



General Certificate of Education
Advanced Subsidiary Examination
June 2014

Economics

ECON1

Unit 1 Markets and Market Failure

Tuesday 13 May 2014 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 **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. No deductions will be made for wrong answers.
- 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

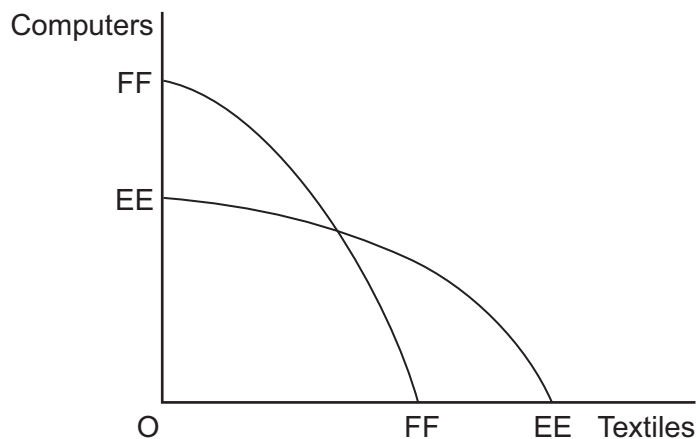
Answer **all** questions in **Section A**.

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 Which one of the following is true?
- A A positive statement is one which can be tested against the facts.
 - B A positive statement is one which never contains words such as 'could' or 'should'.
 - C A normative statement is one which can be scientifically proven to be true or false.
 - D A normative statement is one which never contains words such as 'is' or 'will' or 'always'.
- 2 The diagram below shows two production possibility boundaries for an economy.



The movement of the boundary from EE to FF is likely to have occurred because

- A consumers have switched their preferences from textiles to computers.
- B there has been an increase in productivity in the computer industry and a decrease in productivity in the textiles industry.
- C the production of computers has become more profitable than the production of textiles.
- D economic resources are being underused in the textiles industry.

- 3 A market is initially in equilibrium. The government then intervenes in the market, creating excess supply at the initial equilibrium price.

Other things being equal, which one of the following types of intervention would most likely have been carried out by the government?

- A A tax on production
- B A subsidy on production
- C A minimum price set below the initial equilibrium price
- D A maximum price set below the initial equilibrium price
- 4 The table below shows a household's demand for four different goods, **A**, **B**, **C** and **D**, at two separate income levels.

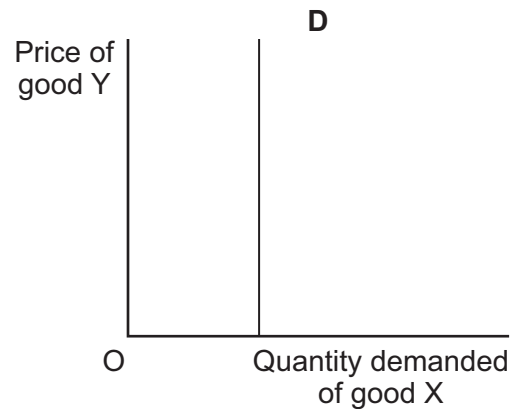
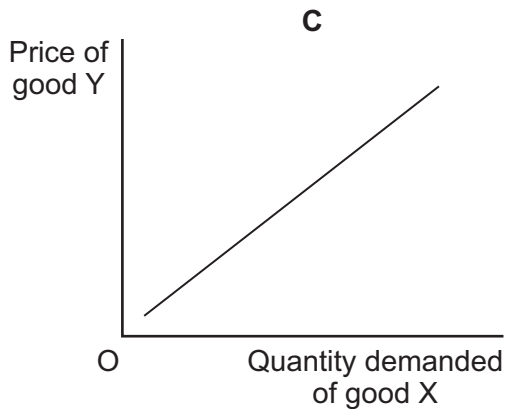
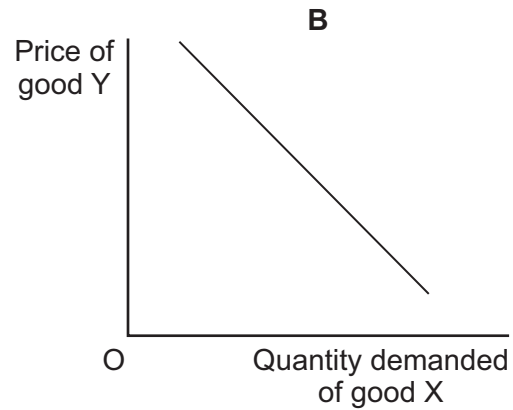
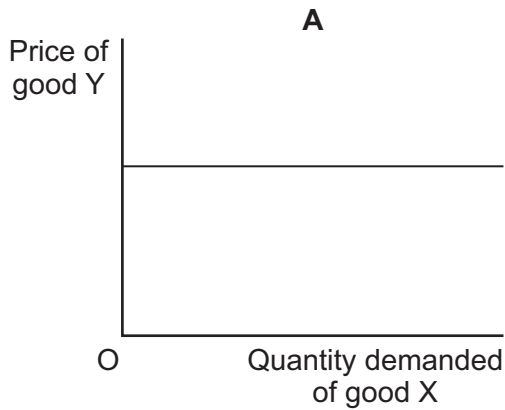
Income	Units of goods demanded			
	A	B	C	D
£40 000	200	200	200	200
£48 000	280	260	240	200

When income changes from £40 000 to £48 000, for which good (**A**, **B**, **C** or **D**) does the household have an income elasticity of demand of unity?

Turn over for the next question

Turn over ►

- 5 Which one of the diagrams below illustrates the relationship between two goods, X and Y, which are complementary goods?



- 6 A product has a price elasticity of supply of +1.5. If its price falls from £10.00 to £8.00, its supply will
- A decrease by 30%.
 - B decrease by 40%.
 - C increase by 30%.
 - D increase by 40%.

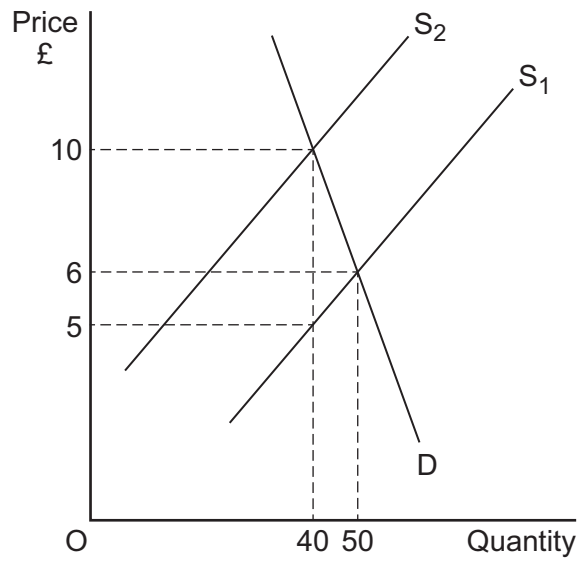
- 7 Government intervention in a market economy is most likely to lead to an increase in economic welfare if
- A the market mechanism fails to take account of externalities.
 - B it leads to an increase in the consumption of demerit goods.
 - C the price elasticity of supply of private goods is high.
 - D the demand for inferior goods rises as income increases.
- 8 Which one of the following would an economist be most likely to classify as a consumption activity?
- A The extraction of coal
 - B An individual doing the washing and ironing for clients
 - C Someone enjoying the flowers in a public park
 - D A garage mechanic replacing the battery in a car
- 9 The table below shows the marginal private and external benefits and the marginal private and external costs of a product at the free market equilibrium level of output.

	£
Marginal private benefit	12
Marginal external benefit	9
Marginal private cost	12
Marginal external cost	0

Government intervention in this market could improve the allocation of resources because the product is most likely to be

- A a public good.
- B a demerit good.
- C an inferior good.
- D a merit good.

- 10 The diagram below shows the impact of a government imposing an indirect tax on a good, with the supply curve shifting from S_1 to S_2 .



What is the tax per unit?

- A £1
 - B £4
 - C £5
 - D £10
- 11 Which one of the following is most likely to reduce market failure?
- A Increased economies of scale in production
 - B The existence of merit goods
 - C A decrease in the mobility of labour
 - D Improving the information available to consumers

- 12 The table below shows the value of the price elasticity of demand facing each type of provider of passenger transport.

Train companies	Coach companies	Bus companies	Airline companies
-1.4	-0.8	-1.0	-0.5

If the fares charged for the use of each of these forms of transport rose by the same percentage, which type of provider would see the greatest proportionate increase in total sales revenue?

- A Train companies
- B Airline companies
- C Bus companies
- D Coach companies
- 13 A merit good, such as healthcare, is
- A non-rival with positive externalities in consumption.
- B rival with positive externalities in production only.
- C non-excludable with positive externalities in production.
- D excludable with positive externalities in consumption.

- 14 The table below shows the wealth distribution for an economy in 2008 and 2012.

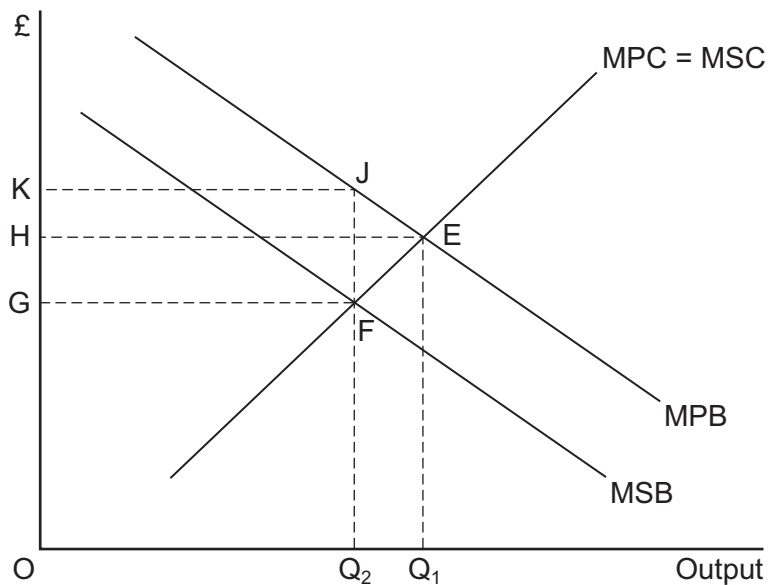
Percentage of wealth owned by	2008	2012
Most wealthy 1%	20	25
Most wealthy 5%	35	40
Most wealthy 10%	45	50
Most wealthy 25%	70	75
Most wealthy 50%	90	95

Between 2008 and 2012, it may be concluded that

- A there has been a reduction in inequality of income.
- B there has been an increase in the wealth of all individuals.
- C there has been a reduction in inequality of wealth.
- D market failure is likely to have got worse.

Turn over ►

- 15 A market in which a number of firms are competing is gradually taken over by a monopolist. Unless there are economies of scale, this is likely to lead to lower
- A costs.
 - B output.
 - C profits.
 - D prices.
- 16 A company wishes to increase labour productivity. All other things being equal, this is most likely to be achieved if the company
- A employs more workers.
 - B reduces the wages it pays its employees.
 - C reduces current output.
 - D invests in more capital equipment.
- 17 The diagram below shows the marginal private benefit and marginal social benefit (MPB and MSB) curves and the marginal private cost and marginal social cost (MPC and MSC) curves for Good X.



To reduce the market equilibrium output from Q_1 to Q_2 , the government could

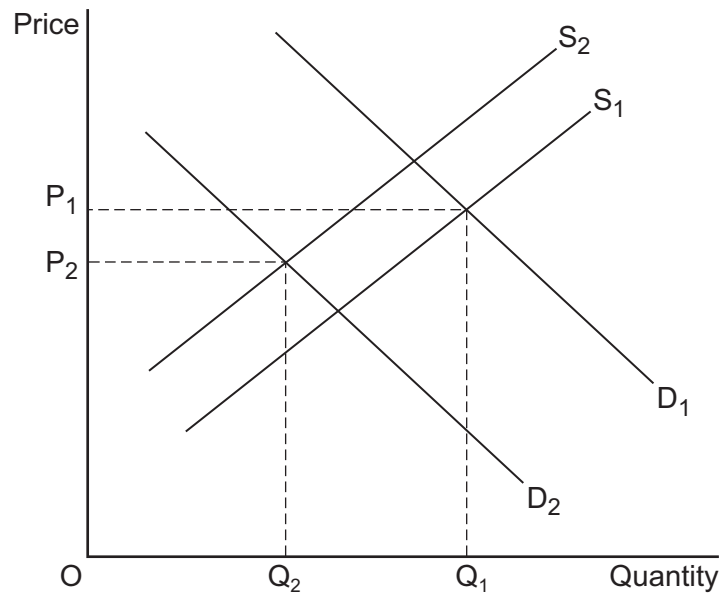
- A introduce a subsidy of GH.
- B set a minimum price of OG.
- C introduce a per unit tax of FJ.
- D set a maximum price of OH.

-
- 18** The main role of prices in a market economy is to
- A** determine the elasticity of demand curves.
 - B** provide a mechanism for firms to make profits.
 - C** improve the distribution of income.
 - D** allocate scarce resources.
- 19** Which one of the following statements about subsidies is most likely to be correct?
- A subsidy
- A** increases the price elasticity of demand of a good.
 - B** leads to an increase in the output sold of a good.
 - C** shifts the supply curve for a good to the left.
 - D** leads to a rise in the equilibrium price of a good.
- 20** A free good has which one of the following characteristics?
- A** It has no opportunity cost in supply.
 - B** It is generally supplied by the government because its consumption is considered to be socially desirable.
 - C** It has no externalities associated with its consumption or production.
 - D** It is in perfectly inelastic supply.

Turn over for the next question

Turn over ►

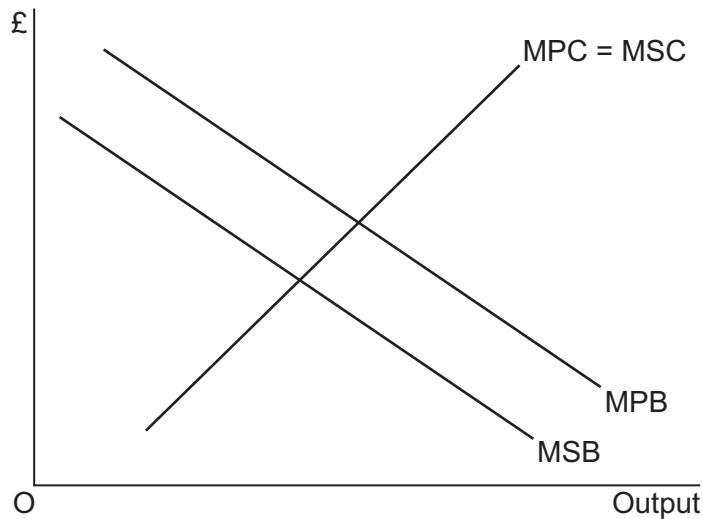
- 21 The diagram below shows the demand and supply curves of a consumer good where P_1 is the initial equilibrium price.



The decrease in price from P_1 to P_2 may be caused by a decrease in

- A the price of substitutes and a rise in raw material costs.
 - B interest rates and a rise in incomes.
 - C the wages paid to all workers.
 - D income tax and value added tax.
- 22 One reason why the free market fails to achieve an optimal allocation of scarce resources is because
- A public goods are provided free of charge to users.
 - B positive externalities lead to overproduction of a good.
 - C there is underproduction of goods with positive externalities.
 - D individuals' incomes and wealth are not identical.

- 23 All other things being equal, which one of the following is most likely to discourage the growth of a firm?
- A Marketing economies of scale at high levels of output
 - B Low unit costs of production compared with competing firms
 - C An increase in market power at high levels of output
 - D Diseconomies of scale at low levels of output
- 24 The diagram below shows the marginal private benefit and marginal social benefit (MPB and MSB) curves and the marginal private cost and marginal social cost (MPC and MSC) curves for Good X.



From the diagram it can be inferred that Good X is a

- A merit good.
- B public good.
- C demerit good.
- D normal good.

Turn over for the next question

Turn over ►

- 25** A government imposes an indirect tax on a product. The price of the product is likely to rise by the full amount of the tax if the price elasticity of
- A** supply is perfectly elastic.
 - B** supply is perfectly inelastic.
 - C** demand is unit elastic.
 - D** demand is perfectly elastic.

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

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

Now turn to page 14 for Section B

Turn over for the next Section

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

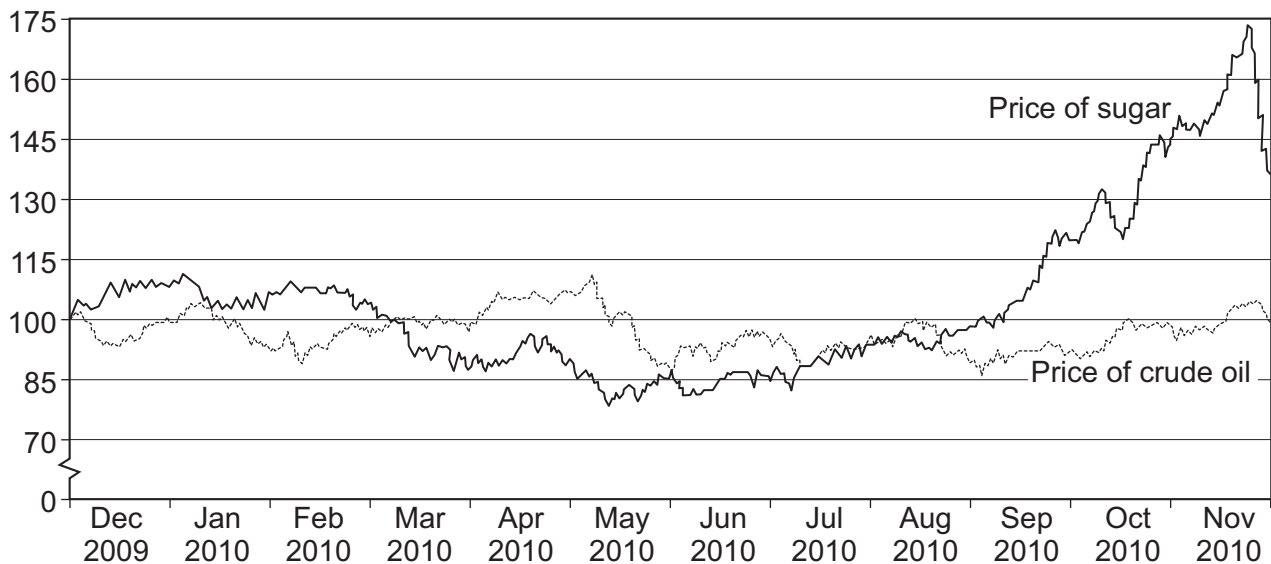
EITHER

Context 1

CRUDE OIL AND FOOD MARKETS

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

Extract A: Price indices for sugar and crude oil, December 2009 to November 2010 (1 December 2009 = 100)



Source: official statistics, 2010

Extract B: How crude oil markets and food markets affect each other

Global food markets and crude oil markets have become much more interrelated in recent years. Changes in crude oil markets affect food markets. Likewise, changes in food markets affect crude oil markets. Composite demand and derived demand provide part of the explanation.

1

One link between food and crude oil prices stems from the growing use of biofuel as an alternative to petrol and diesel fuels. Petrol and diesel fuels are both produced from crude oil. Crops such as sugar and wheat, which have always been used as foodstuffs, are now in demand as raw materials for biofuel production.

5

Rising incomes in China and India have increased the demand for motor fuels. This has affected the price of crude oil. A significant rise in the price of crude oil increases the demand for biofuel, which then results in the diversion of sugar cane and wheat away from foodstuffs into biofuel production.

10

Source: news reports, 2012

Extract C: Biofuels, poverty and the environment

Some economists argue that the increase in food prices, caused by the rapid rise in biofuel production, is a major cause of famine and poverty in some of the world's economies.	1
According to an Oxfam report, the environmental policies of rich countries and the replacement of traditional fuels with biofuels have dragged more than 30 million people worldwide into poverty. Oxfam also says that biofuels will do nothing to combat climate change.	5
The report criticised rich countries for using subsidies and exemptions from tax to encourage the use of crops for biofuel rather than for food. Rich countries were said to be stealing crops and land away from food production, and they were destroying millions of livelihoods in the process. One adviser from the United Nations has described biofuels as a "crime against humanity".	10
However, the President of Brazil, a major biofuel-producing country, believes that the biofuel boom provides poor nations with a great opportunity. It creates a profitable export for farmers in Africa and Latin America that may enable them to grow their way out of poverty.	15

Source: news reports, 2012

- 0 1** Define the term 'derived demand' (**Extract B**, line 3). **[5 marks]**
- 0 2** Using **Extract A**, identify **two** significant points of comparison between the price indices for sugar and crude oil over the period shown. **[8 marks]**
- 0 3** With the help of an appropriate diagram and the information in **Extract B**, explain how rising incomes in China and India have affected the global price of wheat. **[12 marks]**
- 0 4** 'Some economists argue that the increase in food prices, caused by the rapid rise in biofuel production, is a major cause of famine and poverty in some of the world's economies' (**Extract C**, lines 1–2).

Using the data and your economic knowledge, evaluate the case **for** and **against** governments intervening to prevent agricultural products from being used to produce biofuel. **[25 marks]**

Turn over ►

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

Total for this Context: 50 marks

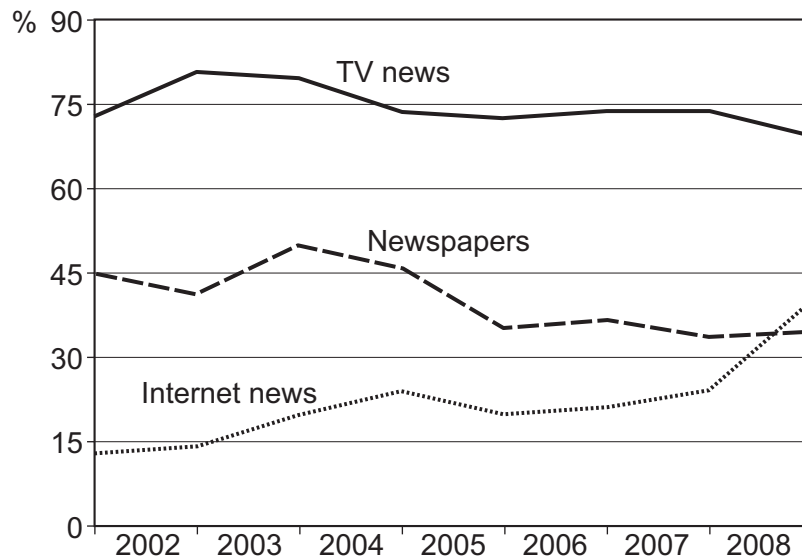
OR

Context 2

THE NEWSPAPER MARKET

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

Extract D: Percentages of the US population accessing news from various sources, 2002 to 2008



Source: news reports, 2009

Extract E: The declining sales of newspapers and the growth of online news

Traditionally, the main products sold by newspaper companies were newspapers themselves. Newspapers are generally regarded by economists as private goods. Newspaper companies earn revenue, partly from the price charged for the newspapers, and partly from money received from advertisers. Advertising in newspapers is necessary because the prices that readers pay are less than the journalism, paper and delivery costs that are incurred when producing and selling newspapers. 1
5

In recent years, the cost of producing newspapers has risen while sales have dropped significantly. Between 2008 and 2009, more than seventy local newspapers shut down in the UK. Most national newspapers make losses. Some survive because they have rich owners who pay for the losses. 10

However, virtually all newspapers now provide news on the internet, in the hope that money made from internet advertising can cover losses incurred from selling newspapers.

Source: news reports, 2010

Extract F: How the internet is changing the ways in which people access news

When news is available completely free on the internet, it possesses some of the properties of a public good. However, whilst the owners of newspapers such as The Daily Mail and The Guardian provide free online versions of their printed newspapers, other owners do not. For example, readers of The Times and The Sunday Times must pay subscription fees to access online versions of these papers. Between these extremes, The Economist provides most of its online content for free but readers have to pay to read certain articles. 1 5

The variety of different pricing policies reflects the fact that newspaper companies are experimenting with a number of 'business models', as they seek to earn sufficient money from the internet to offset losses made from newspaper sales.

Some people argue that, because newspapers are such an important source of information and education, the government should help them to survive. Some argue that the government should also encourage free availability of online versions of newspapers. Whilst subsidies undoubtedly affect resource allocation, should newspaper companies be subsidised so that the general public can buy cheaper newspapers and access free online news? 10

Source: news reports, 2012

- 0 | 5** Define the term 'private goods' (**Extract E**, line 2). **[5 marks]**
- 0 | 6** Using **Extract D**, identify **two** significant points of comparison between the various sources of news accessed over the period shown. **[8 marks]**
- 0 | 7** With the help of an appropriate diagram and the information in the **Extracts**, explain why the quantity of newspapers sold by most newspaper companies has fallen. **[12 marks]**
- 0 | 8** 'Some people argue that, because newspapers are such an important source of information and education, the government should help them to survive' (**Extract F**, lines 10–11).
Using the data and your economic knowledge, evaluate the case **for** and **against** the government subsidising newspapers and online news. **[25 marks]**

END OF QUESTIONS

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