AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



EXAM QUESTION PACK

3.1.8.9 GOVERNMENT INTERVENTION IN MARKETS

SCORE	PERCENTAGE
/1206	%

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1. **INVESTIGATION**

Scenario

You are an economist working for the Ministry of Housing, Communities and Local Government (MHCLG).
You have been asked to investigate the state of the UK housing market.
As part of this investigation, you are to provide answers to three questions.

Referring to the **Extracts A**, **B**, **C** and **D**, use them and your knowledge of economics to help you answer this question.

After considering **Extract E**, and the original evidence in Extracts **A**, **B**, **C** and **D**, would you recommend that the Government should increase its spending on housing? Justify your recommendation.

[25 marks]

2. 'In tackling environmental problems there is not really a straight choice between perfectly performing markets on the one hand, and wonderfully wise governments on the other.' (**Extract C**, lines 18 – 19).

Using the data and your knowledge of economics, assess the relative importance of market forces and government intervention in encouraging businesses to behave responsibly towards the environment.

[25 marks]

3. 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]

4. 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]

5. 'The UK government would be happy with state control of British railways "as long as it's not the British state"' (**Extract C**, lines 19 – 21).

Evaluate, using the data and your knowledge of economics, the case for and against the UK government privatising public services while allowing foreign ownership of these services.

[25 marks]

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6. ‘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]

7. ‘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]

8. 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]

9. Attempts by governments to equalise incomes are well-intentioned but counter-productive. They destroy incentives for people to lift themselves out of poverty.

To what extent can the problem of poverty in the UK be solved through the operation of market forces? Justify your answer.

[25 marks]

10. 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]

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11. 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.

Assess the view that regulation is a better policy for dealing with the problem of air pollution than the allocation of property rights or taxation.

[25 marks]

12. **Extract E** (lines 14–16) states that 'The market economy is not going to create the jobs by itself for those workers who are most affected by the change.'

Extract F (lines 4–5) states that 'taxing productivity-enhancing tools like robots or machines makes no economic sense.'

Use the extracts and your own knowledge of economics to evaluate whether governments should allow markets to respond freely to the opportunities and challenges presented by technological progress, without any state intervention.

[25 marks]

13. **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]

14. 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]

15. **Extract B** (lines 16–18) states that, 'Gig economy defenders claim that today's flexible labour markets offer modern workers the opportunity to move freely between jobs and this gives them more choice over their working hours.'

Assess the view that government intervention in the UK labour market is necessary to protect the interests of people who are working in the gig economy.

[25 marks]

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16. **INVESTIGATION**

Scenario

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Referring to the **Extracts A**, **B**, **C** and **D**, use them and your knowledge of economics to help you answer this question.

Explain the likely causes of the main changes in house prices that have taken place between 2007 and 2017.

[15 marks]

17. 'Each time the Government imposes a minimum price or wage, the result is almost always excess supply. What matters is the extent to which this is a problem.'

Discuss the view that a national minimum wage is beneficial for an economy.

[25 marks]

18. 'Each time the Government imposes a minimum price or wage, the result is almost always excess supply. What matters is the extent to which this is a problem.'

Explain how the impact of a minimum price for a good or service is affected by its price elasticity of demand and its price elasticity of supply.

[15 marks]

19. For a long time, supermarkets and other commercial firms have understood the benefits of behavioural economic concepts such as choice architecture and framing. The public sector has been slow off the mark, but at last governments are now taking advantage of the opportunities provided by nudging.

Using examples to illustrate your answer, assess the usefulness of behavioural economic theory compared to traditional economic policies in helping governments to correct market failures.

[25 marks]

20. Using the data in **Extract D** (Figure 1), calculate the amount of government funding per £ of passenger income in the UK rail industry for the year 2015–16. Give your answer correct to the nearest penny.

[2 marks]

21. **Extract F** (lines 9–10) suggests that 'the British public really don't care about who runs the trains; what they care about is reliability, comfort and price.'

Use the extracts and your knowledge of economics to evaluate the case for renationalising railways in the UK.

[25 marks]

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22. **Extract C** (lines 17–19) states: ‘Many environmental economists suggest that making firms pay for the costs of landfill associated with their products, or taxing raw material inputs, will be necessary to ensure a sustainable future for all.’

Using the extracts and your knowledge of economics, evaluate policies, if any, that governments in developed countries should pursue to reduce waste and encourage the recycling of waste products.

[25 marks]

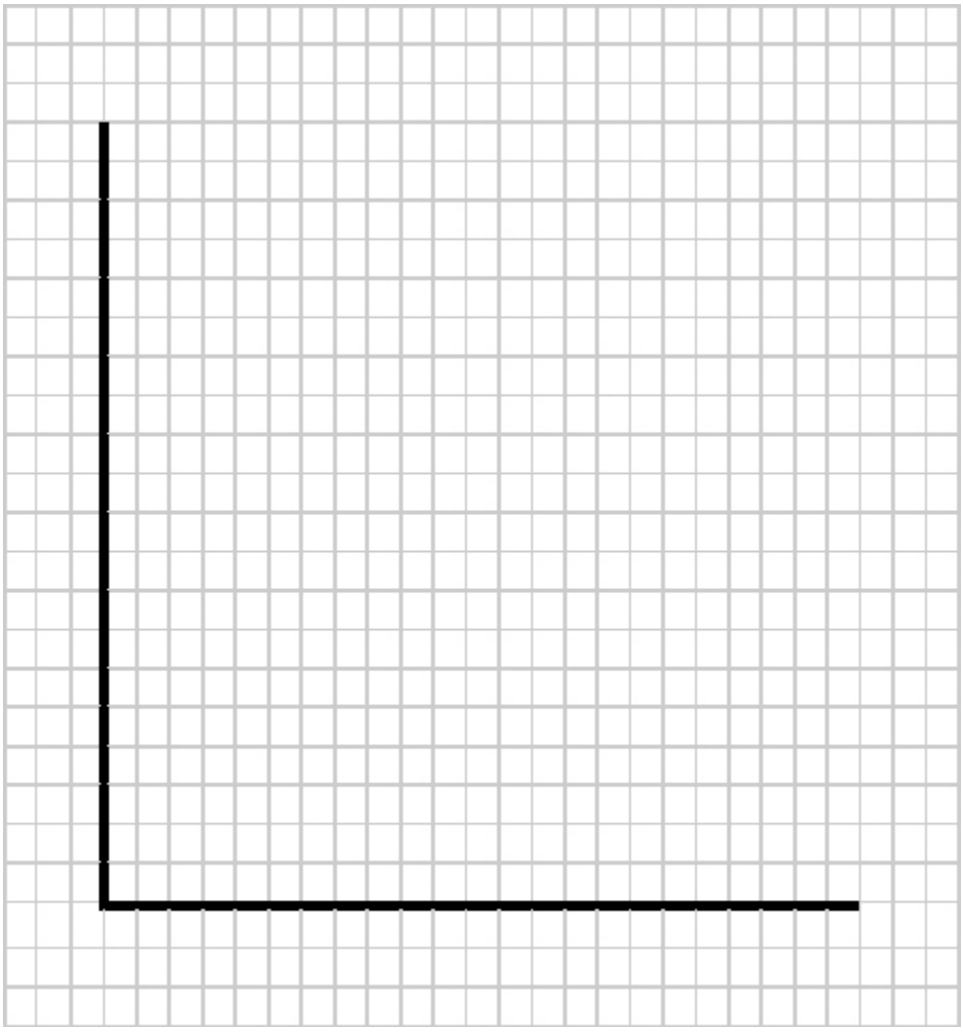
23. **Extract C** (lines 14–15) states that ‘Rising prices will eventually also force builders in developing countries to explore alternatives to sand.’

Use the extracts and your knowledge of economics to assess the view that the increasing scarcity of sand is a problem best solved by market forces, rather than through government intervention.

[25 marks]

24. **Extract C** (line 20) states: ‘Perhaps a maximum price should be set for water’.

Draw a diagram to show the impact on the market for water of setting a maximum price below the equilibrium.



[4 marks]

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25. After considering **Extract D**, and the original evidence in **Extracts A**, **B** and **C**, would you recommend that the UK government provides financial and other support to companies involved in the production of commercial aircraft? Justify your recommendation.

[25 marks]

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1. Assess the view that wide wage differentials are good for the economy and that governments should therefore play no part in deciding wage rates.

[25 marks]

2. It is ‘difficult to judge whether GM crops will boost productivity to feed the world and create social benefits or cause market failure through monopoly, environmental damage and adverse side effects on human health’ (**The Global Context Extract B**, line 38–40).

Using the data and your economic knowledge, evaluate the view that the UK Government should support the production and use of GM crops.

[25 marks]

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3. THE GLOBAL CONTEXT

Extract B: Diminishing returns and food production

The British political economist Thomas Malthus (1766-1834) argued that because cultivatable land is in fixed supply, food production is subject to the law of diminishing returns and cannot keep pace with population growth. Technological improvements and international trade have meant that his gloomy predictions of famine and drought have largely been avoided, certainly for industrialised countries like the UK. Now that the world has more than 6 billion people, predicted to rise to 9 billion by 2050, there is a worry once again that diminishing returns will set in. Some estimates suggest that the world's undernourished could soon number over a billion people.

Genetically modifi ed (GM) crops are seen by some experts as providing a way around the problem of diminishing returns. Supporters of GM technology claim that by developing crops that are resistant to disease, drought, salty soil and flooding, more land can be cultivated and existing farmland used more efficiently. The result is improved agricultural productivity. They also claim that private goods like rice and tomatoes can be turned into merit goods by being modifi ed to contain vaccines or cures for diseases.

Anti-GM groups have mounted high profile campaigns against what the media have called 'Frankenstein foods'. In response, the British frozen food chain Iceland decided that there was a competitive advantage in announcing that all of its products would aim to be GM-free and the major British supermarkets quickly followed. Meanwhile, the UK Government's official position is that it has an open mind, and that its priority is to protect human health and the environment while being 'pro-consumer choice'. In the USA, the 'choice' argument has been undermined by the view that foods containing GM products need not be labelled as such.

Can GM crops really guarantee 'food security'? Critics claim that a lack of spending power, not food supply, is the real problem, with poor people in failing economies often starving in front of full stores and granaries. They also claim that GM crops cause negative externalities. For instance, their pollen can contaminate the crops of nearby organic businesses. Also, most GM crops are developed for resistance to weed-killers and pesticides, and this encourages farmers to use more chemicals, killing wildlife and reducing biodiversity. Furthermore, there are fears that eating GM foods might have long-term risks to human health which have yet to be fully investigated.

Regulations in Europe are so strict that it costs a seed manufacturer at least ten times as much to develop a new GM crop than a conventional crop. This means that only big companies can afford to develop them. Globally, the American company Monsanto controls the seeds on over 80 per cent of the world area of planted GM crops. Furthermore, Monsanto bans 'seed saving'. It uses patent laws to sue farmers if they save seeds for planting, rather than buying new seeds every year.

Almost every single piece of evidence on each side of the debate is contested, making it difficult to judge whether GM crops will boost productivity to feed the world and create social benefits or cause market failure through monopoly, environmental damage and adverse side-effects on human health.

Source: news reports, 2008 / 9

4. ‘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]

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

[25 marks]

6. Using the data and your economic knowledge, evaluate the view that mergers, such as the one proposed between *British Airways* and *Iberia Airlines*, are usually ‘good for consumers as well as for the companies involved’ (**The European Union Context Extract D**, lines 22−23).

[25 marks]

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7.

THE EUROPEAN UNION CONTEXT

Extract D: *British Airways and Iberia Airlines*

Until about twenty years ago, most European countries had at least one large 'national carrier' airline which was in public ownership. When airlines were privatised, there were fears that a state-owned monopoly would simply become a private monopoly. On some routes, de-regulation took some time and it was not until 2008 that the 'Open Skies' agreement sought to eliminate anti-competitive practices among airlines flying from Europe to North America. These anti-competitive practices included denying smaller airlines the opportunity to rent landing slots (landing spaces) at major airports.

In the face of greater competition from smaller, more innovative airlines such as *Virgin Atlantic* and the low-cost carriers such as *easyJet*, there has been increasing collaboration between some of the larger, traditional companies. *British Airways (BA), Iberia Airlines (Spain) and American Airlines (AA)*, together with five other airlines, belong to *One World Alliance*, an arrangement which enables member airlines to sell seats on each other's flights.

With *BA* reporting a pre-tax loss of £401m in May 2009, its Chief Executive proposed a 'tie-up' with *Iberia* and *AA* which would come closer to a full-blown horizontal merger, enabling not only the marketing of flights but also joint pricing and a sharing of revenues. The proposal needed to be cleared by both EU and US anti-monopoly authorities, but it quickly failed when the European Union's Competition Commissioner objected, mainly on the grounds that it would raise prices and reduce consumer choice.

In October 2009, two European members of *One World Alliance, BA* and *Iberia*, tried again to reach a preliminary agreement for a full merger which they aimed to complete in late 2010. They claimed that a merger would be good for consumers as well as for the companies involved because duplicated European routes could be rationalised, while the routes operated in North America by *BA* and in South America by *Iberia* were complementary rather than competitive. The merger would need to be approved by the European Commission but there was a precedent because, in 2004, *Air France* was allowed to merge with Dutch airline *KLM*.

The merger between *BA* and *Iberia* would create Europe's biggest airline. Critics raised concerns about the new company's market share and claimed that *BA*'s dominance at Heathrow Airport would increase to even more than its existing 44% of landing slots. Meanwhile, both *BA* and *Iberia* workers were planning strikes over cost-cutting proposals and pay offers.

Source: news reports, 2009

8.

Explain the term 'public ownership' (**The European Union Context Extract D**, line 2) **and** analyse **two** economic reasons that could be used to support public ownership of industries such as airlines.

[9 marks]

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9. ‘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]

10. ‘…given the activities with which it is involved, there are commercial and wider economic and social arguments against a body such as the MHPA being privatised’
(**The Global Context Extract B**, lines 12–14).

Using the data and your economic knowledge, do you agree with the view that enterprises such as the MHPA should be privatised? Justify your answer.

[25 marks]

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11.

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

12.

An oligopolistic firm is trying to decide on the selling price and output of its product, and is also considering colluding with other firms in the industry.

Evaluate policies which a UK government could use to control the activities of oligopolists.

[25 marks]

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13.

THE GLOBAL CONTEXT

Extract B: Climate change

In 2004, Russia signed up to the Kyoto Protocol, an international agreement on policies to manage climate change. This committed Russia to a United Nations programme to reduce emissions of greenhouse gases. In 2010, Russia's emissions were as low as their 1990 levels, but this was less to do with environmental policy and more to do with the collapse of heavy industry following the fall of the Soviet Union. A large contribution towards the UK's Kyoto targets also came from deindustrialisation. However, China, like the USA, did not sign up to the Kyoto Protocol.

International action to control carbon emissions is necessary. One policy is known as 'carbon trading'. Countries agree overall emissions limits and try to create an international market for permits to pollute. The idea is to put a money value on emissions and, over time, to create incentives for businesses to invest in less-polluting technology. As well as the large compulsory 'compliance' market for carbon credits, there is also a smaller voluntary market for 'carbon offsets'.

For example, an organisation can be paid to plant trees to allegedly offset the damage that an airline journey does to the ozone layer. Some companies are using these offsets, together with greater energy efficiency and reduced polluting activities, to claim to be 'carbon neutral'. Some environmentalists are suspicious of offset schemes and claim, for instance, that offset schemes have hidden environmental costs.

Some economists argue that the pollution and depletion of communal resources such as clean air, water reserves and fish stocks are made worse by a lack of property rights. Critics say that carbon trading amounts to 'privatisation of the atmosphere', with property rights in this vast new market being grabbed by speculators or by those who already pollute the most. They also claim that activities such as buying credits from Russia are an 'accounting fraud' because they do not necessarily arise from energy efficiency but from the collapse of heavy industry. There is concern that carbon trading is a further blow to manufacturing and that service industries are treated more leniently. If the UK relies on manufactured imports, it can be argued that factories located in China are actually creating UK emissions.

Some major UK businesses appear happier with permit trading than with alternative policies such as quotas on emissions or the taxation of fuel. There is a suspicion that carbon trading might mislead the public into believing that pollution from airlines and other industries is no longer damaging. Governments are accused of being overgenerous in allotting permits to industries that they see as nationally important, such as car manufacturing and electricity generation. While the UK might reduce its domestic demand for carbon, it continues to contribute to the world supply of fossil fuels through activities such as oil prospecting and opencast mining. Russia, China and less-developed countries with coal reserves show few signs of reducing their output of this form of carbon.

Source: news reports, 2010

14.

Explain what is meant by 'property rights' (**The Global Context Extract B**, line 20) **and** analyse how an absence of property rights can worsen the environmental market failures of **both** pollution **and** the rapid depletion of natural resources.

[9 marks]

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15. Which combination of example and policy, **A**, **B**, **C** or **D**, is most likely to be consistent with the source of market failure identified?

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

[1 mark]

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16. THE GLOBAL CONTEXT

Extract B: Supplying the energy market: the case of Milford Haven

For hundreds of years, the harbour of Milford Haven in West Wales has responded to changes in the global economy. It has accommodated many global activities, including trade, defence, transport and tourism. These activities are often in potential conflict with the environment. Although it is surrounded by the Wales coastal footpath and the *Pembrokeshire National Park*, Milford Haven contains two massive oil refineries, several leisure marinas, an international car ferry port and quays for what little remains of the West Wales fishing industry.

Milford Haven Port Authority (MHPA) is a nationalised enterprise, accountable to the *Department of Trade and Industry* in London. Ports have often developed historically as 'public works' due to their strategic importance and because of the large amount of investment needed to build port installations. Governments are trying to reduce the size of the public sector in order to improve efficiency and competition. However, given the activities with which it is involved, there are commercial and wider economic and social arguments against a body such as the MHPA being privatised. For example, the MHPA has argued that privatisation would reduce its ability to take part in infrastructure projects in public-private partnerships. These partnerships involve a variety of companies and government bodies at local, regional, national and international levels.

A major strategy adopted by the MHPA involves anticipating and reacting to changes in the global energy market. The boom years of North Sea oil and gas, which created high wages in skilled jobs for northern ports such as Aberdeen, are drawing to a close. Global oil and gas markets are often concentrated markets. For this reason, as well as for reasons of ensuring security of supply, new sources such as biofuels and other diverse forms of energy are being sought.

The MHPA, together with the UK government, has negotiated a long-term deal with the government of Qatar in the Arabian Gulf for the supply of liquefied natural gas (LNG). This is sent to Milford Haven in refrigerated container ships and then stored in huge tanks at the port. When the gas is warmed up, it expands to 600 times its liquefied volume. The gas is sent through a new pipeline to a pumping station 150 miles away in Gloucestershire. It is then distributed into the UK national grid for industrial and domestic use. This is an example of a public-private partnership in action.

The distribution of fuels such as gas and oil involves some negative externalities. There was controversy when the new pipeline was laid through attractive Welsh countryside, including the *Brecon Beacons National Park*. Some 15 years ago, the oil tanker *Sea Empress* sank near the entrance to Milford Haven and it took the local economy several years to recover from the environmental impact of the resulting pollution. Given the recent environmental experiences of BP in the Gulf of Mexico, environmentalists are concerned about the possibility of some sort of disaster arising from the storage or movement of LNG.

There are also concerns about the UK's possible over-reliance on a single product (LNG) from a monopoly source (the state of Qatar) and a single distribution channel (the Pembroke-Gloucester pipeline). Supporters of the MHPA strategy claim that the LNG business actually aids consumer choice and competition through diversification, adding gas installations to the existing oil and renewable energy installations in and around the port. The MHPA states that safety and the prevention of environmental incidents are the 'most important priorities' of their business.

Sources: news reports and industry information, 2010

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17. ‘Many ideas in the UK for coping with rising health care costs are imported from other EU countries’ (**The European Union Context Extract F**, lines 1 and 2).

Using the data and your economic knowledge, assess whether the UK Government should encourage greater use of market forces in the provision of health care.

[25 marks]

18. In recent years, the EU has decided that the agricultural sector must become ‘more responsive to market forces’ (**The European Union Context Extract F**, line 12).

Using the data and your economic knowledge, discuss whether UK farming would benefit from greater responsiveness to market forces and less intervention by the UK government and the EU.

[25 marks]

19. ‘The supply and use of water result in many externalities, both positive and negative’ (**The Global Context Extract B**, line 16).

Using the data and your economic knowledge, evaluate UK government policies that could be used to deal with problems associated with the supply and use of water.

[25 marks]

20.

THE EUROPEAN UNION CONTEXT

Extract F: UK health reforms

Many ideas in the UK for coping with rising health care costs are imported from other EU countries. For example, in 2002, the Labour Government introduced the idea of ‘Foundation Trust Hospitals’, which had been tried in Spain. These not-for-profit organisations are able to set their own clinical and financial priorities and have greater freedom to borrow money, invest their surpluses, and form public-private partnerships. Meanwhile, in Spain, some doctors were complaining that their newly formed Foundation Hospitals had fewer beds, fewer staff and more complaints from patients than before. Some hospitals were returned to their former status because they were said to be bureaucratic, inefficient and ‘cherry-picking’, that is choosing the easiest patients to treat.

During 2011 and 2012, the UK Coalition Government legislated for NHS reforms, promoting the idea of an ‘internal market’ in health provision, with local doctors working in groups to buy hospital services on behalf of their patients. In February 2012, a hospital in East Anglia was the first in the NHS to be taken over by a private company, which hoped to clear the hospital’s £45m debts and make it ‘profitable’ by ‘competing’ for patients with neighbouring hospitals.

21. A government has a policy of reducing taxes on income while increasing taxes on spending, such as Value Added Tax (VAT).

Distinguish between equity **and** equality and explain the effects of this government policy on both equity **and** equality.

[15 marks]

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22. THE GLOBAL CONTEXT

Extract B: Water, water everywhere

Access to clean water is closely linked to production, income and wealth, both within and free good. However, only a small proportion can be used to support human life and even this is not freely available to all.

As underground water levels drop in industrialised countries, and as waterways become polluted, some places, like southern Spain, are desperately short of water. Meanwhile, poorer countries, such as Bangladesh, sometimes suffer from too much water, with sudden disastrous floods. Unlike developed countries, such as the Netherlands, they cannot afford flood defence infrastructure. In Kenya, people living in villages without drinkable water can see irrigation systems in nearby fields spraying water over vegetables and flowers being grown for export to Europe.

There are problems with property rights to water. Indeed, some experts have predicted that, during the twenty-first century, countries controlling the world's fresh water supplies will be in a similarly powerful position to that of the twentieth century's oil producers, and that wars might even take place because of disputes over water.

The supply and use of water result in many externalities, both positive and negative. One-third of the water used by UK households is flushed down the toilet. The water used to carry human waste through sewers has to be kept separate from drinking water. When the water industry was privatised by the UK Government, shares were sold in 'water and sewerage businesses', and these companies were regulated by OFWAT (The Water Services Regulation Authority) for their commercial activities as regional monopolies, and by the Environment Agency for their wider impact such as the extraction of water from rivers.

In recent years, several regions of the UK have repeatedly been declared to be suffering from 'drought', and there has been some debate over which policy responses are appropriate. These include hosepipe bans, metering of water supplies, a national 'grid' for transporting water around rivers and canals, and more reservoirs. The privatised companies have made massive investment in infrastructure which has transformed polluted rivers such as the Wandle, near London, from open sewers into trout streams, but further measures are necessary to prevent annual droughts.

23. **THE GLOBAL CONTEXT**

Extract B: Poverty and age

The UN estimates that half the children in the world live in poverty. The 40 poorest countries in the world contain 500 million people who share a total annual income which is less than the total personal wealth of the 40 richest people in the world.

When measuring poverty within countries, economists generally use an indicator of relative poverty. In the UK, government statisticians generally view people as being 'at risk of poverty' if their household disposable income after housing costs is less than 60% of the average. Politicians in the UK often focus on child poverty, because children from poor families are likely to grow into poor adults, and remain poor into old age. In 1999, the then Prime Minister, Tony Blair, promised to eliminate child poverty by 2020. In 2012, the Office for National Statistics (ONS) reported that relative poverty, as measured by the gap between a family's income and the national average, had fallen since 2008. However, this was likely to be because people in the middle had become worse off, rather than the poorest becoming better off. People aged 18 to 24 saw their risk of poverty rise, due to rising unemployment among that age group. However, it is not necessary to be unemployed to be poor. It has been said that some UK government benefits, such as tax credits, subsidise low wages paid by employers to many workers whose jobs are essential but may require few specialist skills. Training schemes and minimum wage legislation are among government policies aimed at reducing the number of 'working poor' in the labour market.

Sources: news reports, government statistics, 2013

24. '…any negative economic effects of trade unions are outweighed by the positive effects of trade union activities on wages, discrimination and exploitation' (**The Global Context Extract C**, lines 21–23).

Using the data and your economic knowledge, evaluate whether governments, such as those of the UK or China, should intervene in labour markets to increase trade union membership.

[25 marks]

25. '…children from poor families are likely to grow into poor adults, and remain poor into old age' (**The Global Context Extract B**, lines 7−8).

Using the data and your economic knowledge, evaluate whether it is better for the UK government to reduce poverty by using policies to improve people's ability to earn higher wages during their working lives, rather than through the provision of state benefits to those who are poor for various reasons.

[25 marks]

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26. THE GLOBAL CONTEXT

Extract C: *Walmart* and China

Some global companies are willing to negotiate with trade unions, whilst others try to avoid them. US company *Walmart*, the world's largest retailer and owners of *Asda* in the UK, has been known to stop operating in some countries rather than have to recognise unions.

With over a billion people and rising prosperity, China is an irresistible market for the world's largest manufacturers, distributors and retailers. Some of these large companies, such as Walmart, *McDonald*s and *FedEx*, have adopted an anti-union stance in the countries in which they operate.

In China, however, *Walmart* has signed 'collective bargaining' agreements with the *All-China Federation of Trade Unions* (ACFTU). The Federation has 193 million members and is a monopoly, given that no other trade unions are allowed to operate in China. Officially, signing the agreement was a voluntary action on *Walmart*'s part. However, firms which refuse to sign such agreements are likely to face many difficulties in gaining access to Chinese markets. *Walmart* gets a say in the appointment of the trade union Chairman at its workplaces. This official invariably has close links with the Chinese government. So now, if *Walmart*'s management in China wants to close stores, lay off employees, change workloads or amend working hours, it must consult ACFTU. In effect, this gives the Chinese government a say in the running of the business.

ACFTU discourages strikes at a time when working conditions in China have come in for international criticism. ACFTU has also been accused of failing to represent its members properly because the Chinese government prefers to promote business investment and business growth at the expense of workers' rights. However, there is a view that any negative economic effects of trade unions are outweighed by the positive effects of trade union activities on wages, discrimination and exploitation. For this reason, it is argued, the UK government should encourage businesses, wherever they operate in the world, to engage fully with trade unions.

Source: news reports, 2011

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27. THE EUROPEAN UNION CONTEXT

Extract F: The EU milk market

Over recent decades, the governments of most industrialised countries have intervened in their agricultural markets to offer support through subsidies and other measures. In Europe, agriculture employs less than 5% of the workforce, while agricultural intervention has traditionally taken about 50% of the EU budget.

Aimed at limiting state spending on the dairy sector, controlling milk production, and stabilising both milk prices and producer incomes, the EU introduced a milk quota system in 1984 as part of the Common Agricultural Policy (CAP). Milk quotas place a limit on the amount of milk that a farmer can sell every year without paying a 'levy' or penalty to the EU. The CAP has forced dairy farmers to work below capacity and even to dump milk, damaging the EU's reputation for economic efficiency.

The EU plans to end milk quotas in 2015 and wants agriculture to be less influenced by government intervention and more responsive to market forces. As quotas are removed, farms might be expected to become fewer, larger and more intensive. In Spain, for example, the industry has been allowed three times as much milk output since 1993, while the number of dairy farms has fallen drastically and productivity has risen. Meanwhile, like the UK government, the Spanish government has intervened to try to negotiate new pricing contracts between farmers, food processors and retailers. There is always a risk that government intervention in such negotiations in any market can adversely affect efficiency.

Sources: news reports and government information, 2012

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28.

THE GLOBAL CONTEXT

Extract C: Pensions and poverty

A major factor in tackling global poverty is the provision of adequate pensions. According to the think tank, Pensionwatch, four out of five older people around the world have no access to a pension, with many millions living in poverty or working well into their old age. Around 80 countries have some form of state pension which gives a basic income in old age.

An important question is whether individuals should take responsibility for their old age by choosing to contribute to a scheme provided by the state, or an employer, or via the insurance industry. Only a few wealthier countries also have a basic 'universal' state pension, financed from general taxation rather than contributions. These have a cost to the taxpayer but they reduce the social costs of old age poverty.

Statisticians can make long-term predictions of population changes and yet many private and public sector pension schemes are in crisis as countries are faced with ageing populations and rising levels of national debt. This can be seen as government failure, caused by poor forward planning. There has also been some market failure. For instance, due to the selling of inappropriate insurance-based private pension schemes, and a significant fall in the value of pensions being provided by even the better schemes, many consumers have lost trust in the private sector pensions industry.

It could be that many people are simply too poor to be able to afford to save, or it might be that people often prefer current consumption over future consumption. This form of market failure could be tackled by the government imposing a high rate of compulsory pension saving, as in Chile and Singapore. There was a small step in this direction in the UK in 2012 when the government launched 'auto-enrolment', an occupational pension scheme pioneered in Australia and New Zealand where employees are automatically included unless they opt out. While rich countries argue over who should pay for pensions, and by what methods, in poor countries, where pensions are needed the most, they are likely not to exist at all.

Sources: news reports, government statistics, 2013

29.

Explain what is meant by 'market failure' (**The Global Context Extract C**, line 13) **and** analyse **two** reasons why markets might fail to provide adequate pensions.

[9 marks]

30.

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]

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1.

Trade Unions Extract C (lines 21−22) states that '….any negative economic effects of trade unions are outweighed by the positive effects of trade union activities…'.

Using the data in the extracts and your knowledge of economics, evaluate the view that trade unions protect the interests of workers and consequently improve the economic welfare of the society in which they operate.

[25 marks]

2.

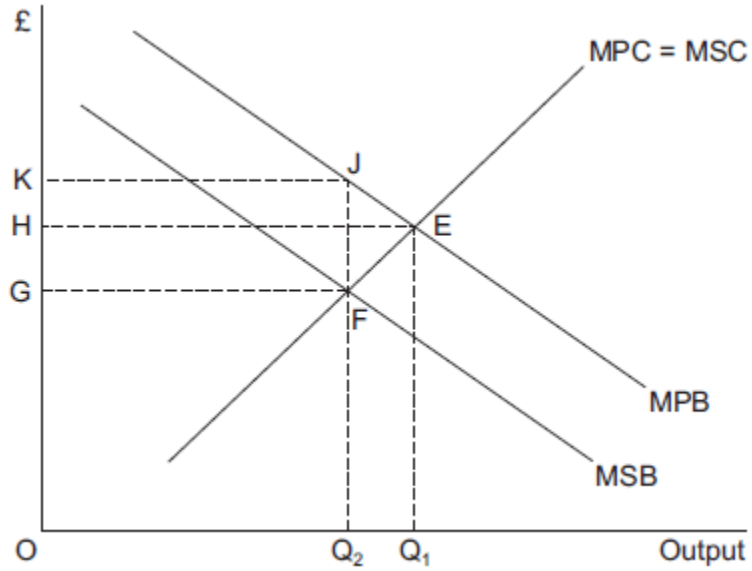
'In future, many young British people will have to adopt the German tradition of renting rather than buying, unless they eventually inherit a house from their parents. This has major implications for many aspects of the economy, including the mobility of labour and the distribution of wealth.' (**The 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]

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3. 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. ⬭

[1 mark]

4. Over the past 35 years, successive governments have reduced taxes on income whilst increasing taxes on spending, such as excise duties and Value Added Tax (VAT).

Assess the economic costs **and** benefits of government action which results in greater inequality in the distribution of income and wealth in the UK.

[25 marks]

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5.

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

6.

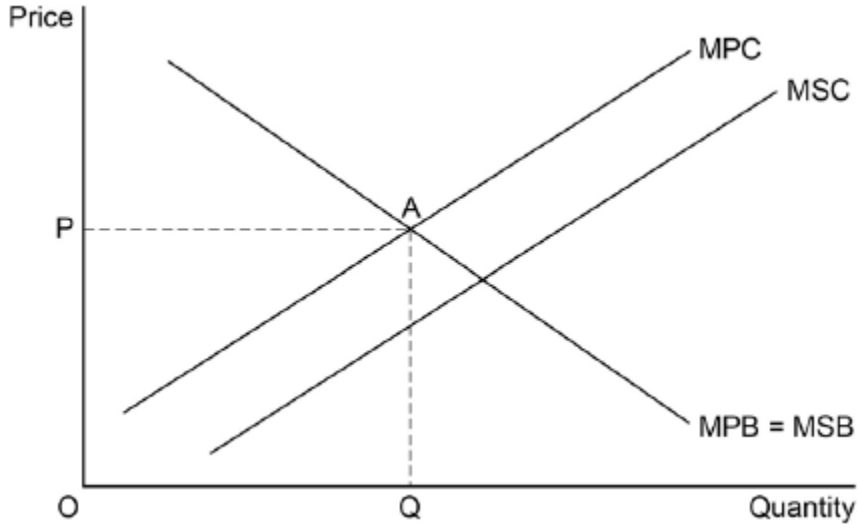
The authors of a report published by the Institute of Economic Affairs have recommended that the NMW for apprentices and under 18 year olds should be abolished and that each region of the UK should have its own minimum wage.

Taking into account the information in **The National Minimum Wage After 15 Years Extract E** and the original evidence, do you support these recommendations? Justify your answer.

[25 marks]

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7. The diagram below shows the marginal private benefit and the marginal social benefit (MPB and MSB) curves and the marginal private cost and marginal social cost (MPC and MSC) curves for good X.



Assuming the free market equilibrium is at point A, what action taken by the government is most likely to lead to output being produced at the socially optimal level?

A Increase in unit taxes on good X ⬭

B Subsidies to the producers of good X ⬭

C Regulation to reduce consumption of good X ⬭

D Issue of permits designed to reduce output of good X ⬭

[1 mark]

8. **The National Minimum Wage after 15 years**

Extract E: The National Minimum Wage: silver bullet or poisoned chalice?

Since its introduction in 1999, the NMW has increased by 75%, whilst average earnings have risen by 61% and the Retail Price Index by 53%. A new report, published by the Institute of Economic Affairs, argues that the NMW should be abolished for apprentices and under 18-year-olds in the UK to tackle persistently high youth unemployment. The rate for 16 and 17 year olds is due to rise to £3.79 per hour in October 2014 and to £2.73 per hour for apprentices. The authors of the report also believe that setting a single NMW is likely to have adverse effects on private sector employment in the regions. In Wales, for example, the NMW is 70% of median hourly earnings in the private sector, compared to just 42% in London. The report recommends that the minimum wage should be regionalised. When determining the minimum wage for each region, differences in productivity and economic conditions should be taken into consideration.

Source: News Reports accessed May 2104

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9. In August 2013, the UK government argued that there needed to be greater competition in energy markets in the UK.

Evaluate the view that if markets can be made more contestable there is no need for further government intervention.

[25 marks]

10. Over the past 35 years, successive governments have reduced taxes on income whilst increasing taxes on spending, such as excise duties and Value Added Tax (VAT).

Distinguish between equity **and** equality and explain the effects of this government policy on the distribution of income.

[15 marks]

11. **Pollution and Climate Change Extract F** (lines 9−10) states 'Some major UK businesses appear happier with permit trading than with alternative policies such as quotas on emissions or the taxation of fuel'.

Using the data in the extracts and your knowledge of economics, evaluate the possible impact on UK businesses of policies to reduce pollution.

[25 marks]

12. **Pollution and Climate Change Extract E** (lines 18-20) states 'They argue that the pollution and depletion of communal resources such as clean air, water reserves and fish stocks are made worse by a lack of property rights'.

With the help of a diagram, explain how the absence of property rights can worsen the environmental market failures of **both** pollution **and** the rapid depletion of natural resources.

[9 marks]

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13. Trade Unions

Extract C: Walmart and China

Some global companies are willing to negotiate with trade unions, whilst others try to avoid them. US company Walmart, the world's largest retailer and owners of Asda in the UK, has been known to stop operating in some countries rather than have to recognise unions.

With over a billion people and rising prosperity, China is an irresistible market for the world's largest manufacturers, distributors and retailers. Some of these large companies, such as Walmart, McDonald's and FedEx, have adopted an anti-union stance in the countries in which they operate.

In China, however, Walmart has signed 'collective bargaining' agreements with the All-China Federation of Trade Unions (ACFTU). The Federation has 193 million members and is a monopoly, given that no other trade unions are allowed to operate in China. Officially, signing the agreement was a voluntary action on Walmart's part. However, firms which refuse to sign such agreements are likely to face many difficulties in gaining access to Chinese markets. Walmart gets a say in the appointment of the trade union Chairman at its workplaces. This official invariably has close links with the Chinese government. So now, if Walmart's management in China wants to close stores, lay off employees, change workloads or amend working hours, it must consult ACFTU. In effect, this gives the Chinese government a say in the running of the business.

Some economists believe that trade unions, by threatening industrial action, can force up wages and make it difficult for management to adopt changes that improve productivity. This, they believe, reduces firms' competitiveness and, in the long run, leads to job losses. However, others argue that any negative economic effects of trade unions are outweighed by the positive effects of trade union activities in counteracting the monopsonistic power of large employers, and in preventing discrimination and exploitation.

Source: news reports, 2011

14. Pollution and climate change

Extract F: Issues over carbon trading

Critics say that carbon trading amounts to 'privatisation of the atmosphere', with property rights in this vast new market being grabbed by speculators or by those who already pollute the most. They also claim that activities such as buying credits from Russia are an 'accounting fraud' because they do not necessarily arise from energy efficiency but from the collapse of heavy industry. There is concern that carbon trading is a further blow to manufacturing and that service industries are treated more leniently. If the UK relies on manufactured imports, it can be argued that factories located in China are actually creating UK emissions.

Some major UK businesses appear happier with permit trading than with alternative policies such as quotas on emissions or the taxation of fuel. There is a suspicion that carbon trading might mislead the public into believing that pollution from airlines and other industries is no longer damaging. Governments are accused of being overgenerous in allotting permits to industries that they see as nationally important, such as car manufacturing and electricity generation. While the UK might reduce its domestic demand for carbon, it continues to contribute to the world supply of fossil fuels through activities such as oil prospecting and opencast mining. Russia, China and less-developed countries with coal reserves show few signs of reducing their output of this form of carbon.

Source: news reports, 2010

15.

Pollution and climate change

Extract E: Climate change

In 2004, Russia signed up to the Kyoto Protocol, an international agreement on policies to manage climate change. This committed Russia to a United Nations programme to reduce emissions of greenhouse gases. In 2010, Russia's emissions were as low as their 1990 levels, but this was less to do with environmental policy and more to do with the collapse of heavy industry following the fall of the Soviet Union. A large contribution towards the UK's Kyoto targets also came from deindustrialisation. However, China, like the USA, did not sign up to the Kyoto Protocol.

International action to control carbon emissions is necessary. One policy is known as 'carbon trading'. Countries agree overall emissions limits and try to create an international market for permits to pollute. The idea is to put a money value on emissions and, over time, to create incentives for businesses to invest in less-polluting technology. As well as the large compulsory 'compliance' market for carbon credits, there is also a smaller voluntary market for 'carbon offsets'.

For example, an organisation can be paid to plant trees to allegedly offset the damage that an airline journey does to the ozone layer. Some companies are using these offsets, together with greater energy efficiency and reduced polluting activities, to claim to be 'carbon neutral'. Some environmentalists and economists are suspicious of offset schemes and claim, for instance, that offset schemes have hidden environmental costs. They argue that the pollution and depletion of communal resources such as clean air, water reserves and fish stocks are made worse by a lack of property rights.

Source: news reports, 2010

16.

Inequality Extract E (lines 6−7) states that ‘growing inequality would create incentives, kick-start enterprise, boost growth and is good for us all’.

Using the data in the extracts and your economic knowledge, assess the view that inequality is ‘good for us all.’

[25 marks]

17.

Government intervention will result in a more efficient allocation of resources if

A it leads to a reduction in the consumption of demerit goods. ⬭

B it leads to a reduction in the subsidies received by firms. ⬭

C it reduces the number of competing firms in an industry. ⬭

D consumers are charged for the provision of public goods. ⬭

[1 mark]

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18. It is generally accepted that we need to adopt new ways of charging for the use of our roads. This is partly because of worsening congestion, but is also due to the reduction in revenue generated from taxes on fuels as a result of more fuel-efficient vehicles.

Assess the view that a system of road-pricing is the best way to tackle the problem of worsening traffic congestion in the UK.

[25 marks]

19. It is generally accepted that we need to adopt new ways of charging for the use of our roads. This is partly because of worsening congestion, but is also due to the reduction in revenue generated from taxes on fuels as a result of more fuel-efficient vehicles.

Explain why, in the absence of government intervention, too many journeys are likely to be made by road and too few by rail.

[15 marks]

20. Traditional economic theory assumes that consumers make rational decisions that maximise their economic welfare, but behavioural economists disagree.

The Government would like to improve the well-being of the population by encouraging people to adopt a healthy diet. Using your knowledge of **both** traditional economic theory **and** behavioural economics, assess alternative policies that the Government might adopt to try to achieve its objective

[25 marks]

21. Explain how the data in **Inequality Extract D** show that taxes and benefits have been successful in reducing inequalities in household income in the UK.

[4 marks]

22. The UK energy market

Extract C: Are price rises inevitable?

Do UK consumers pay too much for energy? Department of Energy & Climate Change research shows domestic electricity prices were fourth lowest and gas prices second lowest in a survey of 15 EU countries. Firms claim profits, averaging a return of 5% in 2012, are not excessive and are used to fund much-needed investment in both infrastructure and future energy supplies.

Will Morris, Group Managing Director of SSE, claims many factors are responsible for driving up prices: "Buying wholesale energy in global markets, delivering it to customers, and government-imposed levies collected through bills all cost more than last year."

Ed Miliband, Leader of the Opposition in the UK, promised that a future Labour government would impose "a price freeze for twenty months because the market is not working", and that the regulator would make the market more competitive.

In the longer term, the UK needs to become less dependent on imported energy and use 'greener' sources such as wind, solar and nuclear. One in five UK power stations will be obsolete by 2023 and there is a risk of power shortages in coming years. The Government guarantees high prices to firms producing energy from renewable and nuclear sources but these costs are then passed on to consumers.

The Government claims that high guaranteed prices for power generators makes good long-term sense. Gas prices are expected to rise over the longer term, despite the discovery of shale gas in the UK. Could more be done to encourage households to reduce their demand for energy? Energy conservation could result in lower bills but few households are making use of the 'Green Deal' scheme to make homes more energy efficient.

Source: News reports, October 2013

23. Inequality

Extract E: In favour of inequality

The way in which society's resources are distributed has long been of major concern to economists, directly affecting as it does the level of social welfare. Changes in the size and distribution of national output raise important questions of efficiency and also involve basic issues of equality. However, what is equitable is a matter of considerable debate amongst economists of different political persuasions.

It has been argued by the supporters of free-market capitalism that growing inequality would create incentives, kick-start enterprise, boost growth and is good for us all. Free market economists would argue that justice automatically arises from the interaction of demand and supply and the existence of competitive markets. In such a scenario, each factor receives what it is worth in terms of the value of its marginal revenue product. Disparities in income and wealth are justified by such factors as greater levels of innate or acquired skills which enable some factors to be more productive than others and earn a greater amount. Differences in the distribution of income and wealth are therefore viewed as inevitable and also desirable in that they provide the necessary incentives for individuals to study, train, supply their factor services and set up new businesses. These differences help the smooth operation of the price system and lead to an efficient resource allocation.

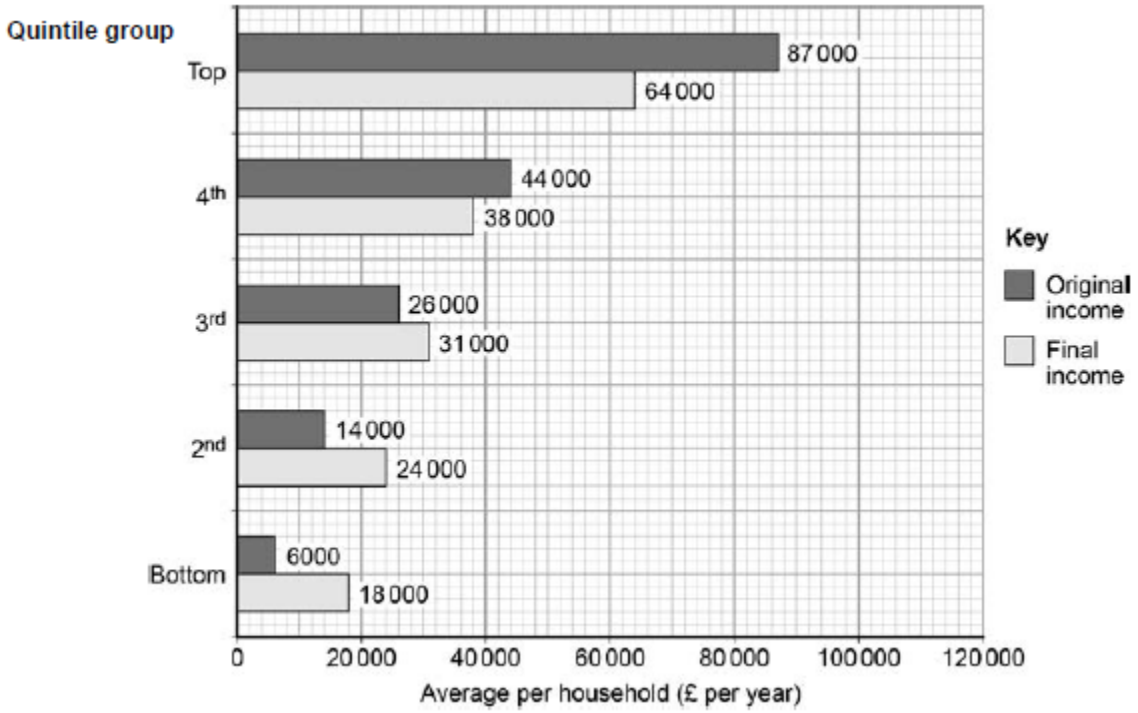
Moreover, an unequal distribution of income is seen as necessary to ensure economic efficiency and a faster growth rate – by making the rich richer, the size of the national cake, that is real GDP, will grow, and the benefits will trickle down to the less well off.

Source: News reports, November 2013

24.

Inequality

Extract D: The effects of taxes and benefits in the UK on household income by quintile groups, 2011−2012



Source: Office for National Statistics licensed under the Open Government Licence v. 1.0.

25.

In **The UK energy market Extract C**, (lines 9−10) Ed Miliband is quoted as saying that a future Labour government would impose "a price freeze for twenty months because the market is not working".

Using the data in the extracts and your economic knowledge, assess whether you agree that fixing a maximum price for energy that is sold to households is the best way of dealing with market failure in the UK energy industry?

[25 marks]

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