AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



EXAM QUESTION PACK

3.1.8.6 MARKET IMPERFECTIONS

SCORE	PERCENTAGE
/342	%

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1. ‘A third runway at Heathrow is essential for the success of the economy of London and the UK.’

‘A third runway at Heathrow would be an environmental disaster and cause huge market failure.’

Explain how an investment project, such as airport expansion, can be commercially successful and yet produce market failure.

[15 marks]

2. ‘The UK’s strong reliance on landfill indicates the existence of widespread environmental market failure’ (**The Global Context Extract B**, lines 16 −17).

Using the data and your economic knowledge, evaluate alternative methods of correcting market failure arising from waste disposal.

[25 marks]

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3. **THE GLOBAL CONTEXT**

Extract B: The recycling market

Scrap metal dealers are once again touring housing estates in their pick-up trucks obtaining steel and other metals from householders. Increased demand for steel and other metals on world markets has led to a change in the fortunes of these dealers, who are price takers.

Recycling has become a global activity. In 2009, with gold selling internationally at well over $1000 an ounce, there were TV adverts from companies wanting to buy unwanted jewellery. A mobile phone also contains tiny traces of precious metals which can be extracted profitably from the millions of phones discarded each year. This is done at large processing centres, usually near sea ports, and much of the recovered material is exported to factories in China. The Olympic stadium in Beijing, China, was built almost entirely using recycled steel.

Germans, Scandinavians and Canadians are used to sorting their rubbish into different coloured bins. But instead of matching the recycling rates achieved in some countries, the UK still dumps many potentially useful materials. These include plastics, glass, paper and metals, which are buried in landfill sites partly because there are insufficient market incentives for recycling. The UK's strong reliance on landfill indicates the existence of widespread environmental market failure. Landfill creates greenhouse gases, threatens to pollute water sources and wastes scarce resources.

Some critics suggest that it would be better for the UK to aim at waste reduction, eliminating unnecessary packaging and other 'bads' at the production and retail stages. The UK pressure group *Waste Watch* also suggests more reuse, for example encouraging people to buy second-hand clothes from charity shops. However, other methods, such as returnable milk bottles, are in sharp decline.

There are now landfill taxes and regulations which provide incentives for recycling. Households could face the prospect of fines for breaking 'bin-bag rules'. However, this may lead to unintended consequences such as illegal dumping of waste. *Waste Watch* wants national targets and other policies to promote composting because, by weight, garden and kitchen waste make up the majority of material sent to landfill. *Waste Watch* also suggests increasing the landfill tax each year and extending it to cover incineration and other waste-disposal methods.

Recovery is a further option. In less developed countries, some homeless people live on city rubbish dumps making a living from what they can find and sell. In the UK, market conditions are such that the metal in a 2p coin is now actually worth 3p. Some experts even predict that within ten years it will be economic to excavate landfill sites to 'mine' the tin cans and other scrap materials that have been buried there.

Source: news reports, 2009−10

4. Discuss whether markets alone can be relied upon to reduce the problems of environmental pollution.

[25 marks]

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5. In August 2011, the UK Secretary of State for Culture said that while there were many local television stations broadcasting in the USA, they did not exist in the UK due to 'market failure'. He proposed a subsidy of £40m from public funds to help create stations which would then be financed by advertising.

Evaluate the view that attempts by governments to eliminate market failure by intervening in markets for public goods and merit goods will inevitably lead to government failure.

[25 marks]

6. 'Imperfect information may lead to market failure.'

Explain how imperfect information may result in the failure of markets for merit and demerit goods.

[15 marks]

7. 'In future, many young British people will have to adopt the German tradition of renting rather than buying, unless they eventually inherit a house from their parents. This has major implications for many aspects of the economy, including the mobility of labour and the distribution of wealth.' (**The European Union Context Extract F**, lines 17−20)

Should government intervene in the UK housing market, for example using subsidies, or leave the provision of housing to market forces? Using the data and your knowledge of economics, justify your answer.

[25 marks]

8. 'Most consumers know, more or less, when and why they are likely to want to replace a TV set or mobile phone. Nobody really knows in advance when or why they might need to go into hospital for a new knee-cap or hip joint.'

Discuss whether economic welfare would necessarily be increased if the provision of merit goods and public goods were always left to governments without ever involving markets.

[25 marks]

9. **THE EUROPEAN UNION CONTEXT**

Extract F: Housing and inequality

The EU Commission has said: 'Decent housing at an affordable price in a safe environment is a fundamental need and right. Ensuring this need is met, which is likely to alleviate poverty and social exclusion, is still a significant challenge in a number of European countries.' Housing inequality can result in part from income inequality and can, in turn, help cause wealth inequality. Most houses are bought using mortgages which are issued by banks and building societies on the basis of income. The UK's 'Right to Buy' policy, dating from the 1980s, makes a one-off redistribution of wealth from the state to low income families when tenants buy their council houses at a subsidised price. Regional and international differences enable some house owners to convert their housing assets into other forms of wealth. For example, someone who sells a former council house they have owned for 30 years in south-east England might release enough profit to be able to purchase a similar house in north-west England, or even two houses in Bulgaria, while still having cash left over.

In most EU countries, 'austerity' pressures on public finances can be expected to cause a further withdrawal by government from a direct role in housing. The financial crash of 2007 was made worse in Europe by excessive property speculation, particularly in the UK, Ireland and Spain. In future, many young British people will have to adopt the German tradition of renting rather than buying, unless they eventually inherit a house from their parents. This has major implications for many aspects of the economy, including the mobility of labour and the distribution of wealth. Moreover, in 2013, a government 'Help to Buy' scheme, intended to assist first-time buyers with their deposits, has also subsidised would-be landlords buying property to rent out. Yet the UK remains short of social housing and affordable private housing.

Source: News reports, 2014

10. Sony, one of the largest electronics and entertainment companies in the world, started out as a two-man operation in a back-yard garage. Facebook, now a huge global company, was created by two college students to enable their circle of friends to communicate with each other.

Since economies of scale give major advantages to large firms, is there any future, without government intervention, for small firms in a global economy? Justify your answer.

[25 marks]

11. 'Most consumers know, more or less, when and why they are likely to want to replace a TV set or mobile phone. Nobody really knows in advance when or why they might need to go into hospital for a new knee-cap or hip joint.'

Explain why imperfect information might lead to market failure in the case of merit goods and demerit goods.

[15 marks]

12. '75% of British workers had no idea of the importance of the EU in creating and guaranteeing many key rights at work' (**Extract F**, lines 5 – 7).

Evaluate, using the data and your knowledge of economics, whether governments should attempt to influence aspects of the labour market such as wage levels, wage differentials and working conditions, or whether such matters should be left to market forces.

[25 marks]

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13. During 2015, the European Commission investigated allegations that people booking at Disneyland Paris, and on the cruises of some shipping lines, paid substantially different prices for the same holiday. British and German customers appear to have paid more than French customers.

Evaluate the view that price discrimination is always good for producers and bad for consumers, and should therefore be banned by regulators such as the EU Commission.

[25 marks]

14. In 2018, the UK Government will impose a new tax on sugary drinks, aimed at tackling obesity. Behavioural economists believe that taxation alone is unlikely to be very effective in reducing consumption. By 2050, obesity is predicted to affect 60% of adult men, 50% of adult women and 25% of children. It is associated with a range of health problems including type 2 diabetes, cardiovascular disease and cancer.

Evaluate the view that imposing a tax is the most effective government policy for reducing the market failures arising from overconsumption of unhealthy food and drink.

[25 marks]

15. Immobility of labour may lead to a misallocation of resources and market failure because

A a change in the pattern of demand results in structural unemployment. ⬭

B the education and training needed to reduce labour immobility is a public good. ⬭

C the government's target for the rate of inflation is too high. ⬭

D the immobility of factors of production is a negative externality in production. ⬭

[1 mark]

16. In December 2018, the Competition and Markets Authority (CMA) announced a range of policies to prevent firms charging existing customers more than new customers. Firms supplying financial services, mobile phones and broadband are no longer allowed to discriminate against loyal customers renewing their contracts.

Explain why imperfect information can lead to market failure.

[15 marks]

17. In 2018, the UK Government will impose a new tax on sugary drinks, aimed at tackling obesity. Behavioural economists believe that taxation alone is unlikely to be very effective in reducing consumption. By 2050, obesity is predicted to affect 60% of adult men, 50% of adult women and 25% of children. It is associated with a range of health problems including type 2 diabetes, cardiovascular disease and cancer.

Explain why, in a free market, sugary drinks may be overconsumed.

[15 marks]

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18. Which one of the following provides a reason for government intervention in a market?

A Firms in an oligopolistic market may limit price competition. ⬭

B Market failures can only be corrected by using regulations. ⬭

C Monopolistically competitive firms earn abnormal profits in the long run. ⬭

D Public goods are excludable and rival. ⬭

[1 mark]

19. **Extract B** (lines 4-6) states that 'banks do not feel enough pressure to compete on price or quality, leading some to call for the Big Four to be split into a number of smaller banks.'

Use the extracts and your knowledge of economics to assess the view that the government should intervene further in the banking sector to promote greater competition.

[25 marks]

20. According to Public Health England, poor air quality is the largest environmental risk to public health in the UK. In particular, diesel cars are estimated to be responsible for 40 000 premature deaths each year. In response, the Government announced in 2017 that it would ban the sale of new petrol and diesel cars by 2040.

Explain why the use of petrol and diesel cars may be a source of market failure.

[15 marks]

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