



# **2011 Economics**

## **Higher**

### **Finalised Marking Instructions**

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SECTION A

ITEM A

	<i>Marks</i>
(a) One mark for definition eg worldwide problems faced by banks, and one mark for some development eg caused by over-lending.	2
(b) One mark for identifying the reason eg the UK has a relatively large financial sector/the UK had a large fiscal deficit prior to the crisis, and one mark for development eg therefore more jobs were lost; more losses were made etc/ therefore our resultant deficit was larger than that of most countries.	2
(c) (i) When a country spends more on importing goods than it earns from exporting goods/when the value of imported goods is greater than the value of exports of goods. When imports of goods are greater than exports of goods – one mark. When imports are greater than exports – no marks.	2
(ii) One mark for the reason eg a loss of comparative advantage/increased foreign competition/a strong pound/de-industrialisation etc. One mark for explanation eg to/from Asia and China/making our exports less competitive/our imports more competitive.	2
(iii) One mark for the reason eg our large surplus in financial services and one mark for development eg many overseas companies use our banks, insurance companies etc/UK has a comparative advantage in financial services.  An answer based on our earnings from tourism – one mark.	2
(d) (i) It would have fallen (or, more correctly, it would have been lower than it otherwise would have been) – one mark, provided the explanation is correct. As sterling is now less attractive – one mark – it will lead to Hot Money (short term capital) outflows/an increase in the supply of sterling – one mark. Accept answers which state that the resultant increase in AMD will lead to an increase in our demand for imports.	3
(ii) To reduce the rate of inflation.	1
(e) (i) It reduces the price of our exports/makes them more competitive – one mark. Overseas buyers now get more sterling for their currency – one mark.	2
(ii) It increases the price of our imports – one mark; which increases costs/ the price of imported goods in the shops/the demand for domestic goods – one mark.	2
(f) The diagram should show a decrease in supply or an increase in demand (or both) – one mark and an increase in price – one mark.	2

- (g) (i) During the boom, champagne consumption soared – one mark.  
The implication is that the increase in income (due to the boom) – one mark, led to a large(r) increase in demand – one mark. **3**
- (ii) Price elastic – one mark, if explanation is correct, because when the price increased, total revenue fell – one mark. **2**
- (25)**

**ITEM B**

			<b>Marks</b>
<b>1</b>	<b>(a) (i)</b>	The situation in which the buyers/consumers of cars meet/come into contact with the sellers/producers of cars – one mark, in order to buy and sell cars/to determine the price of cars – one mark.	<b>2</b>
	<b>(ii)</b>	Former LDCs/poor countries – one mark, which are experiencing high rates of economic growth – one mark. Examples – one mark	<b>2</b>
	<b>(b)</b>	2008 saw the start of the world recession – one mark, the resultant fall in income – one mark, led to a fall in semi-luxury goods such as cars – one mark. Accept any other plausible answer eg a fall in the price of rival cars etc. Mark according to the quality of the explanation.	<b>3</b>
	<b>(c)</b>	Most people who own an old car are likely to be relatively poor – one mark. Therefore, when they scrap their old car they are likely to buy a relatively cheap car – one mark.	<b>2</b>
	<b>(d)</b>	New cars and second-hand cars are substitutes – one mark. As the scrappage scheme increases the demand for new cars, the demand for second-hand cars will fall – one mark. As the old cars are scrapped, the supply of second-hand cars will fall – one mark. The diagram should therefore show a decrease in both demand and supply – one mark. No need to mention price, but credit candidates who mention that the price might rise, fall or stay the same (depending on the relative size of the changes in demand and supply).	<b>4</b>
	<b>(e)</b>	For – it will increase/maintain employment in the car industry – one mark, at a time when unemployment is rising – one mark. Against – it will increase public sector spending at a time when it needs to be reduced. Accept any other plausible arguments for or against. Mark 2:2.	<b>4</b>
	<b>(f) (i)</b>	Look for an understanding of the fact that an externality is something (a cost or benefit) which a producer (or consumer) imposes on the rest of society eg a third party/spill-over effect – one mark, arising from production or consumption – one mark. Examples – one mark.	<b>2</b>
	<b>(ii)</b>	Because it imposes costs on the rest of society (for which no Compensation is paid) – one mark.	<b>1</b>
	<b>(iii)</b>	As firms are profit maximisers – one mark, they will only consider those costs that they have to pay – one mark. Credit references to the fact that firms are often not forced to cover external costs.	<b>2</b>
	<b>(g)</b>	Look for a full description of at least 2 other forms of market failure.	<b>3</b>
			<b>(25)</b>

## SECTION B

### Marks

- 1 (a) (i) Economic goods are scarce/command a price/have opportunity costs – one mark and one mark for example. Free goods are not scarce/have no opportunity costs/exist in sufficient quantities to satisfy all desires for them at a zero price – one mark. Examples include fresh air, sea water, wild fruit – one mark. 4
- (ii) Private goods are rival and excludable – one mark. If only one characteristic is mentioned but it is correctly explained – one mark. One mark for example. Public goods are non-rival and non-excludable – one mark. If only one Characteristic is mentioned but it is correctly explained – one mark. Examples (although debatable) include defence, lighthouses, streetlights. 4
- (b) Key points:
- Basket of 650 goods and services.
  - Consumed by typical/average family.
  - Family expenditure survey.
  - Weighted according to importance.
  - Monthly prices from 180000 retail outlets.
  - Base year chosen and index numbers used.
- One mark per point with a maximum of 4 marks.
- The main difference is that the CPI does not include housing costs – one mark and one mark for an example; these include mortgage payments, council tax, buildings insurance, estate agent fees etc. Also credit candidates who describe the differences in the population bases. Mark 4:1 or 3:2. 5
- (c) Look for a description of any 3 of the following:
- Maintains/increases our competitiveness in overseas markets.
  - Preserves the value of real incomes – and real savings.
  - Makes (investment) planning easier and less risky.
  - Less distortion of the price mechanism.
  - Reduces shoe leather costs.
  - Reduces inflationary expectations. 6
- (d) The aims include:
- A low rate of unemployment – around 6% (LFS). This is enough for 2 marks but also credit descriptions of full employment, the natural rate of unemployment and the NAIRU.
  - A satisfactory rate of economic growth – one mark ie one that is sustainable – one mark, around 3% – one mark.
  - A balanced payments/trade – one mark ie when the value of our exports equals the value of our imports – one mark.
  - A more equitable distribution of income – one mark ie closing the gap between rich and poor – one mark.
  - A cleaner environment – one mark ie reductions in CO2 emissions – one mark. 6
- (25)

- 2 (a)** Barriers to entry are obstacles that prevent/make it difficult for a firm to enter an industry – one mark. Give one mark for development, eg entry barriers lead to high profits; high market concentration; low contestability. Examples include:
- If incumbent firms spend heavily on advertising, new firms will find it difficult to match/afford it.
  - The level of start up capital needed in certain industries (eg oil) might be prohibitive.
  - If a single firm has control of a resource essential for a certain industry, then other firms will be unable to compete.
  - Large incumbent firms may have existing customers loyal to established products. The presence of established strong brands within a market can be a barrier to entry in this case.
  - Exclusive agreements with key distributors or retailers can make it difficult for other manufacturers to enter the industry.
  - Large, experienced firms can benefit from economies of scale and therefore produce goods at lower costs than small, inexperienced firms.
  - Government regulations eg licenses, permits patents, can make entry more difficult or impossible.
  - Restrictive practices, such as air transport agreements that make it difficult for new airlines to obtain landing slots at some airports.
  - Some products (such as microprocessors) require a large upfront investment in technology (R&D) which will deter potential entrants.
  - Exclusive agreements with key links in the supply chain can make it difficult for other manufacturers to enter an industry.
  - Sunk costs cannot be recovered if a firm decides to leave a market. Sunk costs therefore increase the risk and deter entry.

Two marks per example with a maximum of 7.

**8**

- (b)** Total fixed costs do not change as output changes – one mark. Average fixed costs are TFC divided by output – one mark. Therefore an average fixed cost curve falls continuously as output is increased – one mark. This is because the fixed costs are being divided by a bigger and bigger output – one mark. A maximum of 4 marks. Variable costs are costs that vary directly with output – one mark. Average variable costs are TVC divided by output – one mark. As output increases the average variable cost curve falls at first – one mark as the firm is experiencing increasing (average) returns to the variable factor/the average output of the variable factor is increasing – one mark. However the AVC curve will eventually start to rise – one mark, when the firm experiences decreasing (average returns) to the variable factor/the average output of the variable factor decreases – one mark. A maximum of 4 marks.

**7**

- (c) Look for an understanding of the fact that a firm will continue in production in the short run if it is earning enough revenue to cover its variable costs – 2 marks plus one mark for an example of a variable cost. If it shuts down it will still have to pay its fixed costs – one mark and one mark for an example of a fixed cost. Therefore the only costs it saves by temporarily shutting down are its variable costs – one mark. Therefore the firm will be no better off by shutting down if it can cover its variable costs – one mark. Credit the advantages of staying in production eg maintaining customer loyalty, hanging on to the workforce, keeping machinery ticking over etc – one mark per advantage, and the importance of the size of the firm's reserves, the expected time before demand recovers etc – one mark. However this situation can only occur in the short run – one mark as to stay in business in the long run a firm has to cover all its costs – one mark. **10**  
**(25)**

- 3 (a)** The reason was to give the economy a boost ie to increase AMD and increase growth and employment, at a time when the financial crisis was spilling over into the real economy and growth was falling and unemployment was rising. Mark according to the overall quality of the explanation. **4**

- (b)** Direct taxes are levied on income and wealth and indirect taxes are levied on expenditure – one mark. Do not credit examples of direct and indirect taxes.

The (possible) effects include:

- Encourages enterprise and investment – the rewards for risk-taking are not 'lost' in tax.
- Encourages effort and the desire for promotion – reduces the amount of any extra income which is taken in tax.
- Leads to increased FDI – if corporation tax is reduced.
- Increases the availability of ploughed back capital – which could lead to increased economic growth.
- Increases choice – gives income earners more freedom.
- Makes the tax system more regressive – hits the poor harder than the rich.
- Not completely impartial eg car-driving, drunken smokers pay more than cycling, sober non-smokers.
- Can distort demand patterns and create a misallocation of resources
- Inflationary – a rise in VAT will increase the RPI in the short term.

Maximum of 2 marks per effect, but must include at least one negative and one positive effect for full marks – if not, the maximum for the question is 4. **6**

- (c)** Look for an explanation of how the Budget can make taxes (income tax, capital gains tax, inheritance taxes, national insurance etc) more progressive – 3 marks, and how welfare benefits (credit examples) can be increased – 2 marks. Credit an explanation of how these Budget measures, taken together, should reduce the gap between rich and poor – 2 marks. Credit any other government measure which would reduce income inequality – 2 marks per measure up to a maximum of 4. **7**

- (d)** Credit the definition of recession – one mark. Look for an explanation of how the resultant fall in AMD and output will reduce sales/spending and therefore company profits; put some firms out of business and increase unemployment (derived demand) – 4 marks. Candidates should then explain how this sequence of events will increase government spending on welfare benefits – especially JSA and reduce government revenue from income tax, VAT and corporation tax – 4 marks. Taken together, these two results will, almost inevitably create a Budget deficit. Credit references to automatic stabilisers – 2 marks. **8**

**(25)**



- 4 (a) Strictly speaking economic growth is an increase in the productive capacity of a country – one mark, but credit candidates who say or link it to increases in GDP. Also credit references to an outward shift of a PPC and any other relevant development. **3**

(b) Reasons include:

- Regional grants may be available – credit references to Scottish Enterprise and RSA.
- Efficient infrastructure – credit examples.
- A well-educated and skilled labour force.
- Allows non-EU firms to get inside 'fortress Europe'.
- Quality universities and research facilities.
- Relatively cheap land.
- English speaking – important for US firms.

Three reasons, with development for full marks.

**6**

(c) Costs include:

- The danger of becoming a 'branch economy'.
- An increase in 'screwdriver' jobs.
- Could put Scottish firms out of business.
- When the grants run out, the firm could leave.

Two marks for description with some development – maximum 4.

Benefits include:

- Increases employment and income – with multiplier effect.
- Exchange of new technology and management techniques.
- Increases choice and variety for Scottish consumers.
- Increases Scottish exports.
- The increased competition could increase efficiency and reduce costs/prices.

Two marks for description with some development – maximum 4.

**8**

(d) Benefits include:

- Stable exchange rate (within the Eurozone) will reduce the risks of trade and therefore increase the volume of trade.
- No transactions costs (credit explanation) – should lead to increased Scottish investment with the Eurozone.
- Price transparency – easier to compare Scottish prices with those in the rest of the Eurozone – credit consequences.
- Could increase, or at least protect, FDI in Scotland – credit reasons.

Three well described benefits for full marks.

**8  
(25)**

- 5 (a)** Look for a straightforward description of at least 4 of the following:
- Lack of capital – limited technology.
  - Poor infrastructure.
  - Weak social and political institutions.
  - Over-population.
  - Low productivity.
  - Poor financial markets.
  - Large-scale unemployment.
  - Droughts or floods.
  - Serious debt problems.
  - Poor natural resources.
  - Lack of education and training.
  - Dependence on one product etc.
- 8**
- (b)** If the demand for a good is price inelastic then any % change in its price will cause a smaller % change in the demand for it – 2 marks. The correct formula gains one mark as does the point that, if demand is price inelastic, the answer will be less than one. One mark for a correct example and one mark for the reason it is a correct example. Also credit the relationship to total revenue (either by way of an explanation or a diagram) – one mark.
- 6**
- (c)** Credit definition of YED – one mark.  
If the income YED for a good is positive, an increase in income will result in an increasing the demand for it – one mark. If the YED for a good is negative, an increase in income will result in a decrease in the demand for it – one mark. The YED for most goods is positive, especially luxuries – one mark and one mark for a correct example, but the YED for inferior goods is negative – one mark and one mark for an explanation and one mark for a correct example.
- 5**
- (d)** Look for a straightforward description of 3 of the following:
- Amount and closeness of substitutes.
  - Degree of necessity.
  - Degree of habit-forming.
  - Frequency of purchase.
  - When the product is a small but vital part of a more expensive product etc.
- Credit examples and links to PED.
- 6**  
**(25)**

- 6 (a)** Look for a straightforward description of the Claimant Count and the Labour Force Survey – 2 marks each. **4**
- (b)** Negative growth occurs when GDP falls – one mark. There will therefore be a fall in AMD – one mark. This will lead to producers cutting back their output – one mark, which could involve making some workers redundant – one mark, which will increase the level of unemployment. Credit references to the fact that the demand for labour is a derived demand ie if the demand for goods falls, the demand for the labour needed to produce the goods will also fall. **5**
- (c)** Look for a straightforward description of 3 of the following:
- Real wage (classical) unemployment
  - Frictional unemployment
  - Structural unemployment
  - Hidden unemployment
  - Residual unemployment.
- Two marks per description. **6**
- (d)** One mark for a definition of a floating exchange rate.
- Advantages include:
- Possible to adopt an independent monetary policy.
  - No need to defend an over-valued currency.
  - Less strain on reserves.
  - A trade deficit might be self-correcting.
- One mark for the advantage and one for the explanation – max 6 marks.
- Disadvantages include:
- Fluctuating exchange rates.
  - Increased danger of inflation.
  - Can result in a deficit/depreciation spiral.
  - Encourages speculation.
- One mark for the disadvantage and one for the explanation – max 6 marks. **10**
- (25)**

[END OF MARKING INSTRUCTIONS]