

Version 1.1



General Certificate of Education  
Advanced Subsidiary Examination  
June 2009

# Economics

# ECON1

## Unit 1 Markets and Market Failure

**Specimen paper for examinations in June 2010 onwards**

**This question paper uses the new numbering system and new AQA answer book**

**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

**Instructions**

- In **Section A**, answer **all** questions on your objective test answer sheet.
- In **Section B**, answer **EITHER** Question 26 **OR** Question 27 in your answer book.
- For **Section A**, do all rough work in your answer book, **not** on your objective test answer sheet.

**Section A (ECON1/1)**

- Use a black ball-point pen. Do **not** use pencil.

**Section B (ECON1/2)**

- 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** and 50 marks for **Section B**.
- In **Section A**, each question carries 1 mark. No deductions will be made for wrong answers.
- In **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**.

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## 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.

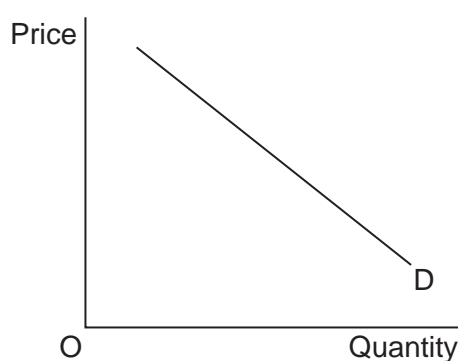
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- 1 The central purpose of economic activity is
  - A to create maximum profit.
  - B to achieve economic efficiency.
  - C the satisfaction of needs and wants.
  - D to save scarce resources.
  
- 2 Positive externalities exist when
  - A production creates private benefits.
  - B private benefits are less than social benefits.
  - C private benefits are greater than private costs.
  - D social costs exceed private costs.
  
- 3 When demand is income inelastic, the percentage change in
  - A income is greater than the percentage change in quantity demanded.
  - B quantity demanded is greater than the percentage change in income.
  - C income is less than the percentage change in quantity demanded.
  - D quantity demanded is the same as the percentage change in income.

4 Which one of the following is classified as an economic resource?

- A Consumption
- B Productivity
- C Production
- D Enterprise

5 The diagram below shows a demand curve for chicken.



The demand curve is drawn on the assumption that each of the following remains constant **except**

- A the incomes of consumers.
- B the price of chicken.
- C advertising expenditure on chicken.
- D the price of beef.

6 Which one of the following is the most likely determinant of the elasticity of supply of good X?

- A The price of good X
- B The price elasticity of demand of good X
- C Total production of good X
- D Spare capacity in the production of good X

- 7 Government intervention in a market economy can lead to an increase in economic welfare if
- A the market mechanism fails to allow for externalities.
  - B it leads to an increase in the consumption of demerit goods.
  - C the price elasticity of supply of private goods is high.
  - D the demand for inferior goods rises as incomes increase.

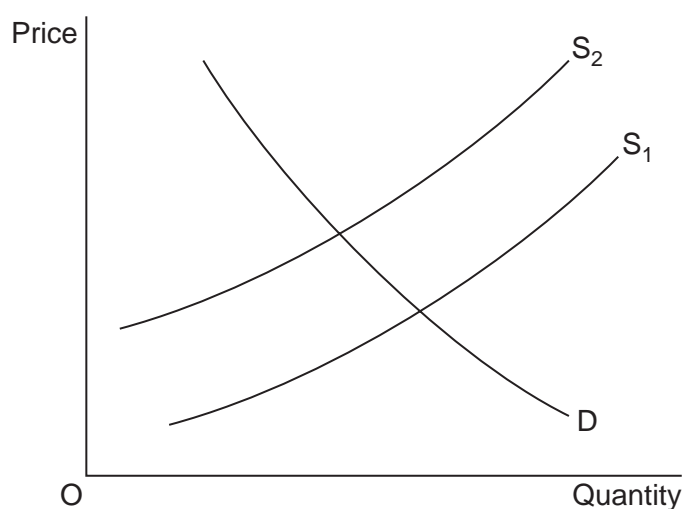
- 8 The table below indicates the average price of organic turkeys in price index number form.

Year	Price index
2004	100
2005	105
2006	120
2007	110
2008	125

Which one of the following can be deduced from the above data?

- A The price of organic turkeys rose throughout the whole period 2004 to 2008.
  - B Compared with 2008, the price of organic turkeys was 20% cheaper in 2004.
  - C Revenue from the sale of organic turkeys fell in 2007.
  - D Between 2006 and 2007, the price of organic turkeys fell 10%.
- 9 A monopoly market will be less economically efficient than a competitive market if, under monopoly,
- A the market demand curve is inelastic.
  - B the main objective of the firm is maximum profit.
  - C there are both economies of scale and diseconomies of scale.
  - D prices are higher and output is lower.

- 10 The demand curve for a good will shift to the left if
- A there is a successful advertising campaign for the good.
  - B the price of the good increases.
  - C the price of a complementary good increases.
  - D the tax on the good increases.
- 11 The diagram below shows the demand and supply curves for tennis balls.



Which one of the following could explain the shift of the supply curve from  $S_1$  to  $S_2$ ?

- A An improvement in the technology for making tennis balls
- B The granting of a subsidy to tennis ball producers
- C An increase in the price of a complementary good
- D An increase in wages in the industry

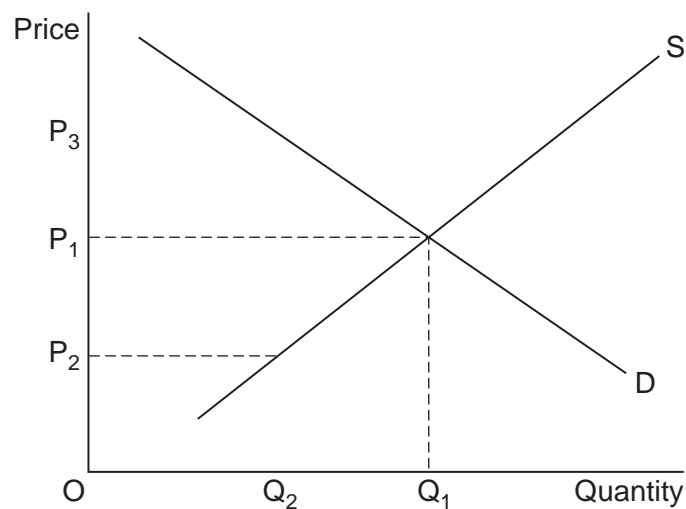
**Turn over for the next question**

- 12 The table below indicates various types of market failure, the consequences of such failure and examples of possible intervention strategies.

In which one of the situations, **A**, **B**, **C** or **D**, is the intervention **not** appropriate?

Situation	Type of market failure	Consequence of failure	Example of intervention
<b>A</b>	Factor immobility	Inefficient allocation of resources	Improved information flows
<b>B</b>	Public goods	Not provided	Government provision
<b>C</b>	Demerit goods	Over-consumed	Maximum price controls
<b>D</b>	Merit goods	Under-provided	Government subsidies

- 13 The diagram below illustrates the market demand and supply curves for a good. The production of the good creates a negative externality.



To reduce production and consumption of the good to  $OQ_2$  the government could impose a

- A** price ceiling of  $OP_3$ .
- B** tax of  $P_2P_3$ .
- C** minimum price of  $OP_2$ .
- D** tax of  $P_2P_1$ .

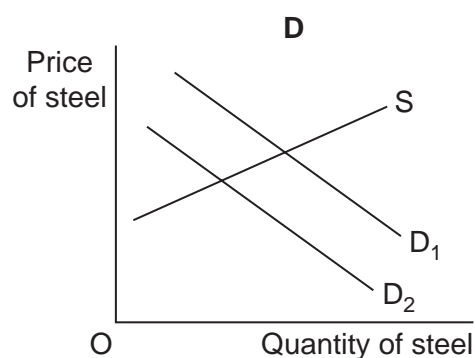
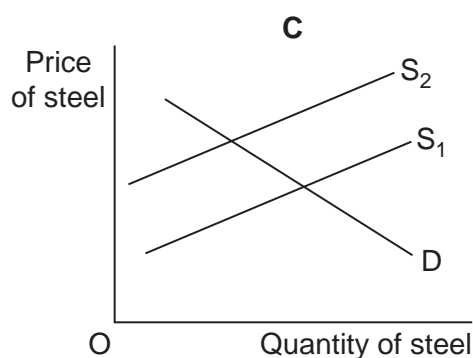
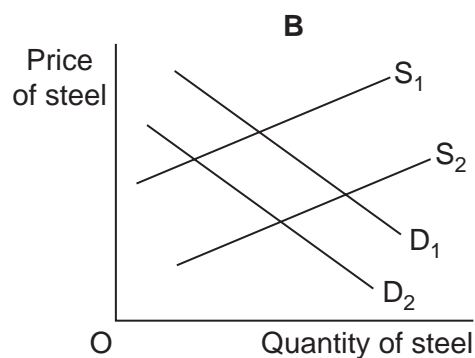
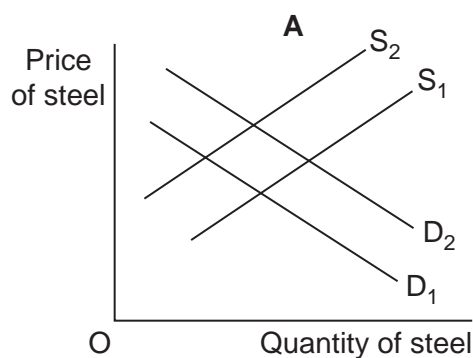
- 14** The government wants to reduce the amount of air pollution arising from petrol and diesel used in transport. Which one of the following combinations of policies would be most likely to achieve this objective?
- A** Subsidise the production of fuel-efficient cars and subsidise the prices of petrol and diesel
  - B** Increase new motorway building and the number of city centre car parks
  - C** Tax the purchase of cars which are less fuel-efficient and use the receipts to subsidise the development of vehicles which are more fuel-efficient
  - D** Tax cars going into town and city centres and use the receipts to lower taxes on petrol and diesel
- 15** Choice is a necessary part of the basic economic problem because
- A** wants are finite.
  - B** economic decisions involve an opportunity cost.
  - C** resources are infinite.
  - D** consumption creates externalities.
- 16** The natural environment in the UK is under threat from urbanisation as more and more new houses are built on unspoilt countryside. It has been estimated that by 2050 a fifth of England could be urbanised.

From the passage above it can be inferred that

- A** the natural environment is an economic resource.
- B** the opportunity cost of land is zero.
- C** land is not an economic resource because it is free.
- D** the private cost of urbanisation is greater than its social cost.

- 17** UK steel production declined last year following a big reduction in demand from UK manufacturers. They have been cutting their production of steel-containing goods due to tough global competition.

Which one of the following diagrams, **A**, **B**, **C** or **D**, best illustrates the reasons given for the decline in the production of steel in the UK?



- 18** Which one of the following is an example of government failure?

- A** The government over-producing a merit good
- B** All government provision of national defence
- C** All subsidies given to private sector firms
- D** The government allowing free market forces to raise the price of oil

- 19** Which one of the following statements involves a value judgement?

- A** The government must devote more resources to health care.
- B** More of a good is demanded at a lower price.
- C** The provision of public goods involves an opportunity cost.
- D** The higher the income, the higher the demand for a normal good.



- 20** 'The government is considering the building of three new runways in south-east England to cope with the boom in air travel. The proposal is bound to cause an outcry from environmentalists, but will be welcomed by business and tourism groups, which have warned that failure to build more runways would lead to higher prices and longer delays.'

If the three runways were built, all other things being equal, which one of the following is most likely to be true?

- A** The overall impact would necessarily create more positive externalities than negative externalities.
- B** The demand for air travel in the south-east would become price elastic.
- C** The supply curve for air travel in the south-east would shift to the right.
- D** The new runways would be examples of public goods.

- 21** The table below shows the price and quantity for two goods, **X** and **Y**.

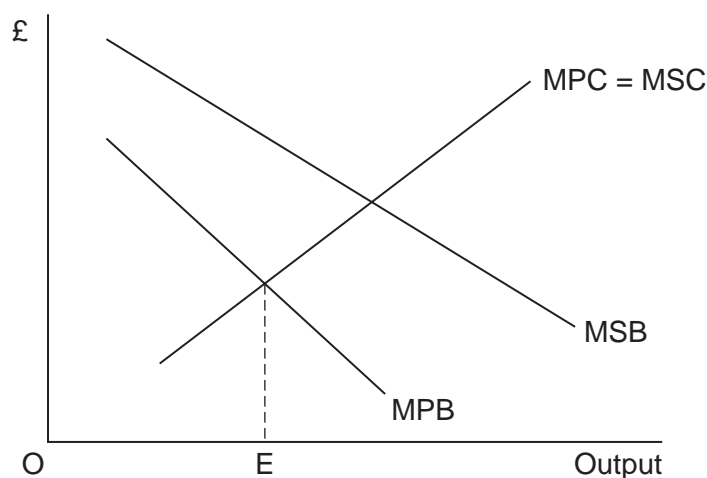
Price of X	Quantity of X demanded	Quantity of Y demanded
£10	20	30
£9	24	42

The cross elasticity of demand for **Y** with respect to the price of **X** when the price of **X** falls from £10 to £9 is

- A** +4
- B** +2
- C** -2
- D** -4

Turn over for the next question

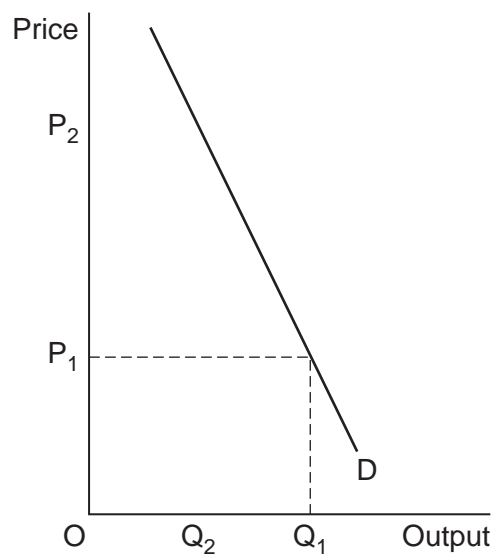
- 22 The diagram below shows a firm's marginal private benefit and social benefit (MPB and MSB) curves and marginal private cost and social cost (MPC and MSC) curves.



The firm produces at output level OE. As a result, there is likely to be

- A a misallocation of resources.
  - B a positive externality in production.
  - C a negative externality in consumption.
  - D excess demand for the good.
- 23 Which one of the following illustrates diseconomies of scale?
- A A firm expands but experiences management problems which increase its average costs.
  - B A firm scales down its activities but, as a result, its average costs rise.
  - C A larger firm is able to increase specialisation which reduces its average costs.
  - D Due to its growth, a firm is now operating at the lowest point of its average cost curve.
- 24 An economy has achieved productive efficiency if
- A it is self-sufficient in all products.
  - B it has eliminated all negative externalities.
  - C cost equals price in all its industries.
  - D it is unable to produce more of one good without producing less of another.

**25** The diagram below shows a market demand curve.



The change in price from  $P_1$  to  $P_2$  and output from  $Q_1$  to  $Q_2$  could have been caused by

- A** the government subsidising production of a merit good.
- B** a shift of the demand curve.
- C** monopoly replacing competition in the market.
- D** economies of scale.

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

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

**Turn over for Section B**

**Total for this question: 50 marks**

## MARKETS FOR ALCOHOLIC DRINKS

Study **Extracts A, B and C**, and then answer **all** parts of Question 26 which follows.

**Extract A: The prices of alcoholic drinks, selected retail outlets in London, March 2008**

	Pint of beer	Glass of wine	Measure of spirit (e.g. whisky)
<b>Public house (Central London)</b>	£3.00	£2.55	£2.40
<b>Specialist shop (off-licence)</b>	£1.33	£1.51	£0.45
<b>Asda supermarket</b>	£1.20	£1.27	£0.43
<b>Tesco supermarket</b>	£1.20	£1.27	£0.47

Note: supermarket and shop prices are based on the prices charged for a measure of the alcoholic drink in a public house (pub).

### Extract B: Reducing the consumption of alcoholic drink

Along with tobacco and narcotic drugs such as heroin, alcoholic drink is classified by many economists as a demerit good. The *British Medical Association* (BMA), which is the main professional group representing doctors, recently said that more than a quarter of all drink-related deaths could be prevented by a 10 per cent rise in taxes on beer, wine and spirits. The BMA suggests tax increases should be linked to the alcoholic strength of drinks.

The BMA backed calls from Tesco for the Government to ban cut-price alcohol, including two-for-one offers and so-called ‘loss-leaders’, in which drinks are sold at prices below cost to attract people into bars and shops that sell alcohol. The BMA Ethics Committee stated: “We have a public health emergency and people need to be prepared to look at an increase in price. They may not want to pay more but they also don’t want to see their children, their friends and their neighbours dying from liver failure in their 20s and 30s.” The Committee went on to say that recent UK governments have worked too closely with the alcohol industry and have refused to intervene in the way that alcoholic drinks are priced.

In 2008, taxes on alcohol in Britain are already among the highest in Europe. Beer and wine are taxed at 33 pence a pint and around £1.50 a bottle respectively, and alcoholic drinks are also subject to Value Added Tax (VAT).

Source: news reports, 2008

**Extract C: Is alcoholic drink too cheap?**

In a free market, should we stop alcohol being cheap? We may wish to end the sale of lager that costs less than bottled water, but it is simplistic to assume that binge-drinking is price-sensitive. And it is wrong to allow drunken yobs to deprive ordinary consumers of the opportunity to buy wine, beer and spirits at a reasonable market price.

1

5

A change in behaviour, not pricing, is needed. There are laws against drunken behaviour and selling alcohol to under 18s, but they are not always enforced rigidly enough; they may also need to be made stricter. Most major supermarkets are careful not to sell alcohol to anyone under 18, but would 21 be a more sensible age limit? Meanwhile, some smaller shops are shockingly casual about the under-18 rule.

10

A Tesco spokesperson recently said: "We can't put up our prices because people will simply shop elsewhere. It could be commercial suicide, and supermarkets can't act together to put up prices because that would be against the law."

Source: news reports, 2008

**Question 26**

- 0 1** Define the term 'demerit good' (**Extract B**, line 2). (5 marks)
- 0 2** Using **Extract A**, identify **two** points of comparison between the prices charged for alcoholic drinks by different retail outlets in London in March 2008. (8 marks)
- 0 3** With the help of a demand and supply diagram, explain how an increase in the age limit to 21 might affect the market for alcoholic drinks. (12 marks)
- 0 4** Evaluate possible economic policies, **other than** increasing the age limit, that a government might use to reduce significantly the consumption of alcoholic drinks. (25 marks)

**Turn over for the next question****Turn over ►**

Do **not** answer Question 27 if you have answered Question 26.

OR

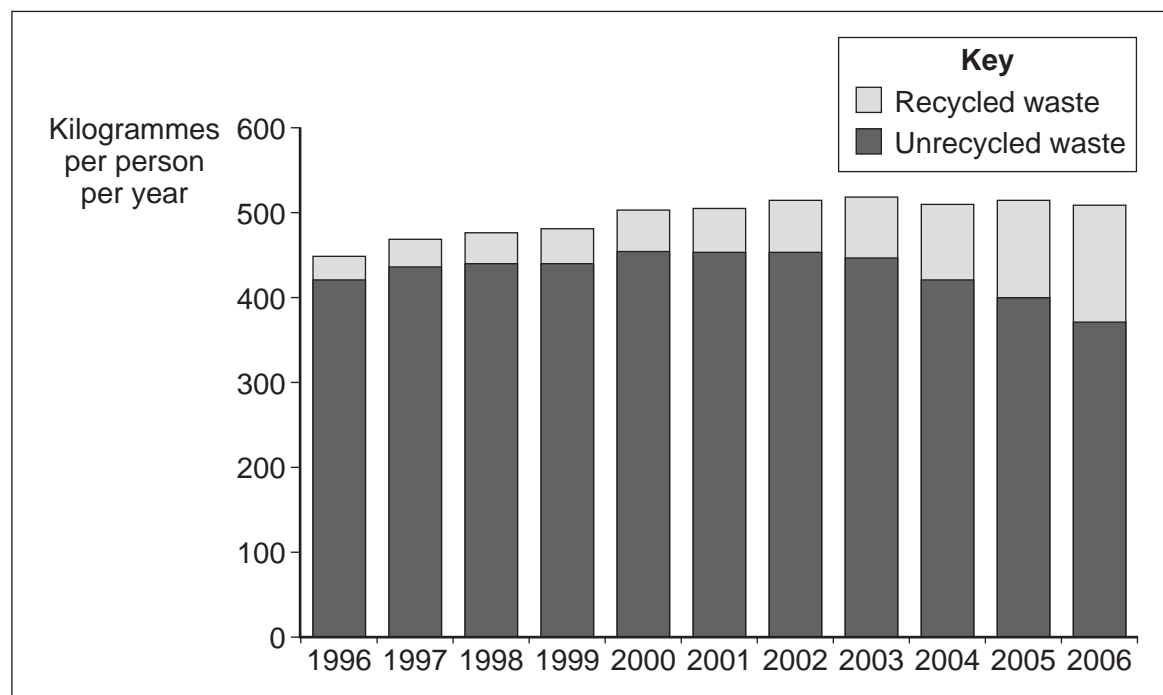
**Total for this question: 50 marks**

**Question 27**

**PLASTIC BAGS AND HOUSEHOLD WASTE**

Study **Extracts D, E and F**, and then answer **all** parts of Question 27 which follows.

**Extract D: Household waste production and recycling, UK 1996 to 2006**



Source: UK government statistics, 2007

**Extract E: Plastic bags, paper bags and negative externalities**

Disposing of a plastic bag creates a negative externality, whether the bag is thrown away as litter or carefully placed in a dustbin. With either method of disposal, future generations will be affected, as will people living today. Plastic bags can take up to 500 years to degrade.	1
In 2002, the Irish Government introduced a tax on plastic shopping bags to encourage people to use paper bags and cotton bags rather than plastic shopping bags. While paper bags degrade and are in some ways better for the environment, studies suggest that the manufacture, use and disposal of paper bags also create negative externalities.	5
More greenhouse gases are released in the manufacture and transportation of paper bags than in the production of plastic bags. And according to a spokesperson for the plastic bag industry, paper bags will one day rot away to give off CO <sub>2</sub> and methane, unlike plastic which eventually just crumbles to a fine non-poisonous powder.	10

Source: news reports, 2008

**Extract F: Should people be charged for the disposal of waste?**

Some economists argue that the plastic bag problem can be solved by the price mechanism. Prices can be charged when people acquire plastic bags, and also when they dispose of them. 1

People use plastic shopping bags because they appear to be free. When supermarkets and other shops charge their customers for the plastic bags they provide, shoppers economise and use fewer new bags. 5

In the United Kingdom, local governments effectively charge households an annual fee to empty dustbins through the Council Tax, however much rubbish is thrown away. When local authorities or councils have charged households per sack of waste collected or per kilo of waste in bins, the amount of waste collected has fallen. However, some people may simply dispose of their rubbish in other ways. 10

Source: news reports, 2008

**Question 27**

- 0 5** Define the term 'negative externality' (**Extract E**, line 1). (5 marks)
- 0 6** Compare **two** changes shown in **Extract D** in UK waste production and recycling over the period 1996 to 2006. (8 marks)
- 0 7** With the help of a demand and supply diagram, explain how a tax on the plastic bags distributed by shops and supermarkets might affect the use of plastic bags. (12 marks)
- 0 8** Assess the view that the environmental problems caused by the disposal of rubbish can best be dealt with by market forces rather than by government intervention. (25 marks)

**END OF QUESTIONS**

**There are no questions printed on this page**