



General Certificate of Education
Advanced Subsidiary Examination
June 2011

Economics

ECON1

Unit 1 Markets and Market Failure

Friday 20 May 2011 9.00 am to 10.15 am

For this paper you must have:

- an objective test answer sheet
 - a black ball-point pen
 - an AQA 8-page answer book.
- You may use a calculator.

Time allowed

- 1 hour 15 minutes

Section A (ECON1/1)

- Answer **all** questions on your objective test answer sheet.
- Use a black ball-point pen. Do **not** use pencil.
- Do all rough work in this question paper, **not** on your objective test answer sheet.

Section B (ECON1/2)

- Answer **EITHER** Context 1 **OR** Context 2.
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON1/2.

Information

- The maximum mark for this paper is 75.
- There are 25 marks for **Section A**. Each question carries one mark.
- There are 50 marks for **Section B**. The marks for questions are shown in brackets.
- You will be marked on your ability to:
 - use good English
 - organise information clearly
 - use specialist vocabulary where appropriate.

Advice

- You are advised to spend no more than 25 minutes on **Section A** and at least 50 minutes on **Section B**.

Section A: Objective Test

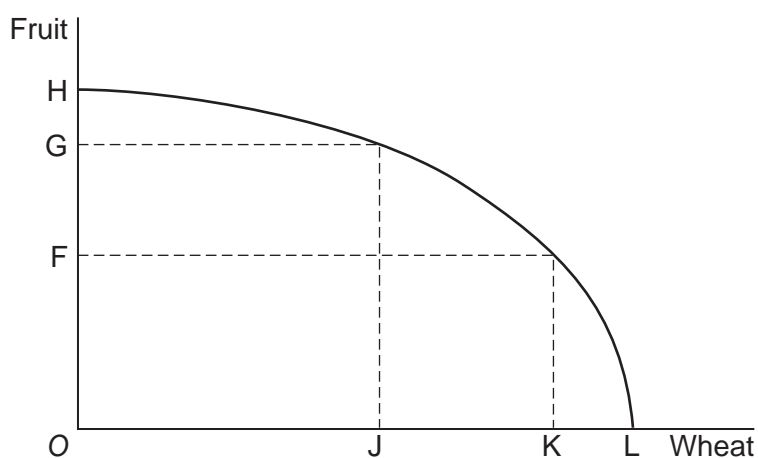
Answer **all** questions in **Section A**.

Each question carries 1 mark. No deductions will be made for wrong answers.

You are advised to spend no more than 25 minutes on **Section A**.

For each question there are four alternative responses, **A**, **B**, **C** and **D**. When you have selected the response which you think is the best answer to a question, mark this response on your objective test answer sheet. If you wish to change your answer to a question, follow the instructions on your objective test answer sheet.

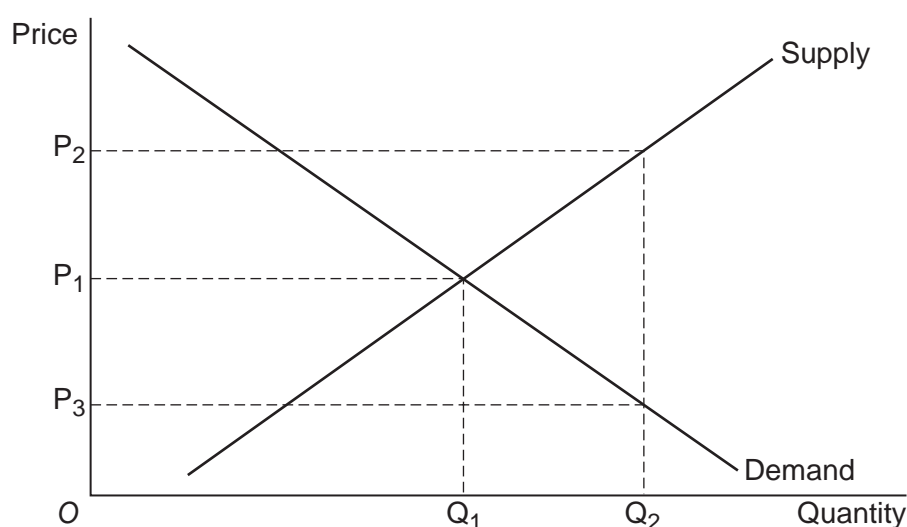
- 1 The production possibility boundary below shows the possible combinations of fruit and wheat that a country could choose to produce.



The country is producing OF fruit and OK wheat. If it decides to increase fruit production to OG, the opportunity cost in terms of wheat would be

- A OJ.
 - B JK.
 - C OF.
 - D KL.
- 2 Which one of the following is a normative statement?
- A Economic theory assumes that firms will maximise profits.
 - B Labour is the human contribution to production.
 - C Producers and consumers may have to consider opportunity cost when making decisions.
 - D Governments must intervene in markets.

- 3 The diagram below shows the demand and supply curves of a merit good.



To increase consumption from OQ_1 to OQ_2 , the government could

- A tax producers by P_3P_2 per unit of the good.
 - B subsidise producers by P_3P_2 per unit of the good.
 - C impose a maximum price of OP_3 .
 - D impose a minimum price of OP_2 .
- 4 The essential feature of an inferior good is that its
- A price elasticity of demand is positive.
 - B income elasticity of demand is positive.
 - C price elasticity of demand is negative.
 - D income elasticity of demand is negative.
- 5 The use of money as a medium of exchange enables an economy to
- A operate outside its production possibility boundary.
 - B increase production of public goods.
 - C prevent market failure.
 - D benefit from specialisation and the division of labour.

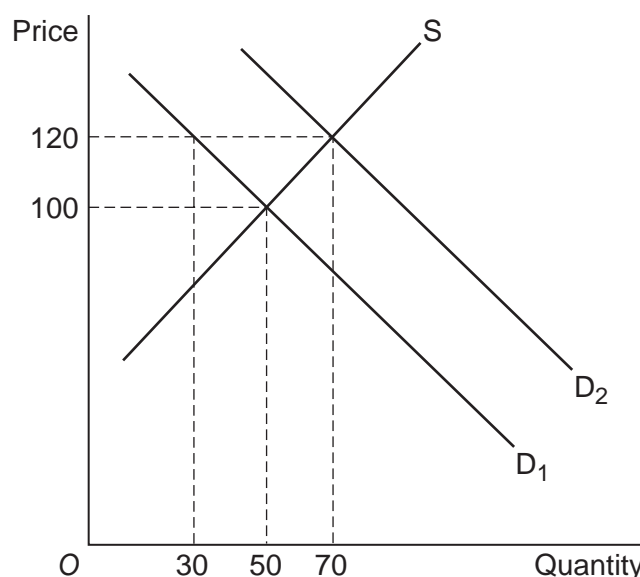
- 6 The table below shows the shares of total income of different income groups in 2005 and 2010 for an economy.

% Income Group	% share of total income	
	2005	2010
Bottom 10%	4.1	2.5
Bottom 20%	9.8	6.8
Bottom 30%	16.0	12.0
Top 30%	47.0	54.0
Top 20%	35.0	41.0
Top 10%	20.0	26.0

From the data, it may be concluded that over the period in question

- A the bottom income groups experienced a fall in their income.
 - B the distribution of income became more unequal.
 - C the distribution of wealth became more unequal.
 - D everyone became better off because total income increased.
- 7 An industry's supply curve is more likely to be price elastic in the short term if
- A the industry uses scarce factor inputs.
 - B its firms are operating below their full capacity.
 - C its firms hold relatively low levels of stock.
 - D there are many substitutes for its output.
- 8 Left to the free market, Good X would not be produced at all. Yet the production and consumption of at least some of Good X increases the welfare of society. The government therefore has an incentive to intervene to ensure its provision. Good X is most likely to be a
- A public good.
 - B free good.
 - C merit good.
 - D demerit good.

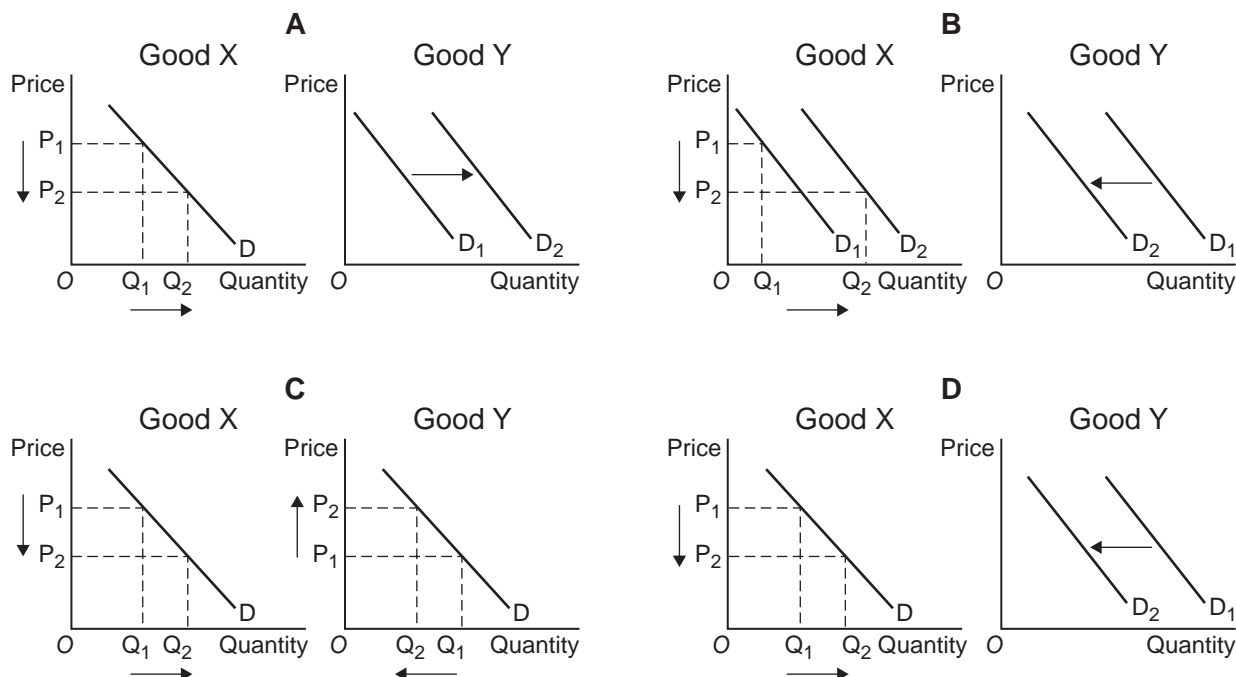
- 9 The diagram below shows the market demand and supply curves for organic apples. An increase in the demand for organic apples shifts the demand curve from D_1 to D_2 .



From the above diagram, it can be concluded that when the price rises from 100 to 120

- A the price elasticity of supply of organic apples is +2.
 - B there will be excess supply of organic apples.
 - C the price elasticity of demand for organic apples is positive.
 - D organic apples are a luxury good.
- 10 An indirect tax on the production of a good will have no effect on price if demand is
- A inversely related to price.
 - B of unitary elasticity.
 - C perfectly elastic.
 - D perfectly inelastic.
- 11 If increased economies of scale are experienced by firms in an industry, this is likely to result in
- A a competitive market replacing a monopoly.
 - B rising unit costs of production.
 - C the demand curve for the good shifting to the right.
 - D the supply curve of the good shifting to the right.

- 12** The cross elasticity of demand for Good Y with respect to the price of Good X is negative. Which one of the following pair of diagrams, **A**, **B**, **C** or **D**, illustrates the effect of a fall in the price of Good X?



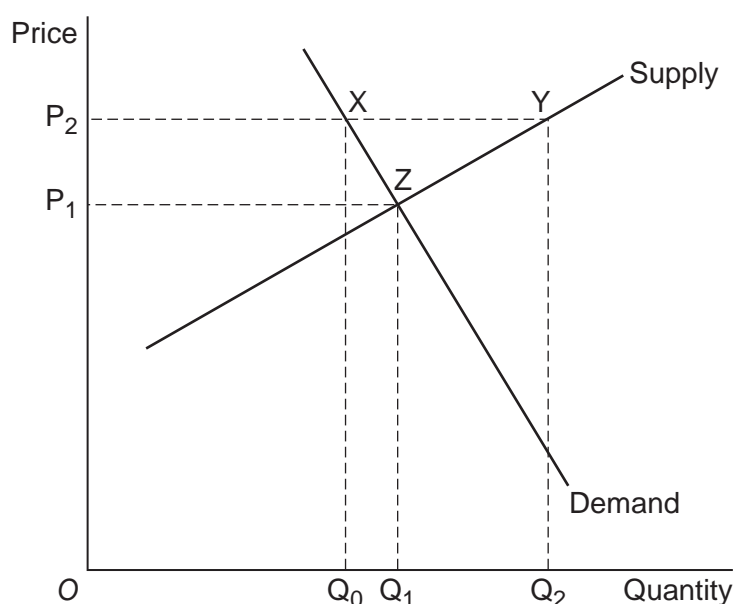
- 13** The government was recently advised that a 40% increase in the price of beer would reduce beer consumption by the rich by 6% and beer consumption by the poor by 20%. It can be concluded from this that
- A** demand for beer is price inelastic for both rich and poor.
 - B** for the rich, beer is an inferior good.
 - C** the rich consume less beer than the poor.
 - D** the demand of the poor for beer is price elastic while that of the rich is price inelastic.
- 14** Features of the fundamental economic problem include
- A** both unlimited resources and many wants.
 - B** both trade-offs and conflicting objectives.
 - C** the provision of goods with no opportunity cost.
 - D** both scarce resources and limited wants.

15 The table below shows possible sources of market failure in current UK markets.

Which combination of example and policy, **A**, **B**, **C** or **D**, is consistent with the possible source of market failure identified?

	Source of market failure	Example of market failure	Policy to correct market failure
A	Missing market	Healthcare	State provision
B	Positive consumption externalities	Education	Minimum price
C	Merit good	Petrol	Indirect taxation
D	Negative production externalities	Electricity generation	Pollution permits

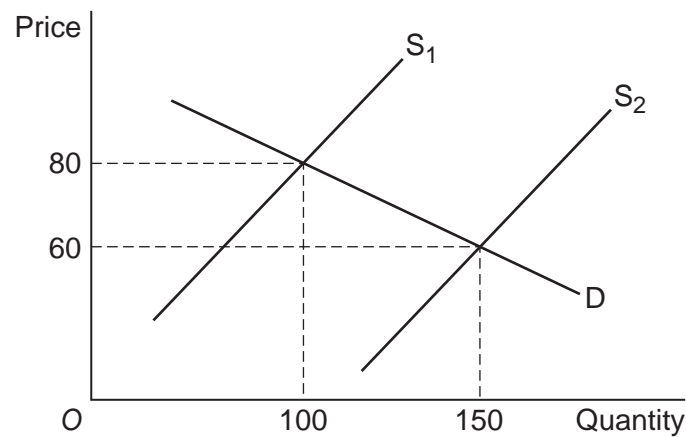
16 The diagram below represents the market for an agricultural product.



A government sets a minimum price of OP_2 . Assuming it buys up all the surplus stocks at the minimum price, farmers' total income will be

- A** $OP_2 Y Q_2$
- B** $OP_1 Z Q_1$
- C** $OP_2 X Q_0$
- D** $Q_0 X Y Q_2$

- 17 The diagram below illustrates the demand and supply curves for mobile phones.



From the diagram it can be inferred that the price elasticity of demand for mobile phones when their price falls from £80 to £60 is

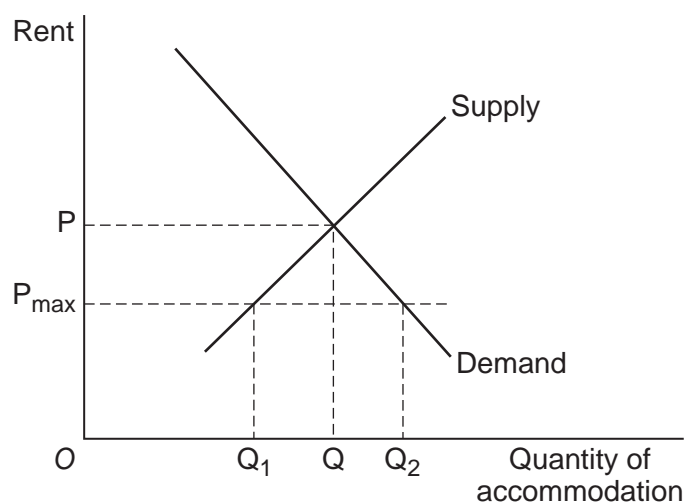
- A -0.4
 B -0.8
 C -2.0
 D -2.5
- 18 The table below indicates the private and external costs and benefits resulting from building a coal-burning power station.

	£ million
Private benefit	180
Private cost	190
External benefit	110
External cost	140

The social cost **minus** the social benefit equals

- A £120 million.
 B £40 million.
 C £30 million.
 D £10 million.

19 The diagram below shows a market for rented accommodation.



Rent is initially at P . If a maximum rent of P_{\max} is now imposed, all other things being equal, the effect will be to

- A** increase the amount of accommodation available from Q_1 to Q_2 .
- B** increase the amount of accommodation available from Q to Q_2 .
- C** decrease the amount of accommodation available from Q to Q_1 .
- D** decrease the amount of accommodation available from Q_2 to Q_1 .

20 Which one of the following is a reason for government intervention to correct a market failure?

The existence of

- A** inferior goods
- B** diseconomies of scale
- C** externalities in consumption and production
- D** goods in composite demand

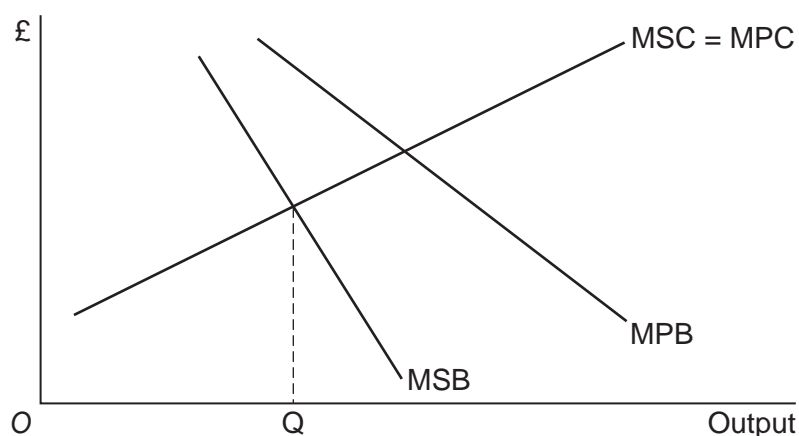
- 21** The table below shows the supply of a good produced by four firms when price increases from £50 to £60. Over this price range, which firm, **A**, **B**, **C** or **D**, has unitary price elasticity of supply for its good?

Price	Quantity of goods supplied			
	Firm A	Firm B	Firm C	Firm D
£50	100	100	100	100
£60	200	130	120	100

- 22** Which one of the following statements referring to a market economy is correct?

- A** Monopolists take no account of consumer preferences.
- B** Prices do not always reflect social costs.
- C** Efficiency is always indicated by high profits.
- D** Large firms are more efficient than small firms.

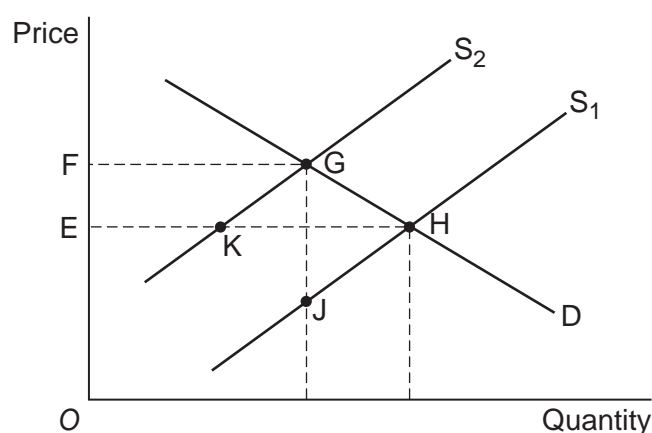
- 23** The diagram below illustrates the marginal private and social benefits (MPB and MSB) and costs (MPC and MSC) of smoking.



Which one of the following explains why, if output exceeds Q, there will be a misallocation of resources? At outputs greater than Q, the

- A** marginal private cost is less than the marginal private benefit.
- B** marginal private cost is greater than the marginal social benefit.
- C** marginal social benefit is less than the marginal private benefit.
- D** marginal social cost is greater than the marginal social benefit.

- 24** A small firm is able to buy any amount of a raw material on world markets at the same price. This means that it faces a perfectly
- A** elastic demand curve for the raw material.
 - B** inelastic demand curve for the raw material.
 - C** elastic supply curve for the raw material.
 - D** inelastic supply curve for the raw material.
- 25** The diagram below shows the market demand curve (D) and two market supply curves (S_1 and S_2) for a good. The initial equilibrium point is at H . The introduction of an indirect tax per unit by the government results in a new equilibrium point at G .



The amount of the per unit tax is measured by the

- A** vertical distance JG .
- B** increase in price EF .
- C** the diagonal distance HG .
- D** the horizontal distance KH .

**QUESTION 25 IS THE LAST
QUESTION IN SECTION A**

**On your answer sheet
ignore rows 26 to 50**

Turn over for Section B

Turn over ►

Section B: Data Response

Answer **EITHER** Context 1 **OR** Context 2.

You are advised to spend at least 50 minutes on **Section B**.

Total for this Context: 50 marks

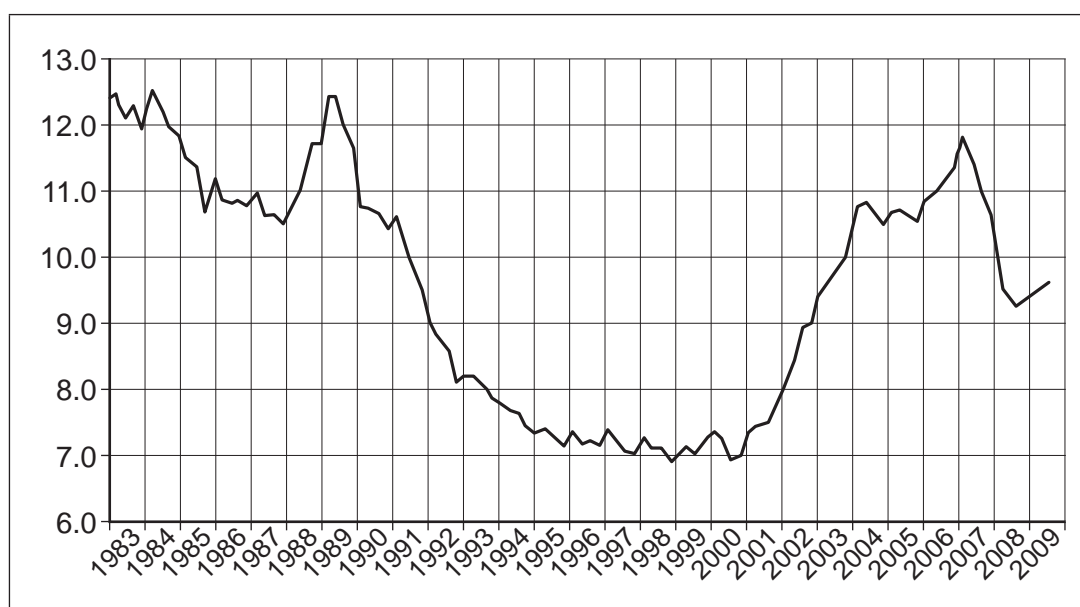
EITHER

Context 1

THE UK HOUSING MARKET

Study **Extracts A, B and C**, and then answer **all** parts of Context 1 which follow.

Extract A: UK house price affordability indicator*, 1983 to 2009



* The house price affordability indicator is calculated by dividing the average price of houses by average income. The lower the number, the greater the affordability of housing.

Source: news reports, 2010

Extract B: Factors affecting UK house prices

In recent decades, with the exception of short periods around 1990 and more recently in 2008 and early in 2009, UK house prices have risen. Several factors have contributed to rising house prices. These factors include changes in population size, changes in the number of households and changes in income.	1
Other factors have been the ease or difficulty of borrowing money to finance house purchase and the fact that the demand for housing is determined not only by people's need for shelter but also by people treating housing as a form of wealth.	5
Elasticities of demand and supply influence how these and other factors affect the price of housing. It has been estimated that, in the UK, the income elasticity of demand for houses is positive, with a value that exceeds +1.0. The estimated value of the price elasticity of supply of houses is +0.5.	10

Source: news reports, 2010

Throughout the recent decades of generally rapidly-rising house prices in the UK, most owner-occupiers have become significantly wealthier than those who pay rent. Owner occupiers, who are people owning the houses in which they live, generally raise the finance needed to buy their houses by taking out a mortgage, which is a type of loan used to purchase property. If house prices rise rapidly, owner-occupiers' wealth goes up in value but their mortgage debt does not.	1
People who rent houses do not benefit from this growth in personal wealth. In this case, it is the landlords owning the rented properties who enjoy the wealth gain. By and large, landlords and owner-occupiers are better off than those who live in rented accommodation. Arguably, the division between the 'haves', who own houses, and the 'have-nots', who do not, has been one of the most prominent market failures in the UK housing market. Market failure has also arisen because poor housing adversely affects people's health, and large differences in house prices can affect the mobility of labour.	10
Should governments intervene to try to correct the alleged market failures occurring in the UK housing market? Intervention could take several forms including subsidies, rent controls and direct government provision of housing.	15

0	1	Define the term 'price elasticity of supply' (Extract B , lines 10–11). (5 marks)
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0	2
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 Using **Extract A**, identify **two** significant features of the UK house price affordability indicator over the period shown. (8 marks)

0	3
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 With the help of an appropriate diagram, explain how **two** of the factors mentioned in **Extract B** may have caused UK house prices generally to rise in recent years.

0 4 “...the division between the ‘haves’, who own houses, and the ‘have-nots’, who do not, has been one of the most prominent market failures in the UK housing market”
(**Extract C**, lines 10–12).

In the light of this statement, evaluate the case **for** and the case **against** government intervention in the housing market in order to correct or to reduce market failures in such a market. (25 marks)

Turn over ►

Do not answer Context 2 if you have answered Context 1.

Total for this Context: 50 marks

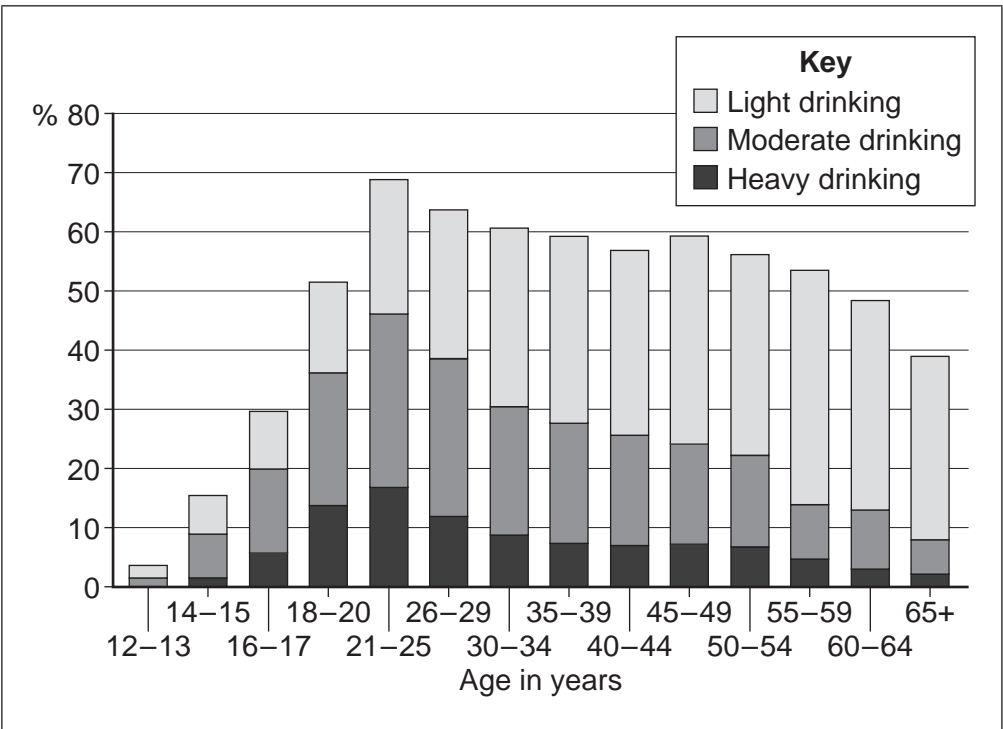
OR

Context 2

MARKETS FOR ALCOHOLIC DRINKS IN SCOTLAND

Study Extracts D, E and F, and then answer all parts of Context 2 which follow.

Extract D: Percentages of different age groups consuming alcoholic drinks, 2006



Source: official statistics

Extract E: The cost of consuming alcoholic drinks

Without regulation or taxation, too much alcohol is consumed when alcoholic drinks are bought at prices set by the market mechanism. The social costs to the whole community resulting from alcohol consumption exceed the private costs incurred by the consumer. The private cost can be measured by the money cost of purchasing the good, together with any health damage suffered by the person consuming the good. However, the social costs of consumption include the costs of damage and injury inflicted on other people resulting, for example, from road accidents caused by drunken drivers. The social costs also include the costs imposed on other people through taxation to pay for the care of victims of alcohol-related diseases.	1
	5

Source: academic research, 2010

Source: news reports, 2010

- END OF QUESTIONS**

There are no questions printed on this page