



2007 Economics

Higher

Finalised Marking Instructions

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Economics 2007

Higher

Marks

ITEM A

- (a) (i) As there is no recognised definition of globalisation, be lenient in your marking and credit any answer that conveys the idea that it means the shrinking of the world in economic terms ie the world has become one single market. A detailed definition (which is not necessary for full marks as it includes the causes of globalisation) would be “a process of rapid economic integration driven by the liberalisation of trade, investment and capital flows and by rapid technological change”. If the candidate mentions any 2 of the points in this definition, they should be given full marks. 2
- (ii) Economic growth is an increase in the productive capacity of an economy (ie an increase in its ability to produce.) Credit references to increases in GDP eg ‘the % increase in real National Income per capita’ would gain full marks. 2
- (b) Look for a straightforward description of **how** economic growth increases income/standard of living, creates more employment opportunities, increases job security, makes it easier for the government to reduce income inequalities, increases government revenue etc. Any 2 for full marks – mark according to the quality of the description. 4
- (c) (i) The reasons include: increased foreign competition (credit examples), loss of comparative advantage in manufactures, the shrinking of the UK’s manufacturing sector, the strength of the pound. 2
- (ii) A wide range of answers is possible but the question refers to Britain, so credit description of any government measure that could possibly increase the competitiveness of our exports or slow down the growth of our demand for imports. These measures include: lower interest rates (to encourage investment), greater government spending on R & D, increased spending on education and training, tight fiscal and monetary policy, reductions in the value of the pound. Also accept subsidies to home producers. Mark according to the overall quality of the description. 3
- (d) Labour productivity is output per worker (usually per hour) – 1 mark. Its importance is that it influences efficiency, unit wage costs and the competitiveness of our goods – at home and abroad. Credit explanations of how labour productivity affects efficiency and its effects on trade and employment. 4

Marks

- (e) (i) Reasons include: cheaper labour, lower rents, government grants, to get inside the EU (fortress Europe), large UK market, reduced transport costs, common language. **2**
- (ii) Difficult question so credit any plausible reason eg better quality machinery, more efficient management techniques, just-in-time trading, greater work incentives, higher wages, profit-related pay etc. **4**
- (f) Credit any plausible good (eg textiles) or service (eg call centres). The main reason is lower labour costs (because of the huge populations of China and India). **2**

Total 25

ITEM B**Marks**

- (a) (i) The lowest price a producer (in this case, a beet farmer) will receive from the sale of his/her product. This is all that is required for full marks, but also credit answers which mention that the minimum price is set and guaranteed by the government (in this case, the EU Commission). 2
- (ii) Look for a supply and demand diagram showing the minimum price above the equilibrium price (1 mark) and the resultant excess supply (1 mark). 2
- (b) (i) Production is technically efficient when the producer is getting the maximum output from his/her inputs. This is all that is required for full marks, but also credit references to optimum output, minimum ATC and highest productivity. 2
- (ii) Straightforward question, so look for a simple description of greater division of labour/specialisation, better machinery, bonus payments etc. 2
- (c) The main aim of the WTO is to promote free trade by reducing all forms of trade restrictions. As a minimum guaranteed price is a form of trade restriction (credit references to the variable import levy and the effects of dumping), any reduction in it will result in freer trade. 2
- (d) It will increase their spending (1 mark), as more people will be eligible for JSA (1 mark) and will reduce their revenue (1 mark), as fewer people will be paying income tax (1 mark). Also credit references to falls in AMD reducing VAT revenue. 4
- (e) The removal of the minimum price will reduce the price of sugar (1 mark). As sugar is a major ingredient in chocolate, a reduction in its price will reduce the cost of producing chocolate (1 mark) which will reduce its price (1 mark). The diagram should show an increase in supply (1 mark) and a reduction in the equilibrium price (1 mark). 4
- (f) (i) Straightforward question – candidates should refer to the producers of sugar and the buyers/consumers of sugar and the price/exchange of sugar. 2
- (ii) Look for an understanding of how sugar dumping reduces the price of sugar (1 mark) and therefore makes it very difficult for other sugar producers to compete (1 mark). 2
- (g) The predicted changes will reduce EU exports and increase EU imports (1 mark). This will reduce the demand for the Euro (1 mark) and increase the supply of the Euro (1 mark). These will result in a fall in the value of the Euro (1 mark – if the explanation is correct). 3

SECTION B

Marks

1. (a) Look for a straightforward explanation of relative scarcity ie although the wants for goods and services are unlimited (credit reasons) the resources required to produce the goods and services are limited. This means that no country in the world has enough resources to produce enough goods to completely satisfy all the wants of its people. Therefore scarcity is universal ie in all economies – rich as well as poor – goods and services are scarce (relative to the desire for them). Credit references to the fact that scarcity is the basic economic problem and is the reason why we all have to economise. Also credit candidates who explain how scarcity leads to choice and that the basic aim of economics is to show how we can make the best (ie most efficient) use of our limited resources. Do not credit references to opportunity cost or the idea that resources are scarce because they are running out.

5

- (b) Straightforward question, but candidates often find it difficult to give correct numerical examples – so be lenient if their figures do not ‘work’, and mark according to their overall understanding of the 2 theories.

Absolute advantage refers to the situation where some countries are better ie more efficient at producing some goods and other countries are better at producing other goods. The theory states that if countries specialise in the production of those goods in which they have an absolute advantage, and then trade these goods for others in which they do not have an absolute advantage, world output will be maximised. Credit numerical examples involving 2 countries – based on output figures or opportunity cost ratios. Maximum 4 marks.

Comparative advantage refers to the situation where some countries have an absolute disadvantage in the production of all goods. The theory states that countries should specialise in the production of those goods in which they have a comparative advantage ie the greatest absolute advantage or the least absolute disadvantage, and then trade. In this way world output will be maximised and everyone can benefit. Again credit examples which use output figures or show how opportunity costs can be minimised. Maximum 4 marks.

8

- (c) The arguments for include: to protect infant or essential industries; to protect employment; to reduce trade deficits; to equalise production costs; to increase economies of scale; to increase wage levels; to prevent dumping. Candidates need to explain fully at least 3 arguments to gain the maximum 6 marks.

The arguments against include: protected ‘infants’ are often loath to admit they have grown up; not always easy to identify an essential industry; may protect employment in import-competing industries at the expense of employment in the exporting industries (because of retaliation); the fall in imports might be outweighed by a fall in exports (retaliation); the main reason for trade being beneficial is the difference in production costs throughout the world; the increase in home demand may be met, not by existing firms getting bigger, but by small, less efficient firms entering the market; wage levels in exporting industries may fall. Again, look for at least 3 well explained arguments for 6 marks.

12

Total 25

- 2 (a) (i) If the income elasticity of demand for a good is positive, then an increase in consumer income will result in an increase in the demand for the good ie consumers will buy more of it. If the income elasticity of demand is negative, then an increase in income will result in a decrease in the demand for the good. Maximum 4 marks.

The sentence implies that the income elasticity of demand for cigarettes is negative ie as people get richer they tend to smoke fewer cigarettes (or fewer of them smoke). Maximum 2 marks.

If no reference to cigarettes, maximum is 4.

- (ii) With progressive taxation, the rich pay **proportionately** more than the poor – credit examples. With regressive taxation the poor pay **proportionately** more than the rich – credit examples. Maximum 4 marks.

The sentence implies that the tax on cigarettes is regressive as those on lower incomes will be spending more of their income on tobacco tax than those on higher incomes. Credit candidates who state that the tax on cigarettes takes a higher proportion of a poor person’s income than that of a rich person. Maximum 2 marks.

If no reference to cigarettes, maximum is 4.

10

- (b) The factors include: the availability of close substitutes, how essential the good is; how habit-forming the good is; frequency of purchase; how fashionable the good is; if it is a small but vital part of a larger good. Credit examples and mark according to the overall quality of the description.

6

- (c) The main reason is to try and correct market failure, so look for at least 4 explanations of situations where the market might fail to allocate resources efficiently (as far as society is concerned). These include: to provide merit goods; to reduce the demand for demerit goods; to provide public goods; to internalise externalities; to control monopolies; to provide unprofitable goods; to reduce income inequalities.

The way the question is worded allows the candidate to give a more micro-answer so credit explanations of minimum and maximum prices, indirect taxation and subsidies.

9

Total 25

3. (a) The question asks for suggestions, so accept any plausible reason and mark according to the quality of the explanation. Reasons include: the increase in foreign competition from low cost producers (credit examples) which has resulted in a loss of comparative advantage in eg textiles; the increase in the size and importance of the tertiary sector (especially finance and tourism) as a consequence of rising demand; the strength of the pound which has reduced the demand for our manufactured exports; the continued decline in shipbuilding due to falling world demand; the decline (until recently) in oil refining because of the reduction in North Sea oil production. Credit actual examples and candidates who mention that Scotland has shifted from heavy to light manufacturing eg from iron and steel to chemicals. Two, very well explained reasons, could gain full marks but most answers will require 3 reasons for full marks. 7
- (b) Look for a clear understanding of how the multiplier process works based on the idea that one persons demand is another persons income. The closure will result in an increase in unemployment which will reduce average income levels – especially in the areas in which the firm was operating. As a result, the overall level of demand/spending in these areas will fall which will reduce the income levels of eg shopkeepers, publicans, cinema owners etc. This will, in turn, reduce their demand and so on. Credit actual examples (not necessarily Scottish) and references to the multiplier formula. 8
- (c) Look for straightforward explanations of how Budget deficits create increases in AMD (the government is putting more income into the economy through its spending than it is taking out through taxation) and how these increases should result in increases in employment (employers hiring more workers to meet the increase in demand). Also credit references to specific fiscal measures such as ‘from welfare to work’, stricter disability criteria etc. The basic monetary measure is a reduction in interest rates. This will encourage borrowing and discourage saving (credit explanations) both of which will increase spending, boost AMD and increase employment. Mark 6:4, 5:5 or 4:6. 10

Total 25

4. (a) Look for an explanation of how the demand for Sterling is determined by the demand for UK exports; the level of FDI in the UK; the amount of tourists visiting the UK; and Hot Money inflows. One mark for the determinant and one for the explanation. Candidates can also gain full marks for explaining the factors which influence the determinants ie relative inflation rates, the UK rate of interest, the state of the UK economy etc. **8**
- (b) The advantages include: no need to defend a particular exchange rate; can adopt an independent monetary policy; possible automatic adjustment to the Balance of Payments (Marshall Lerner). Maximum 6 marks.
The disadvantages include: fluctuating exchange rates – therefore trade becomes more risky; greater risk of high inflation; can lead to a depreciation/inflation spiral; greater scope for currency arbitrage. Maximum 6 marks.
As some of the advantages and disadvantages are complex, it is possible to gain 3 marks for each one. **10**
- (c) The main problem is the risk of overheating with the consequent rise in demand-pull inflation, trade deficits – so look for a detailed explanation of why AMD will rise (borrowing cheaper, saving less rewarding, marginal investments now viable, increased real income of mortgage holders). This is all that is required for full marks but other reasons include the fall in the value of Sterling because of Hot Money outflows leading to an increase in the price of imports and cost-push prices, a large increase in house prices (because of cheaper mortgages) and an increase in consumer debt (maximum of 2 marks each - if well explained). **7**

Total 25

5. (a) Candidates should do what the question asks ie compare and contrast, therefore look for an attempt at doing this eg:
- many firms; one firm
 - no entry barriers; effective entry barriers
 - price takers; price makers
 - can make only normal profit in the long run; can make abnormal profit in the long run
 - perfectly price elastic demand curve; price inelastic demand curve
 - same price in every part of the market: scope for price discrimination
 - no economies of scale; large economies of scale etc.

Five points for full marks. If the candidates simply list the characteristics of both markets in turn, mark out of half marks.

10

- (b) (i) Answers will vary, not only in their approach, but also in their degree of complexity. Fully explained answers can gain 9 marks. A simple explanation is that, as a firm approaches its optimum output (credit definition) it experiences increasing returns ie falling ATC, but when it goes beyond its optimum, it experiences diminishing returns ie rising ATC. A more detailed answer will explain why returns increase and then decrease (eg the fixed factor becomes less and less under-worked but eventually becomes increasingly over-worked) and why increasing returns cause ATC to fall (output is rising faster than costs) and diminishing returns cause ATC to rise (costs are rising faster than output).

Alternatively, candidates can explain the shape of an ATC curve by explaining the shape of its constituent parts ie AFC and AVC. (AFCs fall continuously as FCs are being spread over a bigger and bigger output. AVCs fall and then rise because of increasing and the decreasing average returns.) Therefore an ATC curve will fall at first as both AFC and AVC fall at first, but it will eventually rise when the increase in AVCs becomes greater than the continued fall in AFCs. Credit diagrams.

Another approach could involve an explanation of the shape of a marginal cost curve (variable marginal returns) and its affect on the ATC curve (it pulls down the ATC curve and will continue to do so as long as it is below it. Once it is above it, it will pull up the ATC curve). Credit diagrams.

One mark for a definition of the short run.

- (ii) Look for an explanation, with examples, of how economies of scale lead to falling average total costs and how diseconomies of scale lead to rising average total costs. One mark for a definition of the long run and a maximum of 6 for economies and diseconomies of scale.

15

Total 25

6. (a) Look for a straightforward explanation of the Output, Income and Expenditure methods eg:
- add up all outputs (1 mark) of finished goods and services (1 mark)
 - add up all incomes (1 mark) from production (1 mark)
 - add up all expenditures (1 mark) on finished goods and services (1 mark).
- 6**

- (b) The uses include:
- to help the government plan future economic policy and identify areas of particular concern
 - to measure a country's rate of economic growth and standard of living (real GNP per capita)
 - to compare growth rates of different countries or the same country over a period of time
 - to decide which countries require aid – and how much
 - to calculate the contribution a country should make to certain international organisations such as the EU.

The problems include:

- it is a complex and time-consuming process and mistakes and omissions are bound to occur
- double counting ie counting the same output more than once (credit examples) leads to inflated figures
- unproductive incomes eg pensions etc, must not be included as they have not been received for helping to produce the current output
- the shadow economy ie people not declaring their income (credit examples) results in an underestimation of national income
- when calculating national expenditure, exports must be added and imports deducted (credit reasons)
- producers consuming their own products (eg in developing countries) result in an underestimation of national income
- which services to include and why (credit examples)
- inflation and population growth distort the picture – hence the need for real, per capita figures.

Mark 5:5, but look for at least 3 uses and 3 problems well explained for full marks.

10

- (c) Definitions vary but centre around the idea of achieving growth now without destroying the planet in the future eg sustainable development is a type and rate of economic growth that creates an increase in current living standards but does not jeopardise future living standards. Two marks.

A wide range of answers is possible ranging from macro-policies (the Kyoto protocol, the European Emissions Trading Scheme, carbon reduction targets), through to Budget measures (increased taxes on large cars, landfill taxes, pollution taxes, tax relief on investment in green technology) down to micro-measures (re-cycling rubbish, grants for mini-windmills, cheaper long-life light bulbs etc). Two marks per description with a maximum of 8.

9

Total 25

[END OF MARKING INSTRUCTIONS]