PEARSON EDEXCEL A-LEVEL ECONOMICS B · 9EB0

ECONOMICS



EXAM QUESTION PACK

1.5 MARKET FAILURE AND GOVERNMENT INTERVENTION

GOVERNMENT INTERVENTION

SCORE	PERCENTAGE
/692	%

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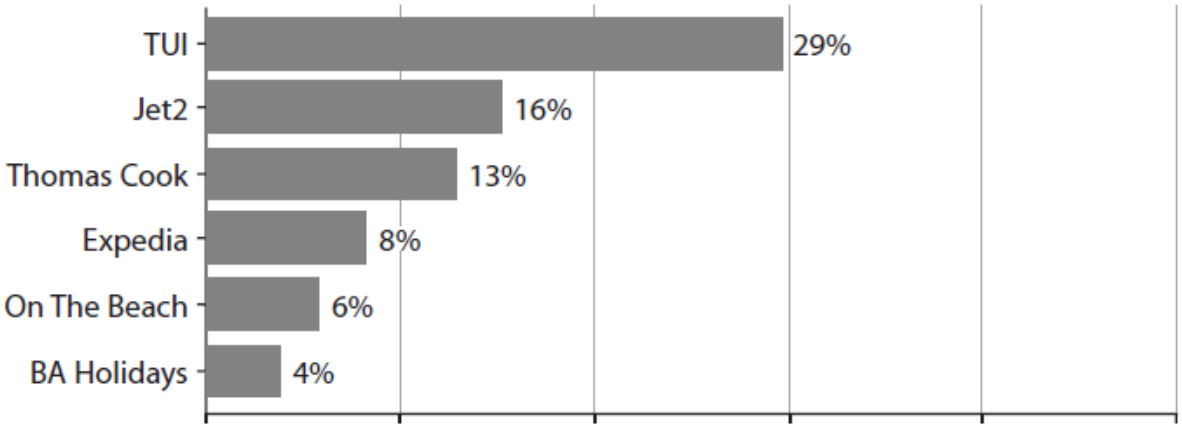
Questions

Q1.

Read Figures 1 and 2 and the following extracts (A to C) before answering this question.

The travel and tourism industry

Figure 1: Package holiday market share of the six largest providers, booked by UK residents, 2019



(Source adapted from: https://knowledge.sharescope.co.uk/2019/10/16/finding-companies-that-control-their-own-destinies/The Times/ATOL)

Figure 2: Jet2 package holiday prices to Sorrento

Price before Thomas Cook shutdown

2 Adults for 7 Nights from Monday 25 May 2020

- Half Board
- 1 x Premium Double or Twin room
- Return flights from Edinburgh
  View flight times
- 22 kg Bag Allowance
- 10 kg Hand Baggage
- ATOL Protected
- Coach Transfers

Holiday price from **£1,576** Per person price **£788**

Price 12 hours after Thomas Cook shutdown

2 Adults for 7 Nights from Monday 25 May 2020

- Half Board
- 1 x Premium Double or Twin room
- Return flights from Edinburgh
  View flight times
- 22 kg Bag Allowance
- 10 kg Hand Baggage
- ATOL Protected
- Coach Transfers

Holiday price from **£1,648** Per person price **£824**

Data accessed: 22nd and 23rd September 2019

Extract A

Marginal productivity of cabin crew

Cabin crew are responsible for loading passengers and providing in-flight meals. United Airlines is planning to reduce the number of its cabin crew members onboard international flights. The airline currently operates its planes with one more cabin crew member than its competitors. The marginal productivity of this additional crew member may be low. By reducing the number of its cabin crew members United Airlines will be able to operate more efficiently and compete more effectively.

(Source adapted from: https://simpleflying.com/united-airlines-to-reduce-number-of-crew-on-international-flights/)

Extract B

Thomas Cook's environmental impact

Thomas Cook Group plc's operations included its airline and 560 high street travel agents providing flights, hotels and package holidays.

The environmental impact of the travel industry is significant. It accounts for 8% of all global carbon emissions. Thomas Cook recognised the risks presented by climate change and actively engaged in reducing their airline emissions. Its plans included using more efficient aircraft and using lower-carbon fuel. In 2018, Thomas Cook was included in the top 10 of the world's most fuel-efficient airlines.

(Source adapted from: https://www.thomascookgroup.com/investors/insight_external_assest/Thomas+Cook+Sustainability+Report+2018.pdf)

Extract C

Why did Thomas Cook shut down?

Thomas Cook Group plc ceased trading on 23 September 2019. The collapse of Thomas Cook left 600 000 travellers stranded overseas and approximately 21 000 worldwide employees were left without a job.

Thomas Cook's management said that the failure of rescue talks between banks, shareholders and the UK Government meant it had no choice but to shut down the business.

But in truth the tour operator's problems go back much further. A disastrous merger in 2007, increased debts, the internet revolution in holiday booking and Brexit uncertainty all contributed to the failure of the business.

In 2007 it merged with MyTravel. Thomas Cook directors had an objective of rapid company growth over short-term profitability. The merger was supposed to create a European giant, promising £75 million-a-year cost savings and a springboard to challenge emerging internet rivals. In reality, Thomas Cook was merging with a company that had only made a profit once in the previous six years, and the deal left the Group with huge debts. In May 2019, the firm reported a £1.5 billion loss.

The role of the management in Thomas Cook's collapse is being investigated by the UK Government. Thomas Cook executives' salaries and bonuses have been questioned. Directors received salaries totalling £20 million in the five years before its collapse. The Chief Executive Officer (CEO) earned a £500 000 cash bonus in 2017 and about £8.5 million in his five years with the company. It seems that around £4 million of this was in the form of shares. The share price reached £1.46 in 2018, but each share is now worthless.

The CEO said that the directors had worked "exhaustively" to rescue Thomas Cook and create a long-term turnaround strategy. "It is a matter of profound regret to me and the rest of the board that we were not successful."

The UK prime minister admitted that the government refused to grant £150 million as a subsidy to help rescue Thomas Cook in the short run. The UK prime minister stated: "Clearly, that is a lot of taxpayers' money and sets up, as people will appreciate, a moral hazard in the case of future such commercial difficulties that companies face. I have questions about whether it's right that the directors, or whoever, the board, should pay themselves large sums when businesses can go down the tubes like that. One is driven to reflect on whether the directors of these companies are properly incentivised to sort such matters out".

(Source adapted from: https://www.theguardian.com/business/2019/sep/23/thomas-cook-as-the-world-turned-the-sun-ceased-to-shine-on-venerable-tour-operator

and https://www.ft.com/content/a7dd2554-de23-11e9-b112-9624ec9edc59)

(a) Explain the likely impact of diminishing marginal productivity of labour on cabin crew staffing levels. Refer to Extract A in your answer.

(5)

(b) Examine the likely impact of Thomas Cook's plan 'to reduce their airline emissions' (Extract B, line 6) on the social optimum position. Use an appropriate externalities diagram in your answer.

(8)

(c) With reference to Extract C, assess whether Thomas Cook's failure was caused by the principal-agent problem.

(10)

(d) With reference to Extract C, discuss the proposed government subsidy to prevent Thomas Cook from reaching its shut-down point.

(12)

(e) With reference to the information provided, discuss the decision by Jet2 to increase its package holiday prices.

(15)

(Total for question = 50 marks)

Q2.

Some questions must be answered with a cross in a box (☒). If you change your mind about an answer, put a line through the box (☒) and then mark your new answer with a cross (☒).

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

The Common Agricultural Policy (CAP) is a system of minimum prices and other programmes covering farming, environmental measures and rural development. The CAP applied to British farmers before the UK left the EU in January 2020.

(Source adapted from: https://www.gov.uk/government/collections/common-agricultural-policy-reform)

(a) Define the term 'minimum price'.

(1)

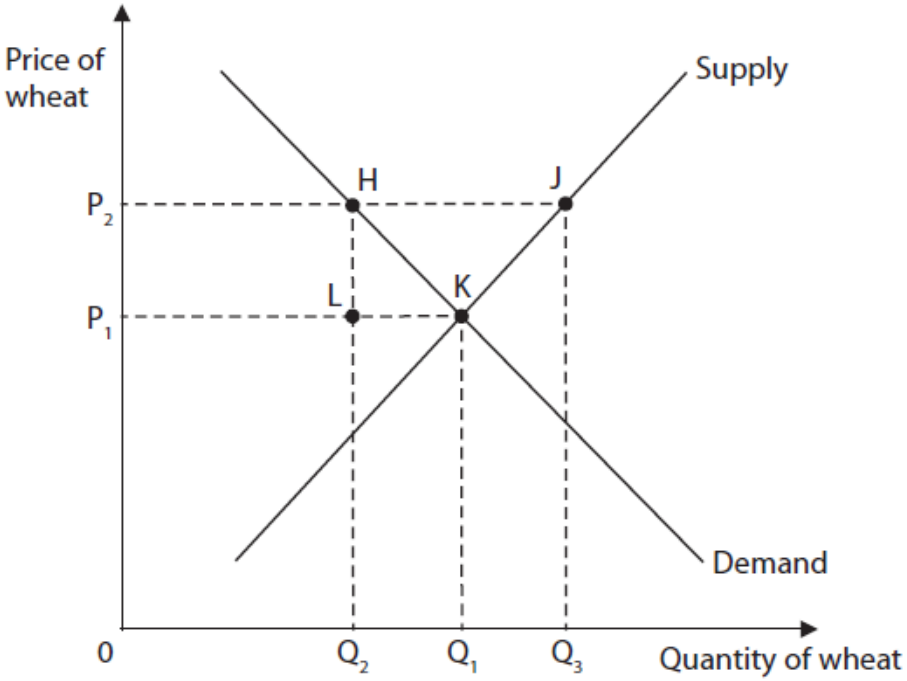
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The diagram below shows the demand and supply curves for wheat in the European Union (EU).



The free market price of wheat is P_1. It had been agreed as part of the CAP to maintain a price of P_2 within the EU and to do so through intervention buying.

(b) In achieving a price of P_2, the amount spent on intervention buying by the EU would be

(1)

☒ **A** HKL

☒ **B** JHQ_2Q_3

☒ **C** LKJH

☒ **D** Q_1Q_2LK

(c) Explain **one** likely problem for the EU of maintaining prices at P_2.

(2)

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(Total for question = 4 marks)

Q3.

(a) With reference to Figure 5 and Extract C, explain **one** likely reason for the fall in the exchange rate of the Turkish lira.

(5)

(b) Discuss the costs to the Argentine economy of an inflation rate "estimated by some economists to be over 25%". (Extract D, line 9)

(12)

(c) With reference to Extract E, examine the impact of restrictions on beef exports on how Argentine farmers decide to use their land.

(8)

EITHER

(d) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic effects of the imposition of 'price controls' (Extract E, line 8) in Argentina.

(25)

OR

(e) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic effects of the 23% devaluation of the Argentine peso.

(25)

(Total for question = 50 marks)

Q4.

'Tradable permits are less effective than taxation in reducing carbon emissions.'

To what extent do you agree with this statement?

(Total for question = 25 marks)

Q5.

Turkey – an emerging economy

Figure 1: Turkey's central bank lending rate, percent, 2013–2018

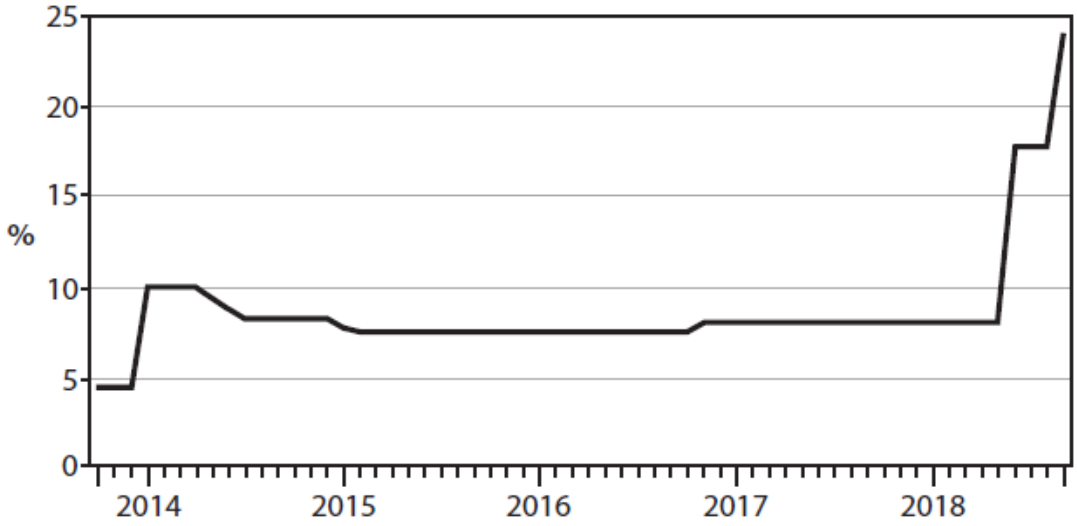
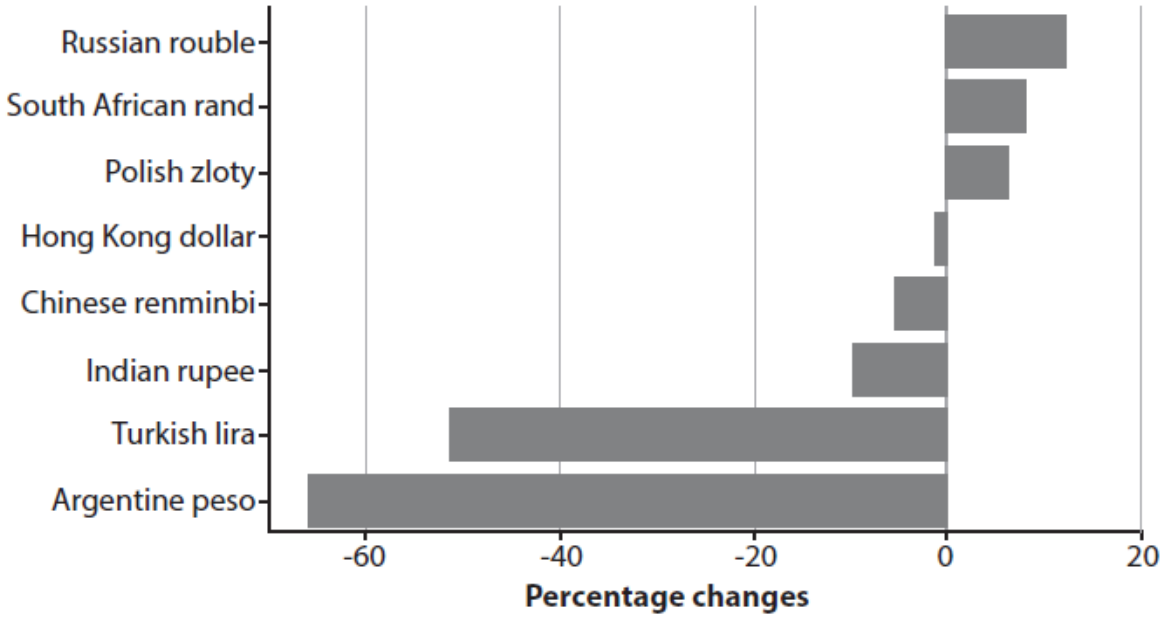


Figure 2: Selected emerging economy exchange rates, percentage change against the US dollar: January 2018 compared to January 2016.



(Source adapted from: FT.com)

Extract A

Can Turkey's central bank avoid another rate rise?

At an annual rate of 25%, Turkey's inflation is alarming. However, it may have peaked. This may be a turning point for the economically struggling country, whose currency (the Turkish lira) has lost nearly a third of its value against the US dollar in 2018. The central bank may be able to avoid tightening monetary policy further, as a severe economic adjustment is already well under way. Turkey is highly indebted in foreign currency. The Turkish government takes measures against excessive appreciation or depreciation of the Turkish lira to reduce financial stability risks. The financial market faces difficulties in trying to restore foreign investors' confidence.

Consumer prices increased by 2.7% in October 2018, a much lower rate than the 6.3% recorded in September 2018. The lira has stabilised, having risen 16% since the central bank raised interest rates by 6.25 percentage points. However, the government wants lower borrowing costs to fuel credit growth and economic expansion. Timothy Ash at a London investment bank says at this point it's "illogical" to raise interest rates again in Turkey. That's because Turkey's economy is already experiencing a severe slowdown.

In the long term Turkey's economic growth is expected to be above that of other emerging markets such as Brazil, Russia and China. Turkey's private sector is resilient. Between 2018–50 we expect Turkey to grow by an annual average of 3.1%. Brazil is expected to grow by an annual average of 2.1%, Russia by 1.6% and China by 2.8%. GDP growth will nevertheless be well below that recorded in 2004–07 and 2010–15. Average growth in GDP per head will be substantially lower, mainly reflecting the expected rise in the total population.

(Source adapted from: https://ftalphaville.ft.com/2018/11/06/1541508141000/Can-Turkey-s-central-bank-avoid-another-rate-hike-/. 6 Nov 2018 Colby Smith and one sentence The president wants lower borrowing costs to fuel credit growth and economic expansion from https://www.theguardian.com/world/2018/aug/07/turkey-urged-to-announce-emergency-interest-rate-hike Larry Elliott 7/8/18 and http://country.eiu.com/article.aspx?articleid=157174199&Country=Turkey&topic=Economy&subtopic=Long-term+outlook&subsubtopic=Summary)

Extract B

Turkey aims to bin the plastic bag

You get a free plastic bag whenever you go to a shop, even if it is just to buy a loaf of bread or a chocolate bar. In Turkey, plastic bags are everywhere, with millions being thrown away, and their use is causing a growing environmental problem.

In Istanbul, the country's biggest city with about 12 million people, around 10000 tonnes of waste are being collected every day. Plastic bags and other plastic waste make up 950 tonnes, or almost 10%, of the total waste.

The Turkish government said it was looking at ways to discourage the consumption of single-use plastic bags. One possible step currently under review is a ban of the black bags that are said to contain carcinogens. Another is that the state may raise taxes on plastic products, which could lead to supermarkets charging consumers for the bags. In Corlu, a town north-west of Istanbul, a local environmental group distributed 20000 canvas bags to shoppers in one month. In some parts of Turkey, plastic bags are completely banned, with heavy fines for both firms and consumers who use them.

(Source adapted from: tseibert@thenational.ae
https://www.thenational.ae/world/europe/turkey-aims-to-bin-the-plastic-bag-1.530059 accessed 11/11/18)

Extract C

Istanbul's third airport set to be the busiest in the world

Istanbul's third airport is being constructed over an area of 76.5 million square metres, to the north of Istanbul. When complete, the new airport will have six runways and have an annual passenger capacity of up to 200 million people, making it potentially the world's busiest airport. "This airport is going to be the most important hub between Asia and Europe," said one business leader.

The airport design includes high vaulted ceilings and spacious, modern and efficient design – and its tulip-shaped air traffic control tower won the 2016 International Architecture Award. It uses mobile applications and artificial intelligence for customers, is energy efficient and has a high-tech security system. The site employs 36000 people and is estimated to cost the equivalent of £10 billion. However, the rush to meet the deadline set by the Turkish government is a major cause of accidents on the construction site, according to the construction workers' union.

(Source adapted from: https://www.lonelyplanet.com/news/2018/08/08/istanbuls-huge-new-airport/ and
https://www.voanews.com/a/istanbul-to-unveil-new-airport-seeks-to-be-world-s-biggest/4632308.html)

(a) Explain how the Turkish central bank intervenes in the currency market to prevent 'excessive appreciation or depreciation of the Turkish lira' (Extract A, lines 7–8).

(5)

(b) Examine **two** reasons why the Turkish government may want to avoid a significant fall in the exchange rate of the Turkish lira.

(8)

(c) Discuss the likely success of policies to reduce the consumption of single-use plastic bags in cities such as Istanbul.

(12)

EITHER

(d) Evaluate the likely microeconomic and macroeconomic effects of a rise in interest rates in Turkey.

(25)

OR

(e) Evaluate the microeconomic and macroeconomic impact of large infrastructure projects such as the building of a third airport in Istanbul.

(25)

(Total for question = 50 marks)

Q6.

The market for beef

Extract A

Boost to UK farmers

The horsemeat scandal of 2013 affected the demand for many processed meat products. Traces of horsemeat were discovered in products labelled as beef, manufactured by many overseas suppliers. With many beef products customers had little knowledge about where the beef came from. If the manufacturers knew, they were not always making this clear to customers.

As a result of the scandal, the proportion of domestically-sourced beef in British shops rose from 81% to 83% in 2013. Consequently, the prices farmers received for beef in the UK rose by 3%.

Another potential boost for UK farmers is demand from emerging markets. As the middle class grows in countries such as China, so does their demand for protein and dairy products. British meat and dairy products are seen as offering a stable and proven supply chain, unlike in China where baby milk has been found with traces of the plastic melamine. State-owned Chinese companies are approaching dairy farmers directly to secure millions of litres of UK milk.

(Source: 'Boom in farming as UK demands quality' by Graham Ruddick, *The Telegraph* 25th Jan 2014. http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/10596862/Boom-in-farming-as-UK-demands-quality.html)

(a) Explain why 'the prices farmers received for beef in the UK rose by 3%' in 2013 (Extract A, lines 7 and 8). Include a supply and demand diagram in your answer.

(5)

(b) Assess the likely impact of a 3% increase in the price of UK beef on the market for lamb.

(10)

(c) Explain **two** likely impacts on dairy farmers in the UK of the growth in the middle classes in emerging markets such as China.

(6)

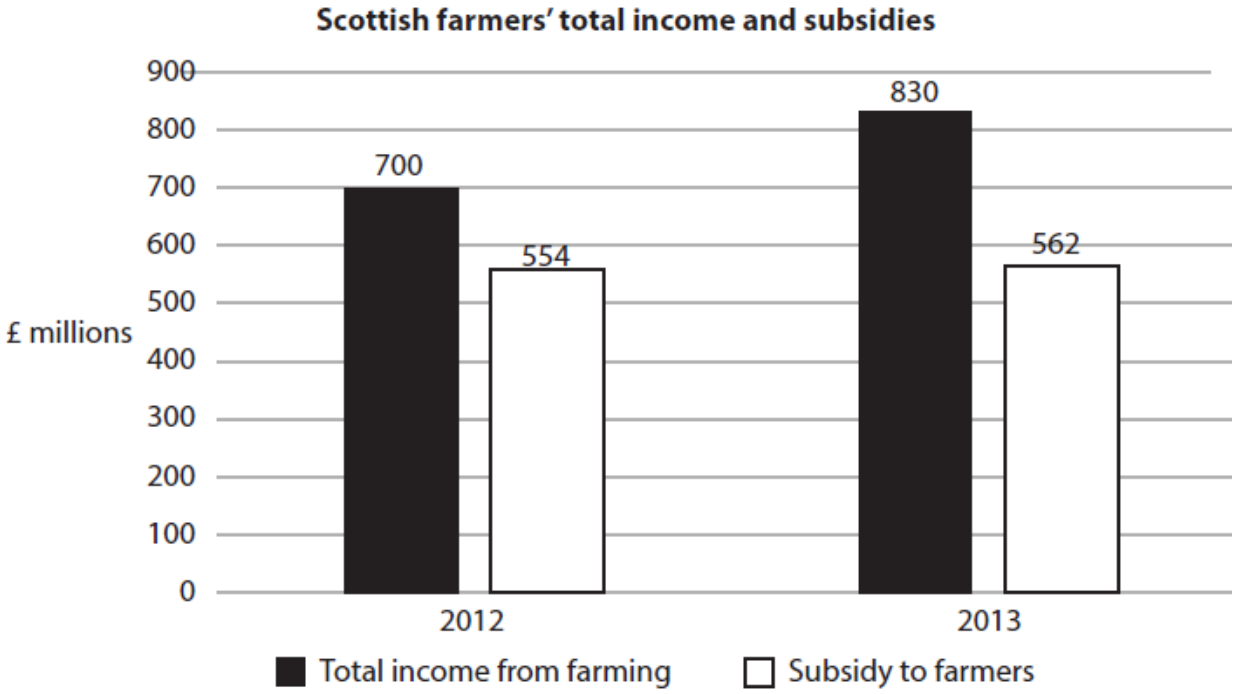


Figure 1

Total income from farming and subsidies for Scottish farms 2012 and 2013

(d) With reference to Figure 1, calculate the value of subsidies as a percentage of total Scottish farm income for 2012 and 2013. You are advised to show your working.

(4)

2012

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2013

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Extract B

Reliance on farm subsidies

There is a reliance on subsidies in Scottish farms. The argument for subsidies is that farming is vital to the rural economy and that support payments to farmers can benefit the local community. The counter argument is that farmers should make a living from the free market for what they produce.

Farm subsidies will continue in the European Union. In many of the member states, agriculture and the vast food industry that depends on it still hold significant political influence. Although farmers in the UK complain that their share of EU subsidies is already too low, changes to the EU farm subsidies due to take effect in 2015 mean they are likely to be slashed by one third to one half.

(Source: adapted from 'Even the best farmers would struggle in a free market,' *The Southern Reporter*, 6th Feb 2014, http://www.thesouthernreporter.co.uk/opinion/columnists/even-the-best-farmers-would-struggle-in-a-free-market-1-3296583)

(e) With reference to Figure 1, Extract B and your own knowledge, discuss the reasons for subsidies being paid to Scottish farmers.

(15)

EITHER

(f) Using the concept of external costs, evaluate the possible economic effects of increased beef production. Use an appropriate diagram in your answer.

(20)

OR

(g) Evaluate the impact of a guaranteed minimum price in the beef market on consumers and producers. Use an appropriate diagram in your answer.

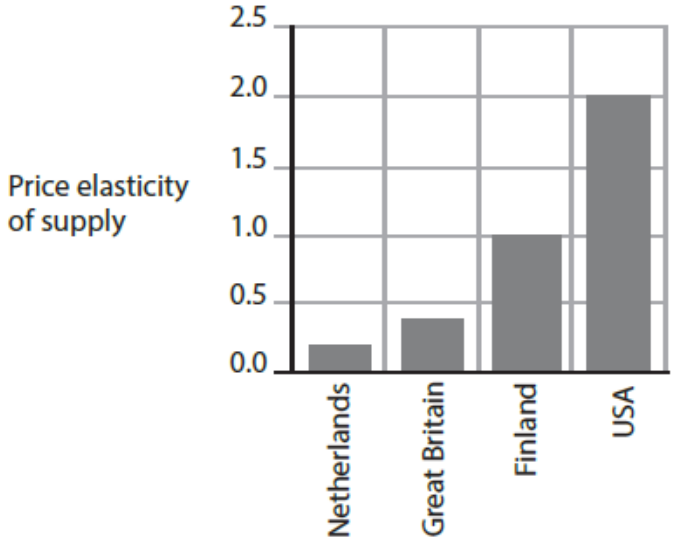
(20)

(Total for question = 60 marks)

Q7.

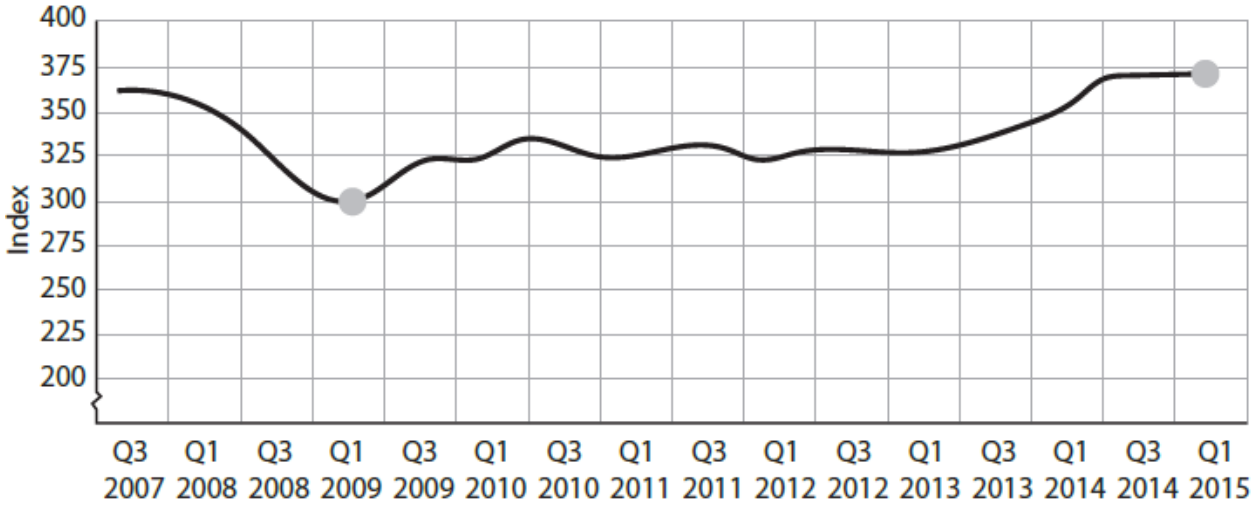
The market for housing

Figure 1 – Estimates of the price elasticity of supply of new housing, selected countries



(Source: adapted from Caldera Sánchez, A. and Å. Johansson (2011), "The Price Responsiveness of Housing Supply in OECD Countries", Figure 3, OECD Economics Department Working Papers, No. 837, OECD Publishing. http://dx.doi.org/10.1787/5kgk9qhrnn33-en)

Figure 2 – Index of UK house prices (1993 = 100)



(Source: http://www.nationwide.co.uk/about/house-price-index/download-data#~)

(a) With reference to Figure 1, explain **one** possible reason for the differences in price elasticity of supply of new housing between countries.

(5)

(b) With reference to Extract A, assess the likely impact of the Help to Buy scheme on the market for rented properties in the UK.

(10)

(c) Explain the likely impact on producer surplus of an increase in the demand for housing. Use a diagram to illustrate your answer.

(6)

(d) With reference to Figure 2, calculate the percentage change in house prices between the first quarter of 2009 and the first quarter of 2015. You are advised to show your working.

(4)

(e) With reference to Figures 1 and 2 and your own knowledge, discuss the functions of the price mechanism in allocating housing.

(15)

Answer EITHER

(f) Evaluate the likely microeconomic effects of government intervention in the UK housing market.

(20)

OR

(g) Evaluate the case for government provision of goods and services such as flood defence schemes or housing.

(20)

(Total for question = 60 marks)

Q8.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

Answer the question with a cross in the box you think is correct ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

Fuel duty is an excise tax imposed on the sale of petrol, included in the price paid by consumers, set at 58 pence per litre.

(Source: https://www.gov.uk/tax-on-shopping/fuel-duty)

(a) Draw a supply and demand diagram to show the incidence of a specific petrol tax on consumers and producers.

(4)



(b) The indirect tax on fuel is increased in a market in which the price elasticity of demand is −0.1.

Which **one** of the following is the most likely effect on consumer and producer surplus?

(1)

☒ **A** Consumer surplus and producer surplus both decrease

☒ **B** Consumer surplus and producer surplus both increase

☒ **C** Consumer surplus decreases and producer surplus increases

☒ **D** Consumer surplus increases and producer surplus decreases

(Total for question = 5 marks)

Q9.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

Answer the question with a cross in the box you think is correct ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

HS2 is a high-speed rail network linking the north and south of England. HS2 will be four years late and cost double the Department for Transport's original estimate.

(Source: https://www.transportxtra.com/publications/local-transport-today/news/58459/hs2-will-be-four-years-late-and-cost-double-the-dft-s-estimate-mps-told)

(a) Define the term 'government failure'.

(1)

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(b) Explain **one** likely microeconomic reason why the government is using taxpayers' money to fund HS2.

(2)

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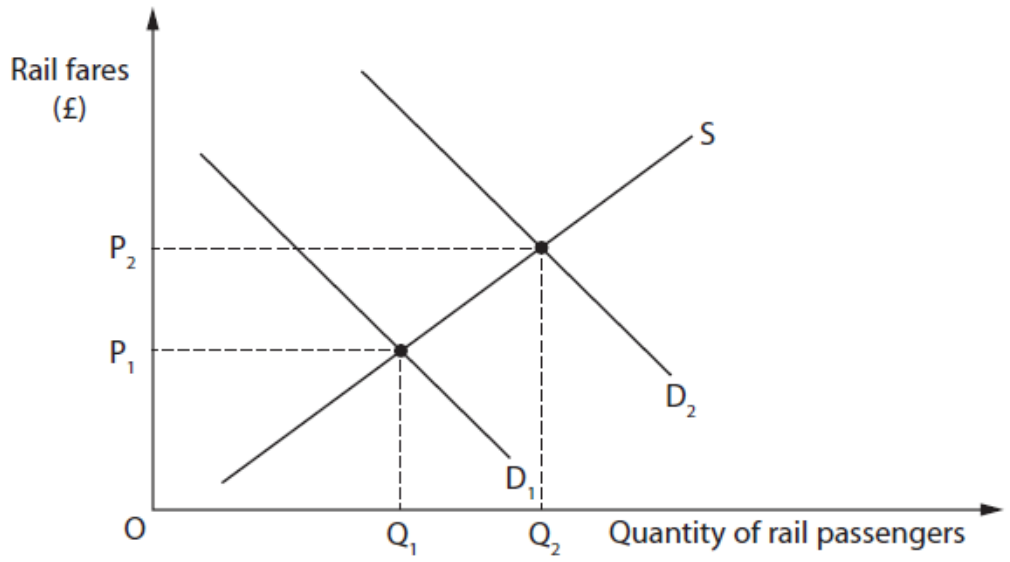
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(c) The diagram below shows the demand for and supply of passenger rail services.



The shift of the demand curve from D1 to D2 is most likely to result from a:

(1)

☒ **A** government decision to impose a tax on workplace parking

☒ **B** government decision to increase subsidies for rail travel

☒ **C** planned expansion of the government's railway track building programme

☒ **D** reduction in the tax imposed on a litre of petrol

(Total for question = 4 marks)

Q10.

The market for cigarettes

Figure 1: Price elasticity of demand - a comparison between tobacco and e-cigarettes

Price of packet of 20 tobacco cigarettes £7.70–£9.50	Price of e-cigarette kit £9.99–£19.99
Average price per tobacco cigarette 48p	Single cigarette equivalent price of an e-cigarette 7p
Price elasticity of demand for tobacco cigarettes –0.35	Price elasticity of demand for e-cigarettes –1.9

(Source: adapted from https://www.blucigs.co.uk/united-kingdom/kits/all-kits)

Extract A

Government intervention on tobacco

There was a time when smoking was fashionable. Television and magazine advertisements glorified smoking. Everyone from your dad to your doctor smoked in all places – cars, restaurants and even hospitals.

Tobacco is still the single biggest cause of cancer in the world and the leading cause of preventable deaths. Nearly 80% of the 1 billion smokers worldwide live in low- and middle-income countries.

Bans on tobacco advertising, promotion and sponsorship can reduce tobacco consumption. Comprehensive smoking bans covering indoor workplaces, public places and public transport have been introduced in 48 countries.

Tobacco taxes are the most cost-effective way to reduce tobacco use, especially among the young and people in low-income groups. A tax increase that raises tobacco prices by 10% decreases tobacco consumption by 4% in high-income countries and 5% in low- and middle-income countries.

However, some 8 million people are expected to die each year by 2030 – because they have smoked tobacco or have been exposed to passive smoking. The use of alternative products such as electronic cigarettes (e-cigarettes) are gaining in popularity but information about their effects is uncertain. Little research has yet been done about the long-term health effects of e-cigarettes and the nicotine dispensed by e-cigarettes is highly addictive. The illegal tobacco market still counts for 1 in every 10 cigarettes consumed globally. In addition, tobacco companies still spend tens of billions of dollars each year on advertising and promoting tobacco products and sponsoring events. They continuously challenge the regulatory measures governments are taking.

(Source: adapted from http://www.who.int/topics/tobacco/en/ and http://www.who.int/mediacentre/commentaries/reducing-tobacco-use/en/)

Extract B

Free market approach

Are free markets incompatible with good health? If the solution to every problem involves banning advertising, raising prices and restricting availability, you might easily conclude that the free market is the disease and government regulation is the cure. From this perspective, the providers of food, alcohol and tobacco are determined to push the most unhealthy products on the public at the lowest prices.

Contrary to this viewpoint, the profit motive is not unhealthy. Businesses have an obvious incentive to keep their customers alive and customers have a strong incentive to seek out healthier options. Any company that can make a scientifically sound health claim gains a competitive advantage over its rivals. Health sells. In contrast, government regulation can lead to negative health outcomes. Markets can correct themselves long before government failures are even acknowledged. Over a million Britons, almost all of whom are smokers or ex-smokers, use e-cigarettes, as a less hazardous product than cigarettes and yet e-cigarettes face increased regulations and in many countries they are banned.

It is neither consistent nor ethical to prevent smokers from switching to much safer alternatives. Efforts to regulate e-cigarettes are a far greater threat to public health than the products themselves.

We argue that the interests of consumers are nearly always better advanced by the provision of accurate information and free choice than by prohibitions and regulations. The government policy of small but steady tax rises on tobacco and ever-larger warning labels is becoming less effective and leads to unintended consequences.

(Source: adapted from http://www.iea.org.uk/blog/free-market-solutions-in-health-should-be-allowed-to-flourish, Christopher Snowdon, 11th July 2013)

(a) Explain why 'bans on tobacco advertising' (Extract A, line 7) may result in a decrease in the revenue of tobacco firms. Include a supply and demand diagram in your answer.

(5)

(b) With reference to the information provided and your own knowledge, assess the view that tobacco consumers switching to e-cigarettes is an example of rational behaviour.

(10)

Tobacco cigarettes and e-cigarettes are considered to be substitutes.

(c) Explain how changes in the price of tobacco cigarettes may affect the demand for e-cigarettes over time.

(6)

(d) With reference to Extract A, lines 11–13, calculate the price elasticity of demand for tobacco cigarettes in high-income countries and in low-middle-income countries. You are advised to show your working.

(4)

(e) With reference to Figure 1, assess the likely reasons for the difference in price elasticity of demand for tobacco cigarettes and e-cigarettes.

(15)

EITHER

(f) Evaluate the possible advantages of a free market approach to cigarette consumption.

(20)

OR

(g) Evaluate the impact of government intervention in the cigarette market.

(20)

(Total for question = 60 marks)

Questions

Q1.

To what extent are subsidies more effective than minimum prices in supporting farmers?

(Total for question = 25 marks)

Q2.

Universities UK raised concerns about the proposal to reduce the maximum tuition fees (fee cap) for undergraduate courses in England from £9 000 to £6 000. It stated "This unfunded proposal to reduce the fee cap would damage the quality of experience our universities could deliver to students and remove opportunities for those seeking to benefit from a university education".

(Source: adapted from tuition fees 2015 Times letter Universities UK http://www.universitiesuk.ac.uk/highereducation/Pages/UUKboardFeesLetter.aspx#.VjoQRbfhDIU)

(a) Explain why reducing the tuition fee cap may result in excess demand for university places.

(3)

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(b) Which **one** of the following statements is correct?

(1)

☒ **A** The marginal social benefits exceed the marginal private benefits from university education

☒ **B** University education is an inferior good

☒ **C** University education is a public good

☒ **D** The social optimum equilibrium quantity is less than the market equilibrium quantity for university education

(Total for question = 4 marks)

Q3.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

Answer the question with a cross in the box you think is correct ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

The EU tradable pollution permits scheme is expected to become more effective by 2020, due to recent reductions in the number of tradable pollution permits.

(Source adapted from: https://ec.europa.eu/clima/policies/ets_en)

(a) Explain **one** likely effect of reducing the number of tradable pollution permits.

(4)

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(b) Regulation of firms that pollute is likely to be a problem because it

(1)

- ☒ **A** allows firms to use price signals
- ☒ **B** creates unintended consequences
- ☒ **C** fills information gaps for businesses
- ☒ **D** means lower administrative costs

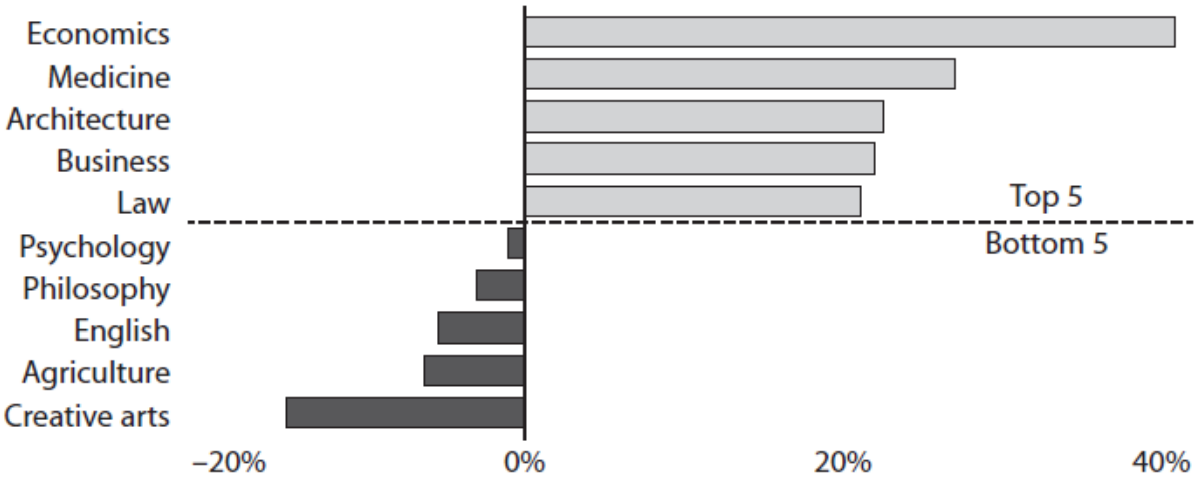
(Total for question = 5 marks)

Q4.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

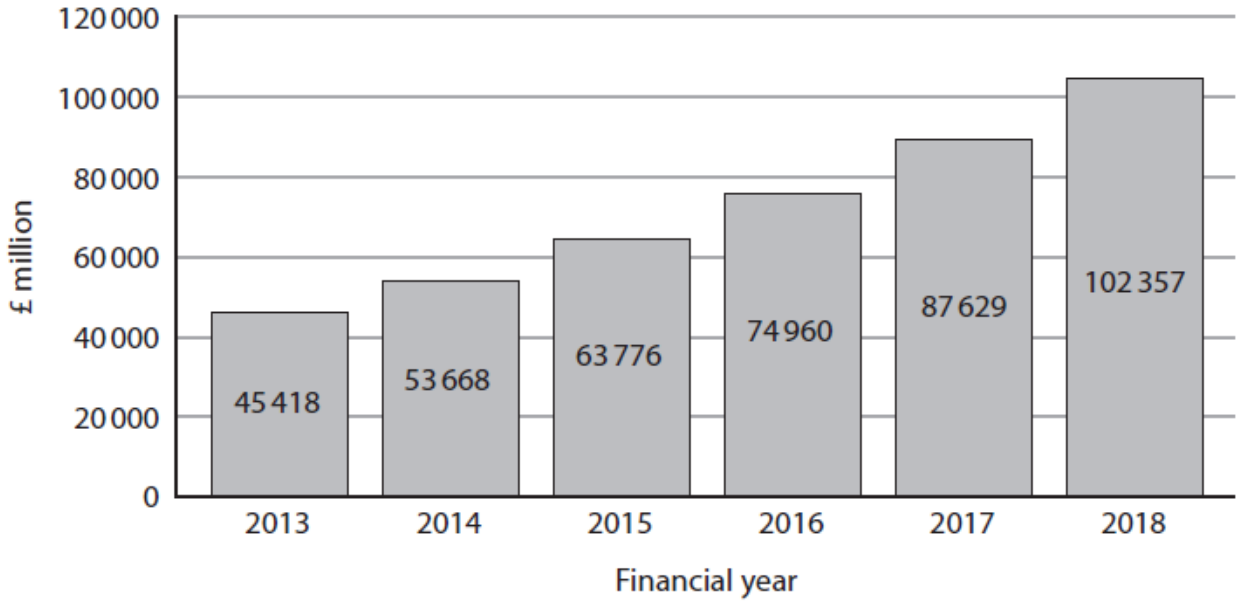
The market for higher education in the UK

Figure 1: Average graduate earnings, according to subject studied, compared to average non-graduate earnings (per cent) 2018 selected subjects.



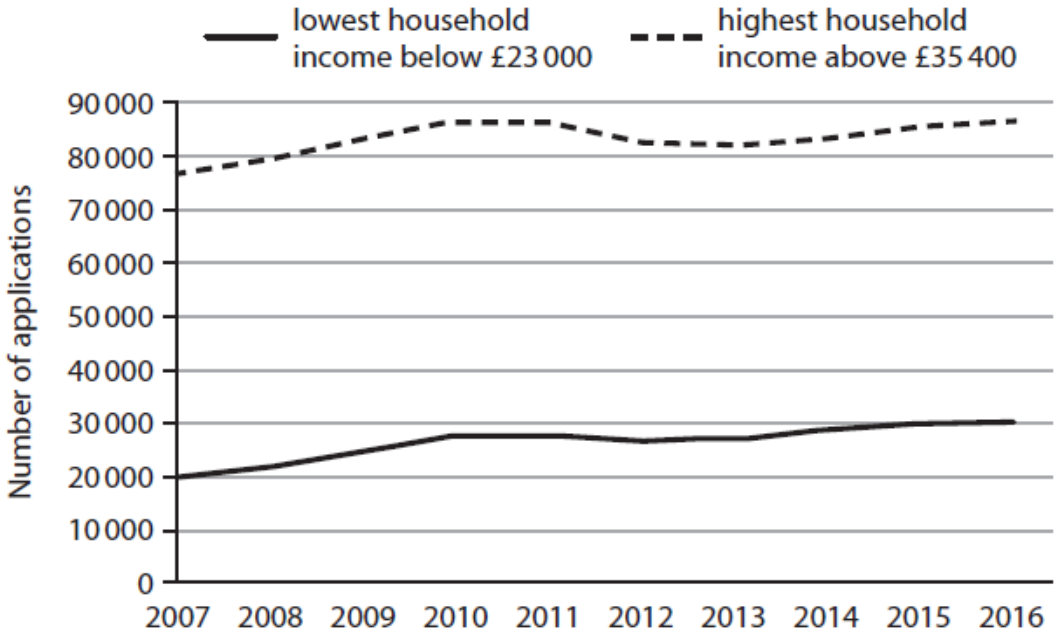
(Source: adapted from https://www.ifs.org.uk/publications/13731
The impact of undergraduate degrees on early-career earnings, Research report, November 2018)

Figure 2: Student loans outstanding at the end of financial years 2013 to 2018 in England



(Source: adapted from https://www.slc.co.uk/official-statistics/student-loans-debt-and-repayment/england.aspx)

Figure 3: Number of applications to UCAS according to median income of area



(Source: adapted from https://www.ucas.com/corporate/data-and-analysis/ucas-undergraduate-releases/2018-cycle-applicant-figures-january-deadline)

Extract A

Rethinking tuition fees

The value of a degree is significant. The latest data shows that the median university graduate income was £10 000 more than the average non-graduate income in 2018. This 'graduate premium' means graduates will contribute significantly to the economy. In addition, the government will benefit greatly from additional tax revenues.

However, funding higher education continues to be a major issue. English universities charge some of the world's highest fees. Interest rates on student loans are now 6.3%. There are a large number of courses where graduates are likely to earn less than non-graduates, despite an average of £50 000 of debt.

The Department for Education estimates that 45% of the value of loans will not be repaid. Outstanding student loans in England totalled more than £100 billion in 2018. By 2023 total outstanding student loans are forecast to rise to £120 billion.

One option for revising student fees could be to charge higher fees for courses that are more expensive to teach or that have a better chance of higher earnings. That would make Science or Mathematics degrees more expensive to study than English or Philosophy.

At most universities the level of fees is likely to be the same flat rate of £9 250 per year. However, science-based courses need more expensive equipment and courses such as medicine require more teaching time and personal instruction.

Tuition fees were introduced in 1998 at £1 000 per year. They are currently £9 250. Economists estimate that the price elasticity of demand for higher education is about –0.5.

Charging £9 250 a year for an undergraduate degree makes England very expensive by international standards. Scotland has no fees for Scottish students, and fees in Wales and Northern Ireland are significantly lower. Much of Europe has low or no fees and Germany, which used to charge fees, has abolished them, replacing them with a graduate tax.

The only country with comparable fees is the United States. Top private colleges can charge more than the equivalent of £30 000 per year while state colleges can charge local students less than fees in England.

Despite this, student numbers at English universities have continued to increase from 450 000 in 1998 to over 700 000 in 2018. Students from all backgrounds are more likely to go to university than ever before.

However, applicants from low-income areas are much less likely to go to university than applicants from high-income areas. The Universities and Colleges Admissions Service (UCAS) found that in the most deprived 10% of postal areas about 20% of young people went to university in 2018, compared with 50% in the highest income areas. Research by University College London revealed that even when candidates from low-income areas had the same exam results, they were much less likely to apply to university than candidates from high-income areas.

(Source: adapted from https://www.theguardian.com/education/2018/dec/16/change-in-student-loan-accounting-could-add-10bn-to-national-debt)

Extract B

Low-income university students twice as likely to drop out than high-income ones

The number of students from low-income areas who drop out of university before finishing their degree is at its highest in five years, indicating a considerable waste of scarce educational resources. This news comes at the same time as a drive to recruit students from poorer backgrounds, with universities spending a total of £725 million on access initiatives in the past academic year alone.

A number of top universities have started to lower their A level grade offers to students from low-income areas, in an attempt to encourage them to apply. However, there is a danger with 'enticing' disadvantaged students through lower grade offers, if universities are not going to provide ongoing support for them once they begin their courses.

The latest figures show that 9% of disadvantaged undergraduates do not continue in higher education beyond their first year. In comparison, the average drop-out rate among students from the high-income backgrounds was less than 5%. The gap continues to widen.

A report, published by the Office for Fair Access, concluded that: 'The significance of this for students is huge. Higher education can be a transformational experience that opens doors to rewarding careers and social mobility, but this is only the case if students achieve successful outcomes.'

(Source: adapted from https://www.telegraph.co.uk/news/2017/06/28/number-poor-students-dropping-university-highest-level-five/)

(a) Explain why 'the price elasticity of demand for higher education is about –0.5' may be of relevance to English universities.

Refer to Extract A in your answer.

(5)

According to Extract B, the drop-out rate of students from low-income households is much higher than that of high-income households.

(b) Assess the likely impact of these drop-out rates on the allocation of resources within an economy.

(10)

(c) With reference to Extract A, explain **one** likely private benefit to students and **one** likely external benefit of higher education.

(6)

(d) With reference to Figure 2, calculate the percentage increase in outstanding student loans from 2013 to 2018.

You are advised to show your working.

(4)

(e) With reference to Figure 1 and Extract A, discuss the benefits of allowing universities to charge higher tuition fees for some degree courses.

(15)

EITHER

(f) Evaluate the possible advantages of a free market approach to providing services such as education.

(20)

OR

(g) Evaluate whether government intervention is able to correct market failure in education.

(20)

(Total for question = 60 marks)

Q5.

Read Extracts A and B and Figure 1 before answering the question.

The market for fish

Extract A

Total allowable catches of North Sea cod halved in response to falling stocks

In 2020, new lower limits on the quantity of cod that can be caught by the UK fishing fleet came into force. These limits on the fish catch, called total allowable catches (TACs), were agreed at the annual EU fisheries negotiations.

It was the last December EU meeting attended by the UK before it left the EU. It was agreed that cod catch limits will be cut by 50% in the North Sea, while reduced limits were agreed for cod in the Celtic Sea, Irish Sea and west of Scotland.

However, there were increases for other types of fish, with TACs for haddock in the North Sea rising by 23% and for sole rising by 19%.

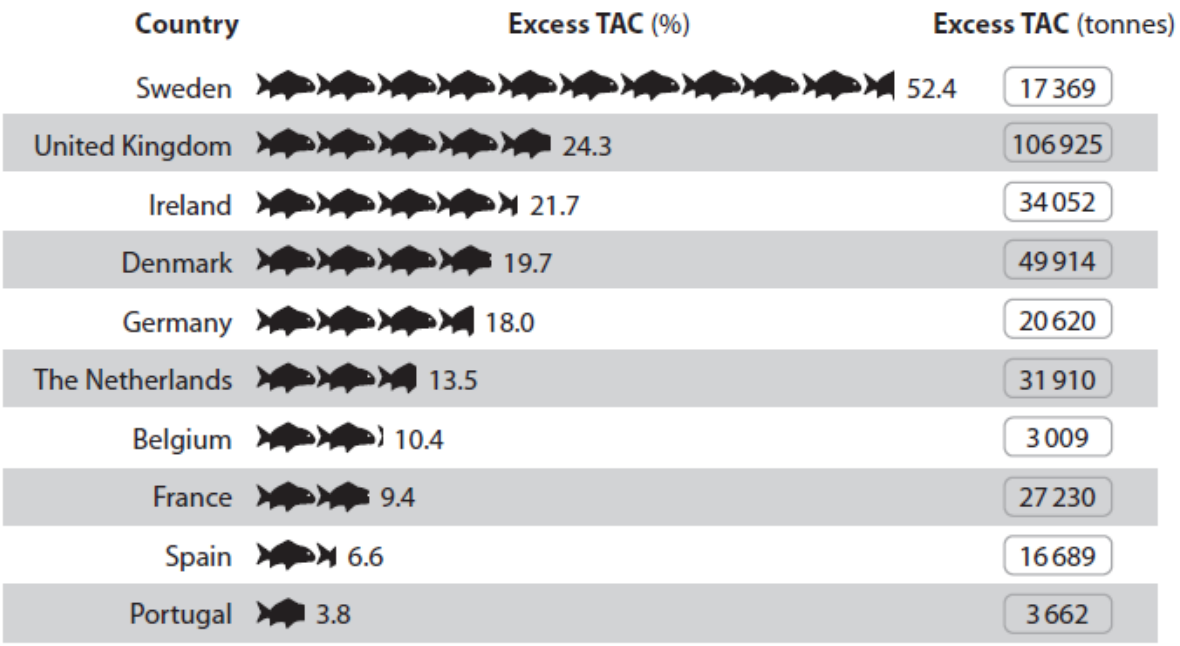
UK Fisheries Minister George Eustice said: "This year there has been mounting scientific evidence suggesting that cod is being overfished in many parts of the northeast Atlantic and we have responded to conserve stocks".

These new regulations applied to the UK while it remained part of the Common Fisheries Policy. In the future it will become an independent coastal state and negotiate on fisheries with the EU and other coastal states such as Norway.

(Source adapted from: https://www.independent.co.uk/news/business/news/north-sea-cod-stocks-quota-climate-change-brexit-a9252196.html)

Figure 1

Atlantic over-fishing: share of total allowable catch (TAC) in excess of scientific advice (2019)



(Source adapted from: Statista 2018)

Extract B

The tragedy of the commons

The 'tragedy of the commons' may occur when there are common access resources (CARs). These are natural resources over which no private ownership has been established. Therefore, there are difficulties in excluding people from using or exploiting them. CARs include fisheries and common grazing lands. Oceans are so vast that it is impractical for one fishing company to establish ownership and control. This means that others cannot be prevented from exploiting the ocean. Economists have suggested that with the lack of ownership of these resources, private producers will act in their own self-interest and exploit CARs to maximise profit. This exploitation is unsustainable. In other words, CARs provide an opportunity for individuals to create profit, while creating negative externalities which impact on everybody else. This process is referred to as the 'tragedy of the commons'.

The 'tragedy of the commons' is at the core of a range of problems that are relevant and threatening to natural resources, environments and human health. In the case of overfishing, fishing companies are not made accountable for the state of the ocean. They continue to fish as much as possible to maximise profit. Today, 90% of fish stocks are depleted.

The reason for such a wide range of problems is because there is an environmental cost for everything. The 'tragedy of the commons' is the outcome of the fact that every resource is limited on this planet, coupled with the rising level of demand for these resources. These issues are large-scale and require laws, regulation and international cooperation.

(Source adapted from: http://felixonline.co.uk/articles/2019-12-09-tragedy-commons-drama-planet-not-enjoying/)

(a) Explain the likely impact of the new 2020 TACs on the price of cod. Include a supply and demand diagram in your answer.

(5)

According to Extract B, lines 15–16, 'fishing companies are not made accountable for the state of the ocean. They continue to fish as much as possible to maximise profit'.

(b) Assess whether it is rational for fishing companies to behave in this way.

(10)

(c) With reference to the information provided and your own knowledge, explain **two** characteristics of private ownership in a free market economy.

(6)

Fish and chips are complementary goods with an estimated cross elasticity of demand of –8. Currently 950 000 bags of chips are sold in UK fish and chip shops each day.

(d) With reference to the information provided, calculate the new quantity demanded of bags of chips from fish and chip shops, following a 2% increase in the price of fish. You are advised to show your working.

(4)

The UK fishing industry employs about 24 000 people, more than half of them working in Scotland.

(e) Discuss the likely impacts on an economy of specialising in the fishing industry. Use a

production possibility frontier diagram in your answer.

(15)

EITHER

(f) Some economists suggest that the market price of cod does not result in the socially optimum level of output. Evaluate the likely external costs from the over-fishing of cod. Use an appropriate diagram in your answer.

(20)

OR

(g) Other than using a TAC, evaluate the policy options which could be used to reduce market failure resulting from over-fishing. Use at least one appropriate diagram in your answer.

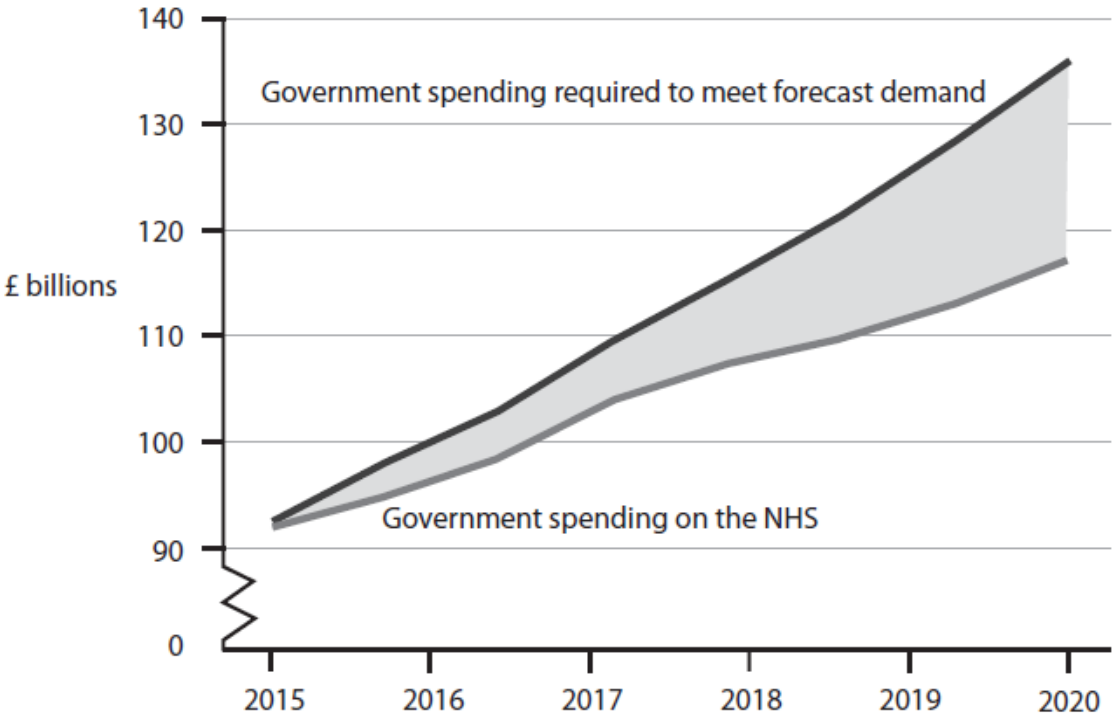
(20)

(Total for question = 60 marks)

Q6.

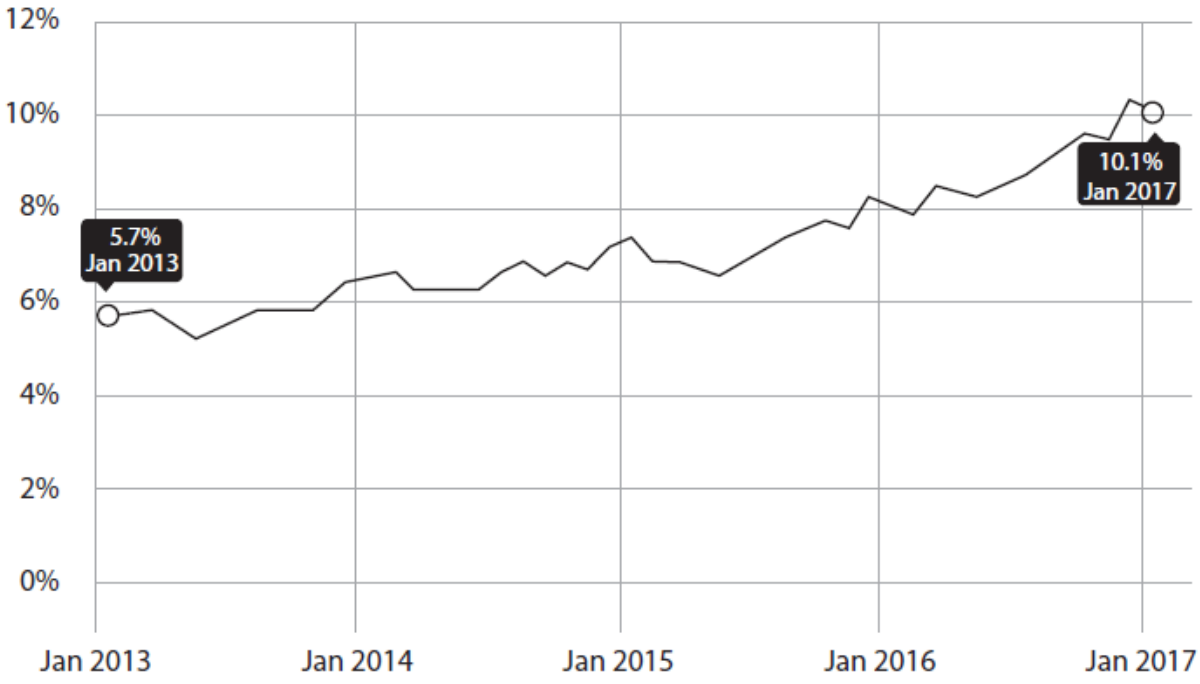
Health provision

Figure 1: National Health Service (NHS) in England: Government spending and projected funding gap, £ billions, 2015 to 2020



(Source: https://www.economist.com/news/britain/21706563-nhs-mess-reformers-believe-new-models-health-care-many-pioneered)

Figure 2: Percentage of NHS patients in England waiting over 18 weeks for non-emergency treatment



(Source: https://www.statista.com/chart/8813/more-and-more-people-made-to-wait-by-the-nhs/)

Extract A

Hospitals already full

National Health Service (NHS) managers' warned that bed occupancy rates are approaching 99% in some parts of the country, compared with recommended levels of 85%. In 2017 the number of patients waiting for non-urgent treatment passed the four million mark, the highest figure for almost a decade.

The chief executive of the NHS suggested that waiting list targets for routine operations such as hip and knee replacements would have to be sacrificed in order to protect other services, including accident and emergency (A&E) and cancer care.

However, the government has insisted waiting time targets must still be met. Recently the Chancellor awarded the NHS £2.8 billion over three years, including £1.6 billion in 2018 - less than the £4 billion which NHS officials had asked for to keep up with an ageing population and new medical technologies.

NHS managers said there was now very little spare capacity in the system, warning of shortages of paramedics, doctors, A&E consultants and nurses.

(Source: adapted from http://www.telegraph.co.uk/news/2017/12/07/hospitals-already-full-bursting-pressures-mount-warn-nhs-chiefs/)

Extract B

How health care is funded

Most countries have a mixed economy of health provision typically funded from taxation, patient fees and private health insurance.

The NHS was launched in the UK in 1948 to ensure direct state provision by the government of health care 'free at the point of use'. The NHS is mainly funded from general taxation. However, some NHS patients pay for some of their medical care, such as prescriptions to buy medicine.

In the ongoing debate about how best to fund the NHS, some people have proposed introducing a £12 charge for visiting a General Practitioner (GP) doctor. Proponents argue that such a charge would deter overuse of GP services by those who do not have genuine health needs. It would also raise additional money for the NHS and create incentives which will stimulate innovation and more choice.

Estimates suggested that a £12 charge on the 450 million visits a year to GPs could have raised enough to cover hospitals' overspend in 2016. Based on exemptions for prescriptions, 90% of patients will not be charged including the elderly, children and low income groups. There would also be administrative costs of collecting the charge and verifying exemptions. These arrangements would significantly reduce the amount a charge would generate, assuming no one paying would be dissuaded from visiting their GP.

The proportion of people in the UK taking out private health insurance (PHI) to pay for private health care has increased to 10.6%, despite significant increases in the prices of treatment in private hospitals. Some economists argue that the government should provide subsidies to encourage people to take out private health insurance. This would reduce the burden on the NHS by taking some people out of the state system. Furthermore it is argued that private health care increases choice for users, encourages competition and drives up standards of care.

A typical PHI policy for a healthy 35-year-old costs about £650 a year but this rises steeply to £2 300 for those aged 70, when claims are far more likely. The level of contribution is based on their risk of requiring health care. PHI also tends to incur high management and administrative costs due to the resources required to assess risk and claims. Also there is the possibility of market failure given asymmetric information.

(Source: adapted from https://www.kingsfund.org.uk/publications/how-health-care-is-funded)

Extract C

Public parks are a public good

Public parks are places which people can use for free to exercise or to relax. Parkrun Limited organises free weekly runs in local parks attracting hundreds of joggers per park to enjoy healthy exercise. The government is proposing to ban local authorities charging Parkrun for the use of public parks to fund the maintenance of public parks. The government considers that it is appropriate for the public to pay a reasonable sum for the private use of a facility such as a tennis court or a football pitch which may be used exclusively. However, the government does not consider it appropriate for a local authority to charge a volunteer community group 'seeking to provide a free weekly event' for the use of a public park. Parkrun share the park with other park users. Although a running course may be marked out there is no restriction on other people using the park.

(Source: adapted from © Crown Copyright Running Free – Government consultation on preserving the free use of public parks, April 2017, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/608372/Parkrun_ConDoc.pdf and http://www.telegraph.co.uk/news/2017/04/14/councils-banned-charging-runners-take-part-regular-saturday/)

(a) With reference to Extract A and Figure 2, explain how the health care market in the UK illustrates the economic problem.

(5)

(b) Explain how 'asymmetric information' (Extract B, line 30) can lead to market failure in health provision.

(6)

(c) 'Public parks are a public good' (Extract C, line 1). Assess this statement.

(10)

(d) Calculate the annual revenue raised by charging £12 per GP visit. Assume there will be 450 million GP visits per year and 90% of these will not be charged. You are advised to show your working.

(4)

(e) Discuss likely reasons why the prices of treatments in private sector hospitals are increasing. Draw a supply and demand diagram to support your answer.

(15)

EITHER

(f) Evaluate possible ways the government could intervene to reduce the excess demand for state-funded health care.

(20)

OR

(g) Evaluate the possible disadvantages of a free market approach to providing health care.

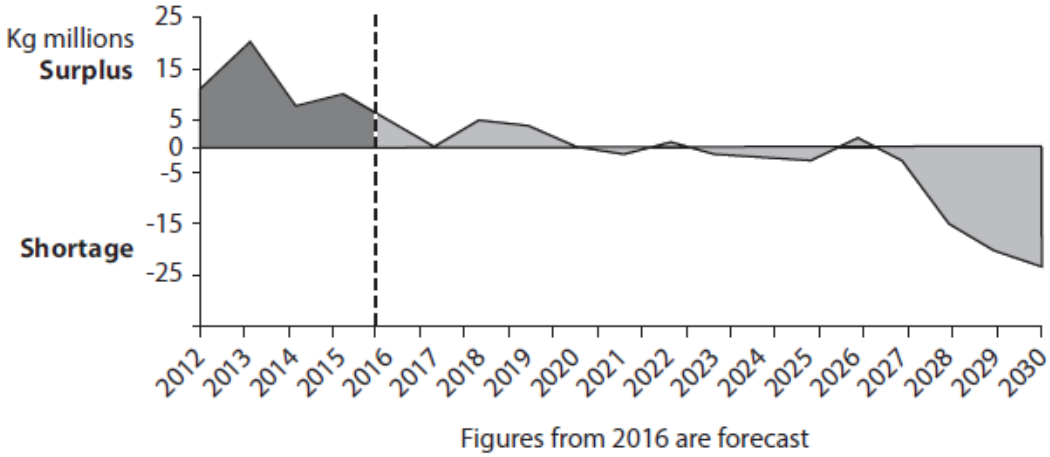
(20)

(Total for question = 60 marks)

Q7.

Energy markets

Figure 1: Annual surplus or shortage of uranium, measured in millions of kilograms



(Source: adapted from http://www.telegraph.co.uk/business/2016/11/20/uranium-the-unloved-metal-whose-price-is-poised-to-go-radioactiv/)

Extract A

Uranium: the unloved metal

Uranium is a fuel source for nuclear energy production. The price of uranium has fallen to a 13-year low. Uranium is a relatively common metal but locating it in the right concentrations can be difficult. Australia has the biggest known resource of uranium, followed by Kazakhstan. Kazakhstan's production has increased significantly since 2007, accounting for a large proportion of the surplus of this metal. Given the large stockpiles of uranium some firms have ceased production.

The biggest impact on the uranium market has been the devastating accident at the nuclear power station in Fukushima, Japan, in 2011. The accident caused a leak of radiation. The accident reduced confidence in the entire nuclear industry, as high doses of radiation leaks increase the risk of cancer. In addition the high cost of safely storing radioactive waste has delayed the building of new nuclear power stations. Japan initially closed all of its 50 nuclear power stations which reduced the demand for uranium. But it has since concluded that nuclear power must be part of its mix of energy suppliers.

Despite this setback in 2016 work started on a new uranium mine in Spain to meet the expected rise in demand for the metal. Uranium is a controlled material, so mining companies have to comply with many regulations before opening a new mine. When it opens in 2018, this will be the only uranium mine in Europe, producing 2.2 million kilos a year. It has been in development for more than a decade.

Most developed countries, with the notable exception of Germany, have concluded that nuclear power is an essential part of their energy supply. The US and UK are committed to building new nuclear power stations, the latter providing a £30 billion subsidy to build a new nuclear plant at Hinkley Point. China is also building a further 60 nuclear power stations.

Supporters of nuclear power say it provides a reliable source of energy at a time when the world's population is increasing, unlike solar power and wind power which both vary with the weather. In addition they argue that no country can significantly reduce carbon emissions, which are causing climate change, without nuclear. France and the UK have committed themselves to shut down all coal-fired power stations by 2025. So demand for uranium over the next two decades seems guaranteed.

(Source: adapted from Uranium: the unloved metal whose price is poised to go radioactive, Jon Yeomans, The Telegraph, 20 November 2016 http://www.telegraph.co.uk/business/2016/11/20/uranium-the-unloved-metal-whose-price-is-poised-to-go-radioactiv/)

Extract B

Irrational consumers pay the price

The UK Government has announced that it might introduce maximum price controls on energy used by households.

The UK's largest energy suppliers are braced for what could be the industry's most significant government intervention following a decade of rising energy bills and low numbers of consumers switching between energy providers.

The Prime Minister promised to intervene because the energy market is "manifestly not working" for consumers. Energy prices have risen by 158% in the last 15 years, and four million households, especially those on low incomes, are still on the most expensive energy rates.

Some energy analysts have warned the Government against taking a highly interventionist approach that could undermine the energy market and leave customers paying higher prices in the future.

(Source: adapted from http://www.telegraph.co.uk/business/2017/03/22/governments-pledge-cut-energy-prices-risks-leaving-consumers/)

Extract C

The economics of climate change

Rising carbon dioxide emissions result from the increase in the use of coal, gas and oil in transport and for energy production. In addition, deforestation, food production and processing methods make the problem worse. These carbon emissions are causing a rise in global average temperatures, known as climate change. Climate change could cause hundreds of millions of people to suffer hunger, water shortages and coastal flooding.

Three elements of policy are required for an effective global response to reduce carbon emissions. The first is the pricing of carbon, implemented through tax, trading pollution permits or regulation. The second policy is to support innovation and the deployment of low-carbon technologies. And the third is action to remove barriers to energy efficiency, and to inform, educate and persuade individuals about what they can do to respond to climate change.

(Source: adapted from www.sternreview.org.uk/)

(a) With reference to Figure 1 and Extract A, explain why the price of uranium has 'fallen to a 13-year low' (Extract A, lines 2 and 3) in 2016. Include a supply and demand diagram in your answer.

(5)

(b) With reference to Extract A and your own knowledge, assess whether the supply of uranium is likely to be price elastic or price inelastic.

(10)

(c) With reference to Extract B, explain **two** likely reasons why many consumers of energy have not switched to suppliers offering lower prices.

(6)

(d) Using examples from the information provided, explain what is meant by renewable and non-renewable energy.

(4)

The UK Government is considering introducing a maximum price for energy.

(e) Discuss the likely microeconomic effects of this decision on energy producers **and** consumers. Include a supply and demand diagram in your answer.

(15)

EITHER

(f) Using the concept of external costs, evaluate whether nuclear power is under-provided or over-provided in the energy market. Use an appropriate diagram in your answer.

(20)

OR

(g) Evaluate ways in which government intervention could be used to reduce carbon emissions. Use at least one appropriate diagram in your answer.

(20)

(Total for question = 60 marks)

Q8.

Read extracts A and B before answering this question.

Hand car wash (HCW) firms in the UK

Extract A

What is the true human cost of your £5 hand car wash (HCW)?

The UK's hand car washes (HCWs) are extremely price competitive, but they have also been linked to modern slavery. Are they ever fair for workers?

There is little agreement about how many HCWs there are in the UK. Estimates range from 10 000 to 20 000. This lack of accurate information about the industry makes government regulation very difficult. Automated car washes, with their fierce rotating bristles, used to be the first option for drivers in a hurry. Now there is more choice. While the economy slows and incomes fail to keep up with inflation, demand for HCWs has grown. Many people see paying £5 for a car washed by someone else, rather than cleaning it at home, as a small expense which yields a high utility. But what is the true cost of a £5 car wash – and what should we be paying?

The growth of HCWs is partly the result of changes in the structure of industry in the UK. Many petrol stations have closed as drivers fill up at supermarkets. Garages and their forecourts have closed as cars become more reliable and locked into service agreements. The available sites for HCWs have therefore increased significantly and rents have fallen.

HCW entrepreneurs have identified available land and have benefitted from changes in the labour market, partly as a result of EU migration. UK drivers are now able to obtain cheap and effective hand car washing. For many migrants, car washes are a first job. "They accept car washing for a short period while they improve their language skills and move into other industries," says Ian Clark, a professor of work and employment at Nottingham Business School. "But there are also car-wash workers without networks who are in a dead end, working there for long periods."

Many drivers are only interested in getting the cheapest wash. If the price is very low, it probably means that workers are receiving less than the minimum wage and working in poor conditions. Crude calculations illustrate the problem. A £5 HCW employing five workers for 10 hours a day would need to wash 79 cars a day to just cover the wage costs. This assumes the workers are paid the minimum wage. This is one car every seven and a half minutes. Even if the profit can be higher on valet services, the price of which can be as little as £12 for a full inside-and-out clean, it's hard to see how a car wash price as low as £5 pays a living wage. This ignores all other costs which HCWs incur such as business rates and rent.

Evidence from car-wash workers is limited but Clark and others have been able to build a picture of some of the tougher conditions on drenched forecourts. "Like nail bars and small garment manufacturers, car washes are what we call 'hard-to-reach places,'" Clark explains. As part of the research, Clark and his team spoke to workers from 45 HCWs in the Midlands.

Clark and his team met and observed workers who lacked waterproof boots or trousers, or hi-vis jackets and gloves. "They're spraying around hydrochloric acid solution for alloy wheels, breathing in the vapour and fumes," Clark says. Some workers were paid a little over half the minimum wage.

(Source adapted from: https://www.theguardian.com/world/2018/jul/16/true-human-cost-5-pound-hand-car-wash-modern-slavery)

Extract B

Government intervention in the HCW industry

There are three main areas of government intervention that might impact on labour intensive firms such as HCWs:

First, there is the planning issue which focuses on the impact on the environment, for example, the disposal and recycling of waste water and chemicals. There could be planning regulations to prevent the use of tarmac rather than concrete on forecourts. Tarmac allows waste water and chemicals to seep into the sub soil. It could also be a requirement to have a sludge trap to stop the waste entering waterways.

Second, there is the health and safety issue for workers. Prolonged exposure to chemicals and lack of protective clothing puts the health of workers at risk. Performance targets could involve minimum levels of protective clothing and rest breaks for the workers.

Third, there is the issue of tax. The informal nature of the business type makes tax evasion easier.

Not all UK HCWs violate regulations. There are legitimate, regulated HCW firms as well as examples of good practice by independent outlets. One national supermarket, Tesco, has banned all independent hand car washes from its car parks. It is now in a partnership agreement with national car wash operator Waves. It uses a WashMark certificate of quality and compliance which was introduced by the industry to improve working conditions. Other major supermarkets are considering similar changes. One adviser believes £9 is a reasonable minimum price for a basic wash. Some pressure groups have developed a mobile phone app where evidence of unreasonable conditions can be reported by drivers.

Involving drivers in the issue, and making them demand fairer car washes, creates an incentive for good businesses to improve practices and come forward to get a WashMark certificate.

(Source adapted from: https://www.parliament.uk/documents/commons-committees/environmental-audit/Hand-Car-Wash-evidence.pdf research into HCWs by Professor Ian Clark, Nottingham Business School May 2018)

(a) Using the information provided, explain the market structure that best describes the hand car wash (HCW) industry in the UK.

(5)

(b) Examine **two** reasons why the demand for HCWs increases during a period when consumer 'incomes fail to keep up with inflation' (Extract A line 8).

(8)

(c) Discuss the likely effects of changes in the level of migration on firms such as HCWs in the UK. Use a labour market diagram and the information provided to support your answer.

(12)

EITHER

(d) Evaluate the microeconomic and macroeconomic factors which determine the number of firms in an industry. Refer to HCWs or another industry of your choice.

(25)

OR

(e) Evaluate the microeconomic and macroeconomic effects of increased government intervention in an industry. Refer to HCWs or another industry of your choice.

(25)

(Total for question = 50 marks)