

2006 Economics

Intermediate 2

Finalised Marking Instructions

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ECONOMICS INTERMEDIATE 2

2006 Marking Scheme

Item A

- (a) Look for a simple explanation of how the RPI is constructed – the main points being the survey of average income households and the average price of the basket of goods. Also credit candidates who say that inflation is measured by calculating the % increase in the general level of prices over time (or words to that effect). 2
- (b) (i) They rose 1
- (ii) Candidates should explain that, although the **rate** of inflation fell, prices still rose as inflation remained positive (no need to mention the actual percentages). 2
- (c) (i) The level of saving would rise (1 mark) as saving is now more rewarding (1 mark). 4
- (ii) The level of borrowing would fall (1 mark) as borrowing is now more expensive (1 mark). 4
- (d) Main items include: social security/protection, health, education, public order and safety, and defence. Credit any logical (not necessarily economic) reason. 2
- (e) (i) A Budget surplus means that the government is receiving more revenue (from taxation) than it is spending (on pensions, health etc). 1
- (ii) A Budget surplus reduces the level of demand in the economy (1 mark) as the government will be taking more money (demand) out of the economy than it is putting in (1 mark). This fall in demand will reduce the rate of (demand-pull) inflation (1 mark). 2
- (f) (i) It will reduce their (disposable) income (1 mark) as they will be paying more income tax (1 mark). Their standard of living will therefore fall (1 mark). 2
- (ii) They will experience a fall in demand for their products (1 mark) which will reduce their profits (1 mark). Credit references to the effect on profit of increases in corporation tax (2 marks). Do not credit references to VAT. 2
- (iii) The level of unemployment should rise (1 mark) because of the decrease in demand (1 mark). Credit references to the demand for workers being a derived demand. 2
- (20)

Item B

- (a) The money received from sales or price x quantity sold 1
- (b) (i) £20,000 1
- (ii) Rent of the factory; interest on any money the firm has borrowed; salaries of the workers in the firm; depreciation of the firm's machinery. If no attempt to relate it to the firm, 1 mark. 2
- (c) The basic reason is because the firm is experiencing increasing returns (1 mark) to the variable factor (1 mark). Also credit reasons why returns are increasing (1 mark per reason) eg the firm is becoming more efficient, it is approaching its optimum output, the fixed factor is becoming less over-worked, fixed costs are being spread over a larger output, increased specialisation/division of labour etc. 2
- (d) At that output it will make a loss (1 mark) of £10,000 (1 mark) as its total costs are greater than its total revenue (1 mark). 2
- (e) (i) Some workers might be made redundant (1 mark) as they might be replaced with machinery (1 mark). Alternatively, they may receive more pay (1 mark) as the firm could become more efficient/profitable (1 mark). Also credit answers which concentrate on how mechanisation can affect the workers work load.
- (ii) They might benefit from a fall in the price (or an increase in the availability) of the juice (1 mark) resulting from the increase in efficiency (1 mark) and therefore experience a rise in real income (1 mark).
- (iii) The firm will become more efficient (1 mark) and experience a rise in productivity (1 mark) which will lead to greater profit (1 mark). The firm could afford to reduce its price (1 mark), become more competitive (1 mark) and experience an increase in demand (1 mark). Mark 2:2:2. 6
- (f) If consumers experience a rise in income (1 mark) existing consumers might now buy more (1 mark) and new consumers might enter the market/be able to afford to buy juice (1 mark).
If the price of another make of juice increased (1 mark) some consumers might switch (1 mark).
If the price of chips, crisps, chocolate (credit any possible complement to juice – 1 mark) decreased (1 mark).
If the firm launched an advertising campaign (1 mark) their juice might become more popular (1 mark)
If it was suggested that drinking juice is good for people (1 mark) then it will become more popular (1 mark) as people will start drinking it for health reasons (1 mark). 4
- (g) The value of sterling (1 mark) in terms of the euro (1 mark). How many euros you can get (1 mark) for one pound (1 mark). 2
- (20)

Essay Questions

- 1 (a) (i)** Look for a simple explanation of scarcity eg although our wants for goods and services are unlimited (1 mark) – reasons also gain a mark – the resources (examples – 1 mark) required to make the goods are limited (1 mark). There are therefore not enough resources to produce all the goods that people want (1 mark). This is why goods are scarce (1 mark). Provided the candidates mention unlimited wants and limited resources, they can gain a mark for mentioning that scarcity is universal and another mark for saying that it is the basic economic problem. **4**
- (ii)** Credit any suggestion that opportunity cost is what we have to give up in order to do something. The standard definition ie the sacrifice of the next best alternative choice, gains 2 marks. Opportunity cost, therefore, occurs every time a choice is made (1 mark) and is the real cost of any choice (1 mark). Scarcity leads to opportunity cost for consumers because their limited income (1 mark) requires them to make choices (1 mark) as they cannot satisfy all of their wants (1 mark). They will choose to buy goods that maximises utility (1 mark). One mark for examples. Producers do not have enough resources (1 mark) to produce all they could (1 mark) so they must also choose (1 mark). One mark for examples. They will use their resources to try and maximise profit (1 mark). **6**
- (b) (i)** Reasons include (maximum of 2 marks per reason):
- British families have higher incomes (1 mark) therefore they can afford to spend more of their income (on luxury items such as) cars (1 mark). People living in a developing country have far lower incomes (1 mark) and therefore tend to spend their income on more essential goods (1 mark).
 - The cost of cars is cheaper (relative to income) in the UK (1 mark) therefore more people can afford them (1 mark). Car prices are higher (relative to income) in developing countries (1 mark) and therefore fewer people can afford them (1 mark).
 - Britain has very good roads (1 mark) which makes it worthwhile owning a car (1 mark). Developing countries have poor road systems (1 mark) and therefore people would not benefit as much from owning a car (1 mark). **4**
- (c)** Look for a simple description of 3 of the following (1 mark for the form of aid and 1 for the description or development): food aid; grants/loans; technical aid; help with education/training; medical aid; military aid; debt relief; free/fair trade etc. **6**

- 2 (a) (i)** The diagram should show an increase in demand (1 mark) and a consequent increase in the equilibrium price (1 mark). Correct labels also gain 1 mark. The explanation should make some reference to an increase in demand creating a shortage (1 mark) which pushes up the equilibrium price (1 mark).
- (ii)** The diagram should show a decrease in supply (1 mark) and a consequent increase in the equilibrium price (1 mark). Correct labels gain 1 mark. The explanation should mention how a decrease in supply will cause a shortage (1 mark) which will push up the equilibrium price (1 mark). **8**
- (b) (i)** Credit definitions of inflation (1 mark). Candidates should explain how the price of oil affects the price of many important commodities eg petrol, electricity, transport etc. Therefore an increase in the price of oil will result in cost-push inflation. Mark according to overall quality. **4**
- (ii)** Look for a straightforward description of 3 of the following:
- increased price of exports – less competitive
 - decreased price (relatively) of imports – more competitive
 - increased unemployment – credit reasons
 - fall in real income if wages rise more slowly than inflation
 - rise in real income if wages rise faster than inflation
 - redistribution of income
 - increased shoe-leather costs
 - instability. **8**

- 3 (a)** Free trade simply means that countries can trade with other countries without any restrictions or trade barriers (1 mark) such as tariffs, quotas, exchange controls, high safety/quality standards, embargoes, or subsidies (1 mark if 2 or more examples are given). The main benefit of free trade is that it encourages countries to specialise on the basis of comparative advantage, but other advantages include: greater choice/variety for consumers; imports may be of higher quality and give better value for money; the increased competition could lead to lower prices; imports can fill gaps in the market and prevent the growth of monopolies. Also credit the advantages of increased specialisation eg increased growth, greater employment, higher living standards. **6**
- (b)** Barriers to trade include:
- Tariffs – a tax placed on the imported goods (1 mark) which increases their selling price (1 mark) and makes them less competitive (1 mark).
 Quota – a physical limit on the amount of a certain good that is allowed to enter the country per year (1 mark). When the quota is reached no more of the good can be imported until the following year (1 mark).
 Subsidies – given to domestic firms (1 mark) thereby reducing their costs of production (1 mark) which allows them to lower their price and become more competitive (1 mark).
 High safety/quality standards – if set very high can effectively prevent some goods being imported (1 mark). Credit examples (1 mark).
 Embargoes – a complete ban on certain goods or goods from a particular country (1 mark). Credit examples (1 mark). **8**
- (c)**
- (i)** The price of exports will rise (1 mark) as foreigners have to give up more euros to buy the same amount of pounds (1 mark).
 - (ii)** The price of imports will fall (1 mark) as each pound is now buying more euros (1 mark).
 - (iii)** The cost will fall (1 mark) as their money will now go further/as each pound is now buying more euros (1 mark). **6**

- 4 (a)** The diagram should show a decrease in supply (1 mark) and an increase in the equilibrium price (1 mark). Correct labels also gain 1 mark. The explanation is that the tax puts up the supplier's costs (1 mark) which will cause him/her to reduce the supply (1 mark) by diverting resources to another product (1 mark). The fall in supply will increase the equilibrium price (1 mark).
- (b)** The most likely reason is to increase tax revenue (1 mark) to enable them to spend more on hospitals, schools etc (1 mark). Credit references to cigarettes being habit-forming/price inelastic therefore demand will not fall very much and total revenue will rise.
Another reason could be to encourage people to smoke less (1 mark) and therefore improve the health/productivity of the nation (1 mark) and reduce the burden on the NHS (1 mark).
Also credit candidates who explain how a tax on cigarettes can slow down the economy and reduce over-heating. **6**
- (c) (i)** Direct taxes are levied on income and wealth, indirect taxes are levied on expenditure (2 marks) or direct taxes are sent directly to the revenue authority, indirect taxes are collected by an intermediary who then sends them to the revenue authority (2 marks) or direct taxes are collected by the inland revenue, indirect taxes are collected by customs and excise (2 marks).
1 mark for the example of direct and 1 mark for the example of indirect **4**
- (ii)** The taxation system will become more regressive/less progressive (1 mark) as direct taxes are progressive (eg surtax) but indirect taxes are regressive (in nature) (1 mark). Credit candidates who explain the difference between progressive and regressive and references to the effect on income distribution. **4**

- 5 (a)**
- (i)** When the import of goods is greater than the export of goods (2 marks). If candidates mention value (rather than volume), they gain an extra mark.
 - (ii)** Look for a straightforward explanation (3 marks) of 1 of the following: the UK's loss of comparative advantage in some goods; the increase in foreign competition; the strong pound; the decline of our manufacturing industries etc. Mark according to overall quality **6**
- (b)** Trade in services (1 mark) – examples also gain 1 mark. Interest, profits and dividends (2 marks – if only 2 mentioned, 1 mark). A correct description of how they arise gains 2 marks. Transfers (1 mark) – examples also gain 1 mark. **6**
- (c)**
- (i)** Not easy to define injections and withdrawals, so be lenient in marking the definitions. Injections are money flows which enter the system/income flow (1 mark) from outwith/outside (1 mark) or money flows which are not the result of spending by UK consumers (2 marks). Withdrawals are money which has been earned (1 mark) but is not passed on (1 mark) within the system. 1 mark for an example of an injection and 1 mark for an example of a withdrawal.
 - (ii)** National Income equilibrium occurs when injections equal withdrawals (1 mark). Injections increase National Income equilibrium (1 mark) withdrawals reduce National Income equilibrium (1 mark). **8**

[END OF MARKING INSTRUCTIONS]