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Centre Number

Candidate Number

**Edexcel GCE**

# Economics

**Advanced Subsidiary**

**Unit 1: Competitive Markets: How they work and why they fail**

Monday 13 May 2013 – Morning

**Time: 1 hour 30 minutes**

Paper Reference

**6EC01/01**

**You do not need any other materials.**

Total Marks

## Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **all** questions in Section A and **one** question from Section B.
- Answer the questions in the spaces provided  
– *there may be more space than you need.*

## Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets  
– *use this as a guide as to how much time to spend on each question.*
- Questions labelled with an **asterisk** (\*) are ones where the quality of your written communication will be assessed  
– *you should take particular care on these questions with your spelling, punctuation and grammar, as well as the clarity of expression.*
- Calculators may be used.

## Advice

- Read each question carefully before you start to answer it.
- Keep an eye on the time.
- Check your answers if you have time at the end.

Turn over ►

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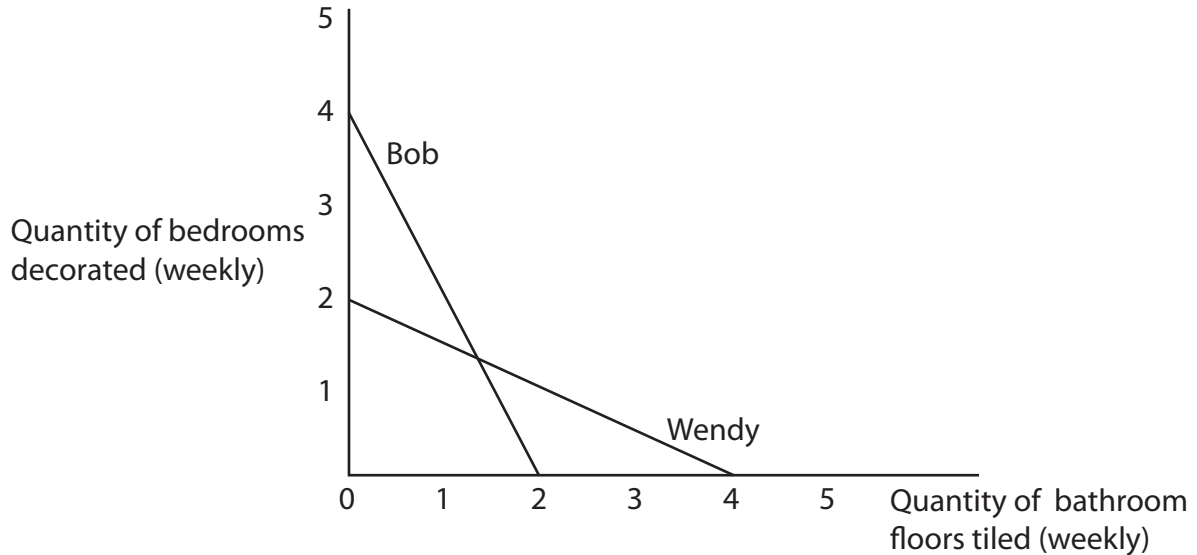


**PEARSON**

**Section A: Answer all the questions in this section**

**You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.**

**1**



The diagram shows the weekly production possibilities of two builders, Bob and Wendy. They **each allocate half** their working time to decorating bedrooms and the **other half** to tiling bathroom floors.

From this information it can be deduced that

(1)

- A** the opportunity cost of decorating a bedroom is the same for both builders
- B** Wendy can decorate more bedrooms and tile more bathroom floors than Bob in a week
- C** the opportunity cost of tiling a bathroom floor is lower for Bob than for Wendy
- D** Wendy and Bob could increase their combined total weekly output through specialisation

Answer



Explanation

(3)

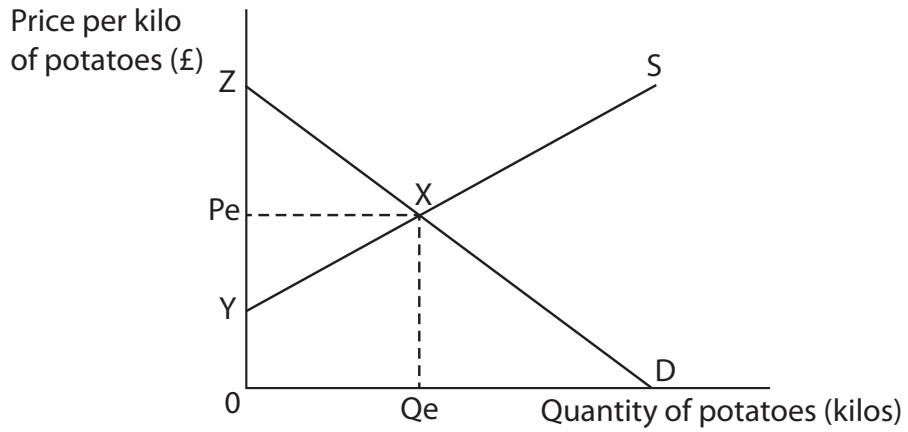
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**(Total for Question 1 = 4 marks)**





3



The diagram shows the market for potatoes where the initial equilibrium price is  $P_e$  and quantity  $Q_e$ . Use the diagram in your explanation.

An increase in demand for potatoes is most likely to

(1)

- A maintain price at  $P_e$  and decrease producer surplus
- B raise price and increase producer surplus
- C maintain price at  $P_e$  and increase consumer surplus
- D raise price and decrease consumer surplus

Answer

Explanation

(3)

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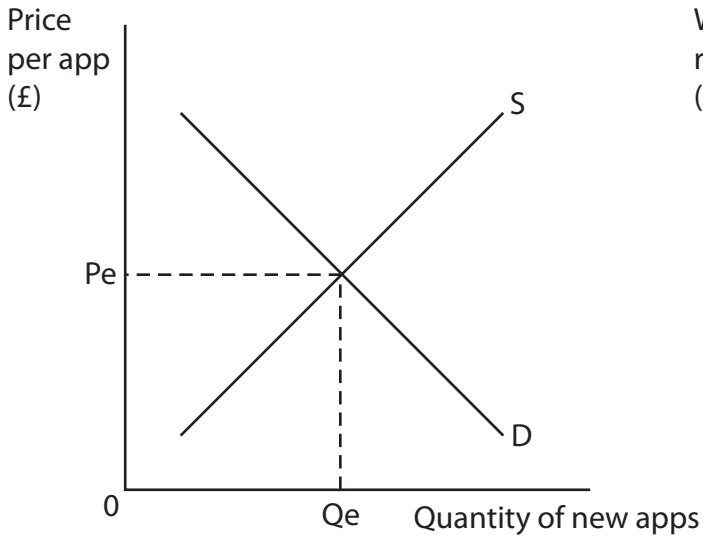
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(Total for Question 3 = 4 marks)

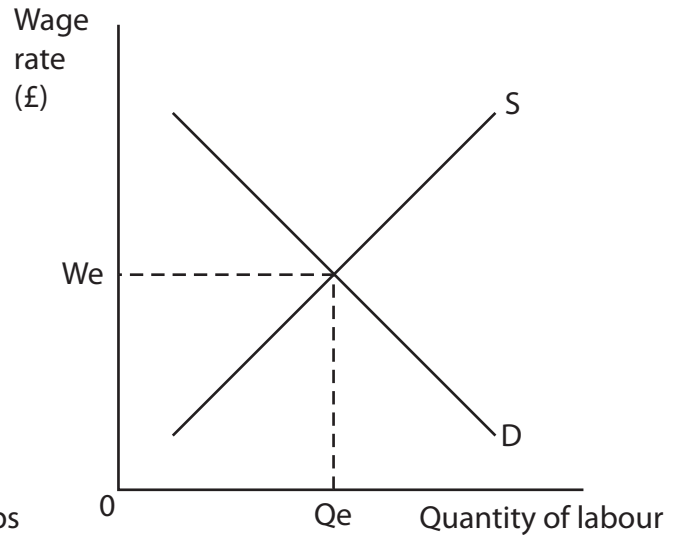


4

Market for new applications (apps)



Labour market for application (app) programmers



The diagrams show the market for new apps (software used on mobile phones and tablet computers) and the labour market for app programmers.

Other things being equal, an increase in the demand for new apps is most likely to (1)

- A affect the wage rate of app programmers
- B decrease the demand for app programmers and mobile phones
- C decrease the supply of app programmers
- D decrease the total revenue of tablet computer manufacturers

Answer



Explanation

(3)

A series of horizontal dotted lines for writing an explanation.

**(Total for Question 4 = 4 marks)**



5 Estimates of income elasticity of demand for selected items in Sri Lanka and UK

Product	Sri Lanka	UK
Cereals e.g. rice	0.46	-0.02
Fish	0.62	0.36
Tobacco	1.02	0.57

(Source: © <http://www.ers.usda.gov/Data/InternationalFoodDemand/>  
NB Figures have been rounded up)

It may be deduced from the data in the table that

(1)

- A the demand for tobacco is income inelastic in both countries
- B the demand for fish is more responsive to changes in income in both countries than the demand for tobacco
- C cereals are a normal good in Sri Lanka but an inferior good in the UK
- D a 10% increase in income would cause a more than 10% increase in demand for fish in both countries

Answer

Explanation

(3)

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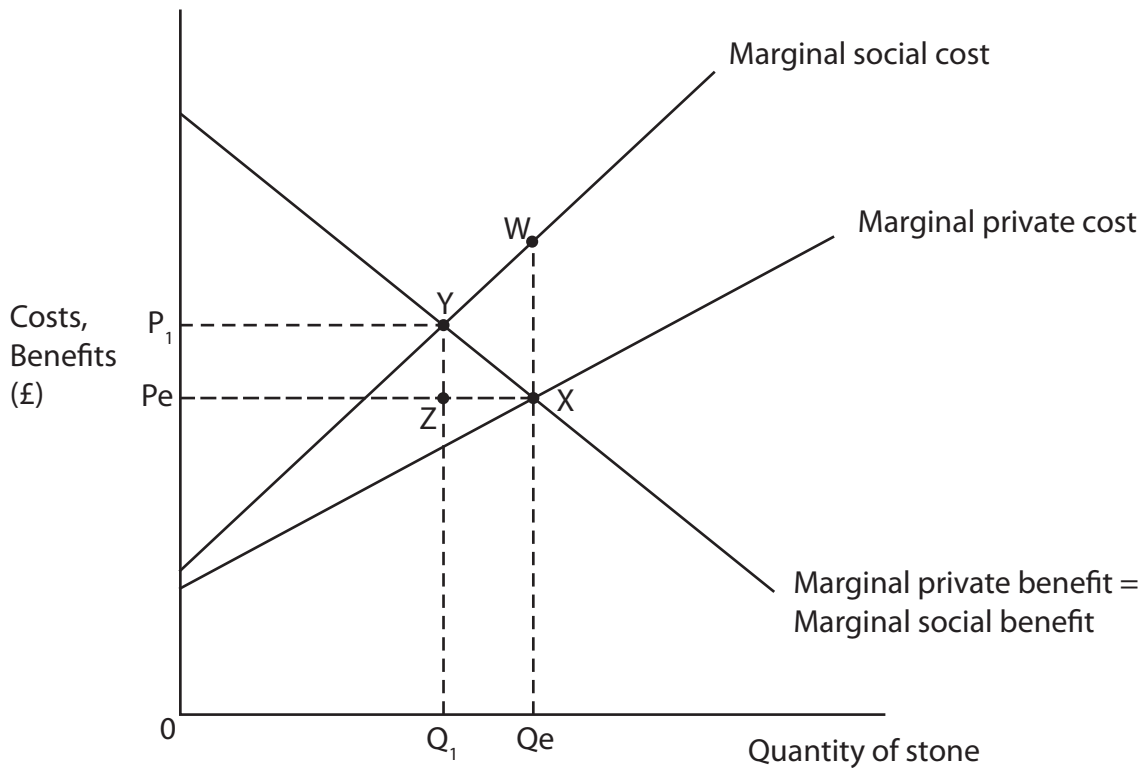
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(Total for Question 5 = 4 marks)









The diagram shows the market for the extraction of stone from a quarry. Assume there are no external benefits.

Which of the following is true?

(1)

- A** The social optimum quantity exceeds the free market equilibrium quantity
- B** The area of welfare loss at the free market equilibrium is XZY
- C** A decrease in the quantity from  $Q_e$  towards  $Q_1$  will reduce the net welfare loss
- D** At the free market equilibrium quantity, marginal social benefit exceeds marginal social cost

Answer



Explanation

(3)

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**(Total for Question 7 = 4 marks)**





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**Section B: Answer either Question 9 or Question 10.**

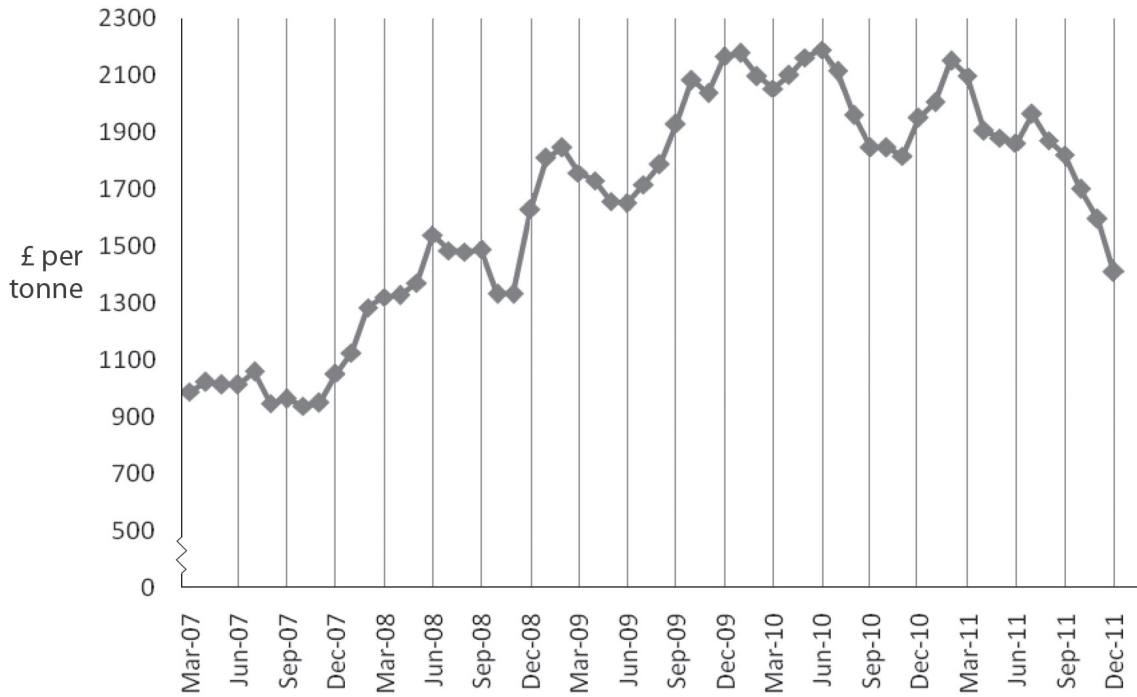
If you answer Question 9 put a cross in this box

**Question 10 starts on page 26.**

**You should spend 55 minutes on this question.**

**9 The price of cocoa**

**Figure 1 Cocoa prices, March 2007 – December 2011**



(Source: © U.S. Department of Agriculture)



## Extract 1 Unstable cocoa prices

The price of cocoa fell sharply from £2 153 to £1 410 per tonne between February and December 2011. This follows a decrease in consumption from Europe - the world's largest consumer of the commodity - amid fears that it was entering a recession. At the same time there was a very good cocoa harvest in the Ivory Coast, the world's biggest producer, which supplies around 40% of global output. 5

The supply of cocoa in 2012 is set to exceed demand by a record 400 000 tonnes, adding to producer stockpiles. There are fears that farmers will abandon looking after their cocoa trees, which take five years to grow to maturity, and switch to growing rubber. However, rubber prices have also decreased in recent years.

Cocoa is subject to enormous price fluctuations: in June 2010 its price reached £2 190 a tonne. This was the highest price for 33 years, resulting from a disappointing crop caused by poor weather, ageing trees and a temporary export ban imposed by the newly elected President of the Ivory Coast. Price fluctuations create instability in income, employment and investment among cocoa farmers. 10

To reduce the damaging effects of fluctuating cocoa prices, the Ivory Coast government has introduced a guaranteed minimum price scheme to support farmers. The success of this scheme will depend partly on the response of international cocoa buyers and whether or not they will seek to purchase from other major producers such as Ghana and Nigeria. 15

In the long term, as the emerging markets continue to grow, demand for cocoa from China and India is likely to increase. Consumers in these countries are developing a strong taste for chocolate. Cocoa is a key ingredient in making chocolate products such as Cadbury's Dairy Milk bar and Nestlé's Kit Kat bar. However, it only forms around 6% of the price of a bar of chocolate. 20

(Source: adapted from 'Euro debt crisis bites into cocoa' by Emiko Terazono, © The Financial Times Ltd, 5th December 2011 and <http://www.traidcraft.co.uk>)

(a) With reference to the first paragraph of Extract 1, explain the causes of the decrease in cocoa prices between February and December 2011. Illustrate your answer with a supply and demand diagram. (6)

(b) With reference to the information provided and your own knowledge, assess whether the supply of cocoa is likely to be price elastic or price inelastic. (6)

(c) Examine the likely effects of a fall in the price of cocoa on the producers of chocolate products such as Cadbury's Dairy Milk bar and Nestlé's Kit Kat bar. (8)

\*(d) Evaluate the likely consequences of fluctuating prices for cocoa producers. (14)

\*(e) Evaluate the likely economic effects of a guaranteed minimum price scheme, such as that introduced by the Ivory Coast for cocoa. Illustrate your answer with a supply and demand diagram. (14)









(c) Examine the likely effects of a fall in the price of cocoa on the producers of chocolate products such as Cadbury's Dairy Milk bar and Nestlé's Kit Kat bar.

(8)

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\* (d) Evaluate the likely consequences of fluctuating prices for cocoa producers.

(14)

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If you answer Question 10 put a cross in this box

## 10 The proposed expansion of Heathrow Airport

### Extract 1 Should a third runway be built at Heathrow Airport?

London Heathrow is the world's third busiest airport and a major hub for the global economy. In 2011 it handled more than 476 000 flights and some 65 million passengers. However, the airport is operating at 99.2% of its capacity, making it vulnerable to any disruption. There is a shortage of runway capacity to meet the forecast increase in passenger demand of 15 million using Heathrow Airport by 2020. 5

Research by a business consultancy claims that Britain could lose out on an extra 140 000 jobs if capacity at Heathrow is not increased in the medium term. It estimates that £4.5 billion will be lost from Gross Domestic Product because of falling foreign investment, as businesses consider locating elsewhere in Europe, and £1.6 billion lost in trade with emerging markets by 2020. 10

However, a third runway at Heathrow would lead to a significant increase in external costs from the extra 900 flights per day over London. Expansion at Heathrow might be unnecessary as almost a quarter of flights are to destinations less than 300 miles away and already well served by train. Domestic flights and short flights to Europe could easily be carried out by train, especially with the continued expansion of Eurostar rail services to many more European cities. Substituting these flights for train services would reduce the need for extra capacity at Heathrow and have significant environmental benefits, as train travel creates one tenth of the pollution per passenger compared to air travel. 15

An alternative might be to develop other airports around London such as Gatwick, Stansted and Luton where significant spare capacity exists. In the long run a new super-sized airport in the Thames estuary might provide the best solution although the financial cost is expected to exceed £50 billion and take at least 15 years to build after planning permission has been received. 20

(Source: adapted from © Guardian News and Media Ltd, 2012 and © Greenpeace, 10 Reasons to Stop Heathrow Expansion (<http://www.greenpeace.org.uk/blog/climate/10-reasons-to-stop-heathrow-expansion>))



**Figure 1: Estimates of price elasticity and income elasticity of demand for UK air travel**

Air travel	Price elasticity of demand	Income elasticity of demand
UK business passengers	-0.2	1.2
UK leisure passengers	-0.7	1.4

(Source: © Crown copyright)

**Figure 2: Air Passenger Duty (APD) rate from April 2012**

Flight distance (miles)	Economy class (tax per passenger)	Other travel classes, e.g. business class (tax per passenger)
0–2000	£13	£26
2001–4000	£65	£130
4001–6000	£81	£162
Over 6000	£92	£184

The APD is an indirect tax introduced in 2006 and is charged to airlines carrying passengers from UK airports. Between 2010 and 2011 APD remained the same. In April 2012 the government increased APD by 8%.

(Source: © Crown copyright)

- (a) With reference to the information provided and your own knowledge, explain **two** possible reasons for the 'forecast increase in passenger demand of 15 million using Heathrow Airport by 2020' (Extract 1, line 5). (6)
- (b) With reference to Figure 1, discuss why business and leisure air travel passengers have different price elasticities of demand. (6)
- (c) Using the concept of cross elasticity of demand and referring to the information provided, assess whether train travel is an effective substitute for air travel. (8)
- \*(d) Using the information provided and your own knowledge, evaluate the case for building a third runway at Heathrow Airport. (14)
- \*(e) Examine the likely economic effects on air travel of the increase in Air Passenger Duty (APD). Use an appropriate demand and supply diagram in your answer. (14)











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\*(e) Examine the likely economic effects on air travel of the increase in Air Passenger Duty (APD). Use an appropriate demand and supply diagram in your answer.

(14)

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