

X038/701

NATIONAL
QUALIFICATIONS
2007

WEDNESDAY, 16 MAY
9.00 AM – 11.15 AM

ECONOMICS
ADVANCED HIGHER

You should answer Section A and **two** questions from Section B.

The marks for each question are shown in the margin.



SECTION A

Read the following passage, and then answer the questions which follow on *Page three*.

House prices keep on rising

UK house prices have increased on average by almost 10% since the beginning of 2006 and have doubled in the past 10 years. Up to half that increase has been put down to speculation, a situation that is bound to collapse sooner or later. In 2002 the Bank of England predicted that house prices would come to a standstill or even
5 fall. Is speculation really driving the market?

Economists usually assume that **market prices are arrived at rationally**, as they sum all available knowledge of the balance of supply and demand. If it is not speculation what is boosting the market? There is a danger that we only view the demand side of the market and ignore the supply side of the equation. To meet
10 demand there is a need to construct 245,000 houses a year and last year 193,000 were built in the UK, the highest number for 15 years. The failure of supply to respond to demand is often ignored because the use of land in the UK is controlled along Soviet lines with a time consuming planning system.

The government's drive to see many more new houses being built has produced
15 many houses that are cheaply built, mass produced and cramped. No real wealth is created by this process. Rising prices transfer wealth from those who do not own houses to those who do. Higher interest rates add to the problems of those who do not own houses.

The Housing Review, commissioned by the UK Government and chaired by Kate
20 Barker, which reported in December 2006, proposed the revision of green belt areas. The review argues that allowing cities to grow would do far more for first time buyers than scrapping stamp duty, which would have no long term benefit at all. It would also remove one of the key blocks to Britain's productivity growth.

If planning is so inefficient and discredited in economic theory, why does it persist
25 in the housing market? People fear the loss of open spaces, the beauty of their towns or the look of their streets. These external costs may not be reflected in the decisions made by developers. The planning system justifies itself as a device to internalise these costs.

Ms Barker has suggested another solution: payoffs. With payoffs there are no
30 losers. Neighbours could be compensated by developers for allowing small developments to homes and small businesses to go ahead. To an economist, using local democracy to solve planning disputes is **sub-optimal**, because it creates winners and losers.

Critics will be appalled because the green belt has held for more than 50 years.
35 However, if the imbalance between demand and supply that lies at the heart of Britain's house price inflation is to be broken, **supply side flexibility** is necessary. This would meet the needs of the poorer members of the community.

Adapted from an article, *Barker's suggestion on planning will not bite*,
by Gabriel Rozenberg, The Times, 11 December 2006

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|----|-------------------------------------------------------------------------------------------------------------------------------------------|-------------|
| 1. | Explain what is meant by the following phrases or terms as used in the passage. | |
| | (a) "Market prices are arrived at rationally" (line 6) | |
| | (b) "Sub-optimal" (line 32) | |
| | (c) "Supply side flexibility" (line 36) | 3 |
| 2. | Explain why speculators might purchase houses. | 2 |
| 3. | (a) Discuss some of the demand side factors that can force up house prices. | 3 |
| | (b) Why is supply unable to respond sufficiently to the demand for new housing? | 2 |
| 4. | Why do rising house prices and higher interest rates benefit the wealthy at the expense of the poorer members of society? | 3 |
| 5. | Give reasons why rigid green belt areas might block Britain's productivity growth. | 2 |
| 6. | (a) Explain the difference between internal and external costs. | 2 |
| | (b) Describe how the house planning system attempts to tackle the problems created by external costs. | 2 |
| 7. | Why does the report suggest that payoffs are preferable to the current planning system as a means of increasing the supply of new houses? | 3 |
| 8. | Discuss some of the consequences for the UK economy of house prices persistently rising faster than the general rate of inflation. | 3 |
| | | (25) |

[Turn over for Section B]

SECTION B

Attempt TWO of the six questions set.

Each question carries 25 marks.

Marks

1. The UK has large firms in many sectors of the economy.
 - (a) Give reasons why some markets are dominated by large firms. 6
 - (b) Explain, with the use of a diagram, why monopoly does not lead to allocative efficiency. 10
 - (c) Describe the measures that have been taken in the UK to limit the power of monopoly and oligopoly firms. Discuss the effectiveness of these measures. 9

2. Crude oil prices doubled between July 2004 and July 2006 without causing a worldwide recession or a rise in world inflation rates.
 - (a) Discuss the demand and supply side reasons for the rise in oil prices between 2004 and 2006. 9
 - (b) Explain why the increase in crude oil prices did not lead to a recession or rising world inflation as had happened in previous years. 9
 - (c) Discuss the likelihood of the current level of oil prices proving sustainable in the future. 7

3. The economic growth rate in Africa has averaged 0.1% per annum for the past 20 years, but economic growth in Asia has averaged almost 10% per annum throughout this period of time. This major difference in economic development has resulted in widespread poverty throughout Africa and a significant increase in Asian living standards. Growth has been especially rapid in China and India.
 - (a) Discuss some of the reasons for the rapid economic development in Asia compared with the limited economic progress in Africa. 8
 - (b)
 - (i) Outline attempts that have been made to reduce poverty levels in Africa. 7
 - (ii) Assess the effectiveness of these attempts to reduce African poverty and suggest other ways in which African poverty can be lessened in the future. 10

4. In 2006 the UK's rate of inflation was persistently in excess of the official inflation target rate. The UK was the only G8 country in which the rate of inflation rose during the course of 2006. However, the Bank of England made only minor adjustments to the rate of interest.
 - (a) Explain how interest rate decisions made by the Bank of England affect the rate of inflation in the UK economy. 10
 - (b) Suggest some reasons for the reluctance of the Bank of England to change interest rates. 8
 - (c) Discuss the consequences for the UK economy of the combined effects of a strong pound and relatively high inflation. 7

5. According to the Chancellor of the Exchequer, the UK has advanced from seventh to second in living standards in the G8 group of countries. However, UK productivity is 10% lower than the G8 average.
 - (a) Suggest some reasons for the UK's relative growth in living standards despite productivity being less than in other G8 countries. 8
 - (b) Explain why UK productivity is lower than in other G8 countries. 10
 - (c) Describe measures that have been taken by the UK Government to improve the UK's relatively poor productivity performance. 7

6. The Stern Review, "The Economics of Climate Change", was published in October 2006. One of the conclusions of the review was that failure to tackle the problems associated with climate change might have a greater effect on world GDP than the Great Depression of the 1930s or the Second World War.
 - (a) Explain how climate change threatens the world's living standards according to the Stern Review. 5
 - (b) Evaluate the benefits and costs of economic growth on the world economy. 6
 - (c)
 - (i) Outline the policy instruments available to governments to reduce the negative impact of economic growth on the environment. 6
 - (ii) Using appropriate diagrams and economic analysis, explain how these policy instruments would work. 8

[END OF QUESTION PAPER]

ACKNOWLEDGEMENTS

Section A Passage – Article is adapted from “Barker’s suggestion on planning will not bite” by Gabriel Rozenberg, taken from The Times, 11 December 2006. Reproduced by permission of NI Syndication Ltd ©The Times, December 2006.