firms will stay here; creates unfair competition for Scottish firms; jobs created mainly ‘screwdriver’ jobs – the highly skilled jobs tend to remain in the home country; the danger of becoming a ‘branch economy’. Credit examples and references to repatriated profits.

The benefits include; increased employment and income – with the consequent multiplier effect; increased competition (leading to lower costs and prices); exchange of new technology and management techniques; increased capital inflows and exports.

Look for a description of three costs and three benefits but can mark 4:6 or 6:4 as well as 5:5.

10

- (c) Advantages include:
- The addition of 105 million people and an increase in land of 34% should boost economic growth and create new jobs
  - The bigger market will create greater opportunities for firms to benefit from economies of scale
  - The lower wage costs in the new member states will provide opportunities for firms to cut costs by re-locating their operations

Disadvantages include:

- Jobs may be lost as firms re-locate
- The CAP will have to be drastically reformed
- Regional funds will have to be altered in favour of the new entrants.

Two advantages and two disadvantages for full marks.

8

- 5 (a) Three reasons; utility, income effect and substitution effect – any two, well explained, can get full marks.

When a good falls in price it becomes a better buy ie consumers get more value for their money (they get the same amount of utility but pay less for it), therefore some consumers may buy more. Credit highly references to the theory of equi-marginal utility.

When a good falls in price, existing consumers experience a rise in real income (credit explanations) and may therefore buy more, and new consumers might now be able to afford the good as it now comes within their income bracket.

If the price of a good falls below that of a close substitute (credit examples), demand for it is likely to rise as some consumers may switch to it and away from the now dearer substitute.

7

- (b) If the price of a good rises then producers of that good will experience a rise in profit (assuming that costs have not changed). As producers wish to maximise profit, they will now be willing (and able) to supply more. In addition new producers who could not afford to produce the good at the lower price might now enter the market.

5

- (c) A reduction in direct tax will increase individuals disposable income and therefore widen their choice of how they spend their money. It may also increase their incentive to work harder or longer and encourage them to seek promotion. It may also encourage some unemployed people to more actively seek work. An increase in indirect taxation will reduce individuals real income and may force them to change their spending patterns eg cut down their driving, smoking and drinking. Credit highly candidates who explain why a shift from direct to indirect taxation will create a more regressive taxation system.

5

- (d) The diagram should show a decrease in demand, a decrease in supply and a reduction in the equilibrium quantity (the price can increase, decrease or stay the same) – max 4 marks. Candidates should explain how an increase in income tax will reduce consumers' disposable income and is therefore likely to reduce their demand for cars. An increase in VAT will increase the cost of producing cars and therefore reduce their supply. Also credit explanations of why the equilibrium quantity must fall but the equilibrium price may fall, rise or stay the same.

8

- 6 (a) The demand for sterling is determined by:
- The demand for UK exports (foreign importers who wish to buy our goods require sterling)
  - The level of foreign investment, either direct or portfolio, in the UK (foreigners who wish to invest in the UK require sterling)
  - Hot money inflows (international speculators and fund managers who wish to transfer their funds into sterling will create a demand for sterling).

A simple description of these three factors is all that is required for full marks but full marks can also be obtained by a correct explanation of the factors that can influence the determinants eg relative inflation rates, relative interest rates, the state of the UK economy etc.

6

- (b) Exports will become cheaper (credit explanation) and therefore more competitive, the resultant increase in demand will boost output, employment and profit in our exporting industries. Imports will become dearer (credit explanation) and therefore less competitive. The resultant increase in demand for UK goods will boost output, employment and profit in our import-competing industries. The combined result will be an improvement in our Balance of Trade and increased economic growth. However the question asks candidates to discuss the effects therefore some mention of the downside must be mentioned for full marks. Look for some understanding of the fact that a prolonged decrease in the exchange rate of sterling increases inflationary pressure in the UK. Imported finished goods are dearer – which will increase the RPI, UK industries which import their raw materials, components etc, will experience a rise in costs – which will increase cost-push pressure and the increased demand for UK goods will increase demand-pull pressure. If disadvantages are not mentioned, maximum is 7 marks.

9

(c) Advantages include:

- Stable exchange rates – reduce the risks of trade and should therefore increase the volume of trade
- No transaction costs – should lead to increased investment throughout the EU
- Price transparency – easier to compare prices throughout the EU (could lead to prices falling)
- Will help maintain the UK's high level of FDI
- Will help maintain London's position as a leading financial centre
- A fully independent ECB should lead to low inflation and increased economic growth and competitiveness.

Disadvantages include:

- Loss of monetary independence – ie the MPC will no longer be able to set interest rates
- One European interest rate will not suit all members. Especially true for the UK which is often at a different stage of the economic cycle to that of the rest of the EU
- Devaluation of sterling (to correct trade deficits) is no longer an option – will have to deflate instead
- UK more sensitive to interest rate changes because of our high % of variable rate mortgage holders
- The menu costs of changing over to the Euro will be very high
- Exogenous shocks eg oil price changes, will impact the UK economy differently from the rest of the EU economies
- The UK economy is currently the healthiest in the EU – if it aint broke why fix it?

Can mark 6:4, 4:6 or 5:5 but look for 3 advantages and 3 disadvantages for full marks.

10

[END OF MARKING INSTRUCTIONS]