



2007 Economics

Advanced Higher

Finalised Marking Instructions

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Marking Instructions
Economics Advanced Higher

Detailed marking instructions/guidelines

These are not solutions

1. The appended marking instructions are guidelines only. Candidates will adopt different ways of tackling particular questions.
2. Differences of interpretation will be resolved at the Markers' meetings in May and June.
3. In essay or extended answers it is not necessary for candidates to include all the points listed in the enclosed mark schemes.
4. Candidates are expected to demonstrate a full appreciation of the topic and a sound understanding of the economic issues under discussion.
5. Marks should not be allocated on a rigid points scoring basis, but on the overall quality of the answer.

Advanced Higher: Marking Scheme

Marks

Section A

- | | | | |
|----|-----|--|---|
| 1. | (a) | Market prices are arrived at rationally. Consumers and suppliers react consistently and in their own self-interest delivering prices acceptable to both. | 1 |
| | (b) | Sub-optimal. Resources are not used in the most efficient manner. Resources could be better used without some individuals losing out (Pareto criterion). | 1 |
| | (c) | Supply side flexibility. House building is slow to respond to demand signals because of restrictions imposed by planning regulations. | 1 |
| 2. | | Speculators buy houses to make a capital gain from the rise in asset prices rather than simply to live in them. Candidates should also refer to the buy to let market and others who purchase to make profit from rent. | 2 |
| 3. | (a) | Demand side is influenced by the size and structure of the population, consumer incomes, mortgage rates and psychological factors associated with employment prospects and the future of the economy. | 3 |
| | (b) | Supply unable to respond because of the lack of availability of building land and decline in the size and role of public sector housing. | 2 |
| 4. | | Rising house prices increase the wealth of house owners and those with larger houses benefit the most.
High interest rates discourage first time buyers from entering the housing market further widening the gap between rich and poor.
Wealthy will have higher savings. | 3 |
| 5. | | Green belt restricts housing availability and labour mobility.
Lack of labour mobility will contribute to inefficient use of economic resources which may be wrongly located or unwilling/unable to locate in the best place. | 2 |
| 6. | (a) | Externalities are costs of economic activity borne by those incurring them and, therefore, not reflect in the priced charged.
Internalities are costs borne by those incurring them and reflected in the price charged to consumers. | 2 |
| | (b) | Planning system forbids or restricts house building in some areas minimising externalities. Open countryside and attractive locations are protected from development. | 2 |
| 7. | | Payoffs are intended to ensure that externalities are charged for development and those who might lose out are compensated with cash sums to make prices a better reflection of market forces. | 3 |

8. **At least three of the following should be discussed:**
- redistribution of income to house owners if not discussed earlier
 - ‘feel good factor’ for house owners affecting their economic behaviour
 - disposable income of some citizens will fall leading to falling consumption on other items or the pursuit of higher wages because of rising housing costs
 - people delay house purchase putting extra pressure on a limited rental sector
 - falling savings ratio
 - fewer savings in the less attractive equities market
 - firms find it harder to attract labour in the most expensive locations
 - impact on general level of inflation.
- 3

[END OF SECTION A]

Section B

		Marks
1.	<p>(a) Reasons for markets dominated by large firms</p> <ul style="list-style-type: none">• Economies of scale – several aspects should be discussed.• Minimum efficient size for international competition.• Consequences of takeovers and mergers.• Effective barriers to entry of new firms.• Lack of effectiveness of competition policy.	6
	<p>(b) Diagram showing allocative efficiency (price = marginal cost) Diagram should be fully labelled and include verbal explanation – diagrams only should be awarded a maximum of six marks.</p>	10
	<p>(c) Measures should include:</p> <ul style="list-style-type: none">• the development and role of the Competition Commission• price regulation• deregulation to ease the entry of new firms• attempts to encourage the establishment of new competitor firms• taxation of excess profit (windfall taxes). <p>Effectiveness</p> <ul style="list-style-type: none">• Monopolies are not illegal (cf USA).• Fines and other punishment limited.• Consistency in applying competition guidelines.• Market concentration is still growing (eg retailing).• Application of policy limited by need to help monopolistic firms survive in international markets and to protect employment and regional industrial clusters in parts of the country.	9
2.	<p>(a) Reasons should be discussed from demand and supply side Demand Side: Rapid growth of world economy, rise of BRIC especially China, speculation and the USA building up reserves.</p> <p>Supply side: Role of OPEC in limiting supply, disruptions caused by war (Iraq) and natural disasters (Katrina), slow rate of new discoveries and the early signs of world wide resource depletion.</p>	9
	<p>(b) Reasons include:</p> <ul style="list-style-type: none">• world less dependent on oil than previously• more efficient use of oil• attempts to source oil from friendlier nations (mainly non OPEC)• sustained growth in world economy compensating for potential effects of higher oil prices• better economics management leading to lower inflation rate in a less inflationary prone environment• greater co-ordination between developed nations avoiding recessionary pressures of the past.	9

- (c)
- Basic point higher prices will lead to higher supply.
 - Will OPEC be able to control supply levels?
 - Future rates of world economic growth.
 - Prospect of new discoveries.
 - Efficient use of oil reserves.
 - Possibility of replacing/supplementing production with other or in particular renewable energy sources.
 - Rates of growth in the developing world.
 - No obvious conclusion – quality of argument given is critical.

7

- | | | | |
|----|--------|---|-----------|
| 3. | (a) | <p>Asia benefited from the wage gap with OECD when technology and liberalisation opened up world wide trade.</p> <p>Reasons include:</p> <ul style="list-style-type: none"> • the enterprise culture in Asia • comprehensive levels of education • lack of stability and endemic corruption in Africa • levels in inward investment • unwillingness of firms to invest in Africa because of uncertainty • Asia in better position to exploit economies of scale because of larger size of national economics • lack of product diversity in Africa dependent on low income extractive industries • many land locked states in Africa trapped by the attitude and pressure of its neighbours • ethnic diversity and conflict in Africa • feeling that Africa missed the boat when Asia developed. | 8 |
| | (b)(i) | <p>Attempts are based on:</p> <ul style="list-style-type: none"> • debt cancellation • increased aid • fairer and freer trade • reference to G8 summit expected • also improve infrastructure, education and training from developed world. | 7 |
| | (ii) | <p>Ways ineffective because:</p> <ul style="list-style-type: none"> • security problem in Africa is unresolved • giving aid is short term only • cancelling debt is short term only • fairer trade will help if OECD subsidies on agriculture can be removed • external assistance with security does help (eg Sierra Leone) • aid needs to help Africa diversify rather than prop up existing industries which are uncompetitive in open markets • give the nations of Africa genuine performance by collective agreement • global taxes and fund facilities to assist poorest nations (Chirac, Brown). | 10 |

4.	<p>(a) A full explanation of monetary transmission mechanism is expected, including reference to:</p> <ul style="list-style-type: none"> • the 2% inflation target • the role of an operationally independent Bank of England • how interest rates are fixed • how disposable income, asset prices and the exchange rate are affected by changes in the rate of interest. 	10
	<p>(b) High inflation rates (figures expected) influenced by external factors to the UK economy especially oil, gas and other commodity prices. Governor has not (yet!) had to write a letter of explanation to the Chancellor of the Exchequer. Bank of England supposed to think long term (18 months to two years) Distortions caused by house price inflation (about 10%) and fears of what might happen if prices fell as in the past or were affected by significant rises in interest rates. Prices expected to drop significantly in early 2007 as the effects of the commodity price rises of the previous year drop out of the index.</p>	8
	<p>(c) In both cases the competitiveness of the UK economy would be affected. Growth would be slower. Manufacturing would be affected and unemployment would rise, supplemented by multiplier effects. Impact on government revenue and expenditure. The balance of payments current account deficit would worsen. A huge potential problem might be that an increase in interest rates would lead to an even stronger pound and make the problem still worse. The lack of competitiveness of UK products and the state of the current account might make this scenario more likely. Rate of exchange effect.</p>	7

5.	Definition of productivity expected.	
(a)	<p>Growth in UK has been consistently higher than the G8 average, indicative of a successful economic policy and some luck. UK employees work longer hours. Growth in size of working population (migration, structure of working population). Size of working population as a proportion of the working age population. More flexible working conditions. Best performance in the UK economy from the service sector where productivity is very difficult to measure. Outsourcing of many parts of inefficient industry to the developing world.</p>	8
(b)	<p>Reasons include:</p> <ul style="list-style-type: none"> • level of education and training • quantity and quality of capital investment • poor organisation of economic resources and ineffective management techniques • long hours leading to diminishing returns • large level of public sector employment • hangover of poor industrial relations and mistrust between employer and employee. 	10
(c)	<p>Measures include:</p> <ul style="list-style-type: none"> • introduction of National Minimum Wage to improve incentives • supply side measures leading to improved education and training, greater investment in plant and machinery. Use of subsidies, grants and tax incentives • greater flexibility in working population through abolition of standard retirement age • cutting bureaucracy • proposed job cuts in the public sector to improve efficiency • encouraging firms to make more efficient use of labour to counter growing levels of international competition • good candidates are likely to suggest that many of the changes are superficial or even illusory and may make suggestions on how productivity might be improved in the future. 	7

6.	(a)	<p>Candidates expected to have a basic knowledge of the Stern Review. Unlimited economic development will lead to a significant rise in temperature in the next 50 years. Damage would include flooding, rising sea levels, falling crop yields, extinction of up to 40% of species and extreme weather patterns. World GDP could fall by up to 20% in the next 20 years. Stern suggested that 1% of world GDP be devoted to the problem for each of the next 20 years. New targets common to all countries should cut carbon emissions by 60% by 2050.</p>	5
	(b)	<p>Benefits of economic development include:</p> <ul style="list-style-type: none"> • rising living standards (lower poverty) • improvement in infrastructure including education and health • more leisure time • extra revenue for governments without the need to increase tax rates. <p>Costs include:</p> <ul style="list-style-type: none"> • depletion of resources • sacrificing current living standards for future prosperity • pollution and other environmental effects • the pressure of urban living. 	6
	(c)(i)	<p>Policy instruments include:</p> <p>By regulation: Government regulations limiting emissions, pollution, certain types of development etc.</p> <p>By price: ‘Making the polluter pay’ through the use of market forces, including charging for external effects of economic development associated with climate change (eg congestion charging, tradable global emission trading).</p>	6
	(ii)	<p>Diagrams should demonstrate how the external costs of economic development can be incorporated in a firm’s cost structure. Diagrams should make it clear that the incidence of taxation and other measures borne by consumers or suppliers depend on the slope of demand and supply elasticity curves.</p>	8

[END OF SECTION B]

[END OF MARKING INSTRUCTIONS]