



General Certificate of Education  
Advanced Subsidiary Examination  
June 2010

## Economics

## ECON1

### Unit 1 Markets and Market Failure

**For this paper you must have:**

- an objective test answer sheet
- a black ball-point pen
- an AQA 8-page answer book.

You may use a calculator.

**Time allowed**

- 1 hour 15 minutes

**Section A (ECON1/1)**

- Answer **all** questions on your objective test answer sheet.
- Use a black ball-point pen. Do **not** use pencil.
- Do all rough work in this question paper, **not** on your objective test answer sheet.

**Section B (ECON1/2)**

- Answer **EITHER** Context 1 **OR** Context 2.
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON1/2.

**Information**

- The maximum mark for this paper is 75.
- There are 25 marks for **Section A**. Each question carries one mark.
- There are 50 marks for **Section B**. The marks for questions are shown in brackets.
- In **Section A**, each question carries 1 mark. No deductions will be made for wrong answers.
- You will be marked on your ability to:
  - use good English
  - organise information clearly
  - use specialist vocabulary where appropriate.

**Advice**

- You are advised to spend no more than 25 minutes on **Section A** and at least 50 minutes on **Section B**.

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**SECTION A: OBJECTIVE TEST**

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

Each question carries 1 mark. No deductions will be made for wrong answers.

You are advised to spend no more than 25 minutes on **Section A**.

For each question there are four alternative responses, **A**, **B**, **C** and **D**. When you have selected the response which you think is the best answer to a question, mark this response on your objective test answer sheet. If you wish to change your answer to a question, follow the instructions on your objective test answer sheet.

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- 1 Government intervention in a free market economy is most likely to improve the allocation of resources if
  - A a shortage has led to a rise in the price of a product.
  - B the price of a product has been increased as a result of an increase in production costs.
  - C the market is under-supplying a product that produces a positive externality.
  - D firms cut back on production in response to a fall in demand.
  
- 2 Which one of the following is the most likely determinant of the elasticity of supply of good X?
  - A The price of good X
  - B The price elasticity of demand of good X
  - C Spare capacity in the production of good X
  - D Total production of good X
  
- 3 A good is in composite demand when
  - A it is demanded for two or more distinct uses.
  - B the demand for the good is the result of the demand for another good.
  - C it is bought together with another good.
  - D it is a substitute for another good.

- 4 The table below shows the world prices (\$/tonne) of various grains for a two-year period.

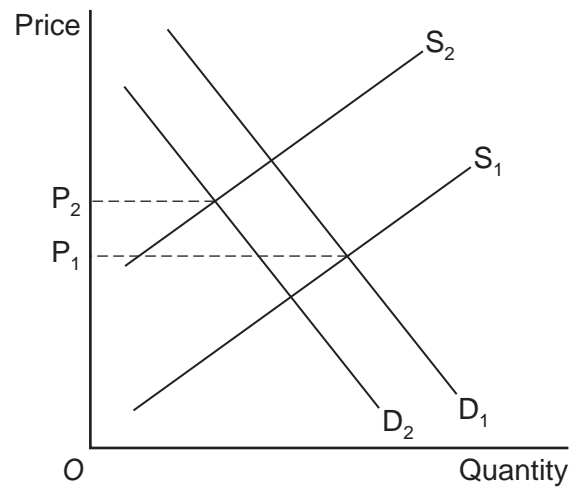
	Year 1	Year 2
Wheat	120	85
Barley	160	115
Oats	95	82
Maize	170	130

Which one of the following is supported by the data?

- A** The earnings of wheat producers will have decreased between Year 1 and Year 2 if the demand for wheat is price elastic.
- B** The trend in the price of barley between Years 1 and 2 will encourage producers of barley to increase output.
- C** The price elasticity of demand is lowest for oats.
- D** Total revenue from the sale of maize will have fallen between Years 1 and 2 if the demand for maize is price inelastic.
- 5 Which one of the following is most likely to lead to improvements in labour productivity?
- A** An increased supply of labour
- B** Less division of labour
- C** Less specialisation
- D** Adopting capital-intensive methods of production
- 6 The state provides some merit goods free of charge because
- A** they can only be produced by monopolists.
- B** it is considered unacceptable that people on low incomes may be unable to afford them.
- C** the consumption of merit goods results in negative externalities.
- D** merit goods are both non-excludable and non-rival.

Turn over ►

- 7 The diagram below shows the demand and supply curves for milk, where  $P_1$  is the initial equilibrium price.



The increase in price from  $P_1$  to  $P_2$  is most likely to be a result of

- A an increase in milk production costs and a decrease in the price of complementary goods to milk.
  - B a successful advertising campaign for a milk substitute and a tax on milk.
  - C a decrease in the population and an increase in the subsidy on milk.
  - D a decrease in wages paid to all workers, including farm workers.
- 8 Which one of the following is a factor of production?
- A The profits made by firms
  - B Land owned or rented by firms
  - C Money held by firms in bank accounts
  - D The productivity of labour

- 9 The table below shows the cross elasticities of demand for the products of four companies with respect to the prices of their closest substitutes.

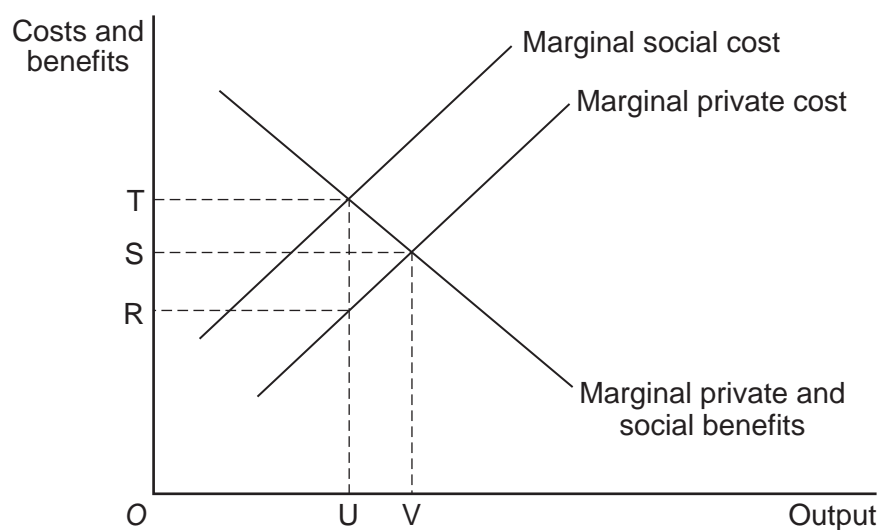
Product of	Cross elasticity of demand
Company A	+2.0
Company B	+1.0
Company C	+0.5
Company D	+0.1

All other things being equal, which one of the above companies is most likely to possess the greatest market power?

- A Company A
  - B Company B
  - C Company C
  - D Company D
- 10 Which one of the following is most likely to be a source of monopoly power?
- A The employment of specialised staff by a firm as it increases its size.
  - B The existence of diseconomies of scale at high output levels.
  - C The granting of a patent to a pharmaceutical company for a newly-developed drug.
  - D The merger of two small firms in a large industry.
- 11 Government failure is most likely to arise directly from
- A inadequate information.
  - B the forces of demand and supply.
  - C market failure.
  - D diseconomies of scale.

- 12 The price of cocoa more than doubled over an 18-month period as a result of increased buying on world markets. Such a development in the cocoa market could be shown on a supply and demand diagram by
- A a movement along the demand curve to the left.
  - B a movement along the demand curve to the right.
  - C a shift of the demand curve to the right.
  - D a shift of the demand curve to the left.

- 13 The diagram below shows the market for a demerit good.



In the absence of government intervention in this market, a misallocation of resources is likely to occur because

- A there will be underproduction of the good equivalent to the distance  $OU$ .
  - B the market price will be too high.
  - C there is a missing market for the good.
  - D there will be overproduction of the good equivalent to the distance  $UV$ .
- 14 The role of prices in a market economy is to
- A allocate scarce resources.
  - B provide a mechanism for firms to make profits.
  - C improve the distribution of income.
  - D determine the elasticity of demand curves.

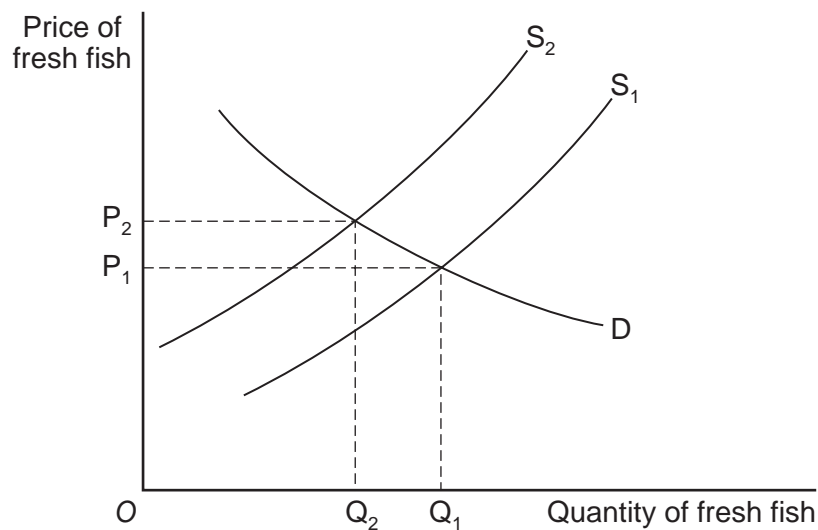
15 Which one of the following combinations, **A**, **B**, **C** or **D**, is true for a normal good which has a downward sloping demand curve?

Combination	Income elasticity of demand	Price elasticity of demand
<b>A</b>	Positive	Positive
<b>B</b>	Positive	Negative
<b>C</b>	Negative	Negative
<b>D</b>	Negative	Positive

16 A shift to the left of a country's production possibility frontier reflects

- A** an under-utilisation of the country's scarce resources.
- B** a rise in the country's level of productivity.
- C** a fall in the country's productive capacity.
- D** a rise in the country's efficiency.

17 The diagram below shows the market for fresh fish.

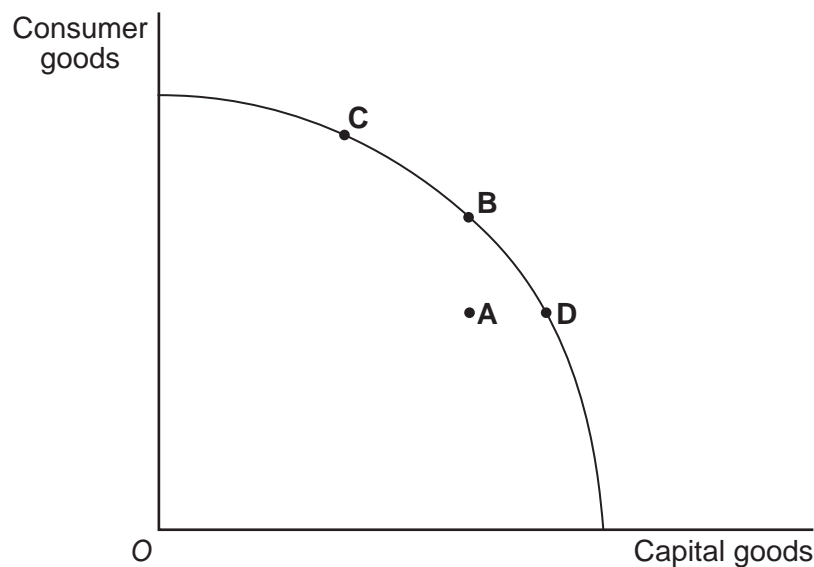


The shift of the supply curve from  $S_1$  to  $S_2$  is most likely to have resulted from

- A** an increase in the wages of fishermen.
- B** improved technology in the fishing industry.
- C** an increased preference for fresh fish by the consumer.
- D** a fall in the price of frozen fish.

Turn over ►

- 18 Diseconomies of scale might arise because
- A firms spend money on new technology which leads to lower average costs.
  - B decision-making by management becomes more difficult in larger firms.
  - C workers are more likely to be productively efficient in larger firms.
  - D larger firms can buy in bulk.
- 19 The diagram below shows a production possibility frontier for an economy. Which point, **A**, **B**, **C** or **D**, corresponds to a situation whereby the economy could increase production of consumer goods without forgoing the production of capital goods?



- 20 The main economic objective of firms in a market economy is most likely to be the
- A achievement of economies of scale.
  - B maximisation of consumer satisfaction.
  - C achievement of an efficient allocation of resources.
  - D maximisation of profits.
- 21 The price elasticity of demand for a good made by a firm is  $-0.6$ . If the firm raises the price of the good, its revenues will
- A rise.
  - B stay the same.
  - C fall by more than 6 per cent.
  - D fall by less than 6 per cent.



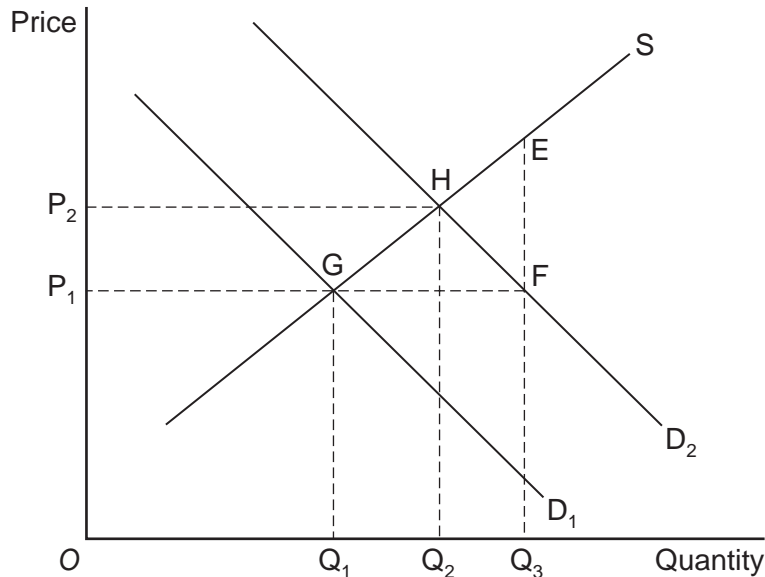
22 The government is considering four possible capital investment projects. It has the resources to implement only one of these projects. The table below shows the estimated value of the private and external costs and benefits that each project is expected to yield.

	New hospitals (£ million)	New roads (£ million)	New schools (£ million)	New airport (£ million)
Private benefits	40	120	10	200
Private costs	100	100	20	100
Positive externalities	140	60	100	50
Negative externalities	40	20	20	160

Which one of the projects should the government adopt if it wishes to maximise the economic welfare of the whole community?

- A New hospitals
- B New roads
- C New schools
- D New airport

23 The supply and demand diagram below relates to the market for a merit good.



The demand curve for the merit good shifts from  $D_1$  to  $D_2$ , raising the market price from  $P_1$  to  $P_2$ . To reduce the price back to  $P_1$ , the government could introduce a

- A minimum price of  $OP_1$  per unit.
- B subsidy of  $EF$  per unit.
- C subsidy of  $P_1P_2$  per unit.
- D subsidy of  $GH$  per unit.

Turn over ▶

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- 24** Which one of the following is a source of market failure?
- A** An increase in a firm's profits resulting from excess demand for its product
  - B** Government intervention to correct a divergence between private and social benefits
  - C** Increasing diseconomies of scale as a firm increases production
  - D** Inequalities in the distribution of income and wealth
- 25** The government is concerned that the economy is not achieving productive efficiency. To achieve productive efficiency in the economy, the government should introduce policies that
- A** move the economy to a point on its production possibility frontier.
  - B** ensure that the goods and services produced match people's needs and preferences.
  - C** limit the amount of profits that companies can earn.
  - D** encourage all firms to expand.

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

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

**TURN TO PAGE 12 FOR SECTION B**

**Turn over for the next question**

**Turn over ▶**

### SECTION B: DATA RESPONSE

Answer EITHER Context 1 OR Context 2.

You are advised to spend at least 50 minutes on Section B.

**EITHER**

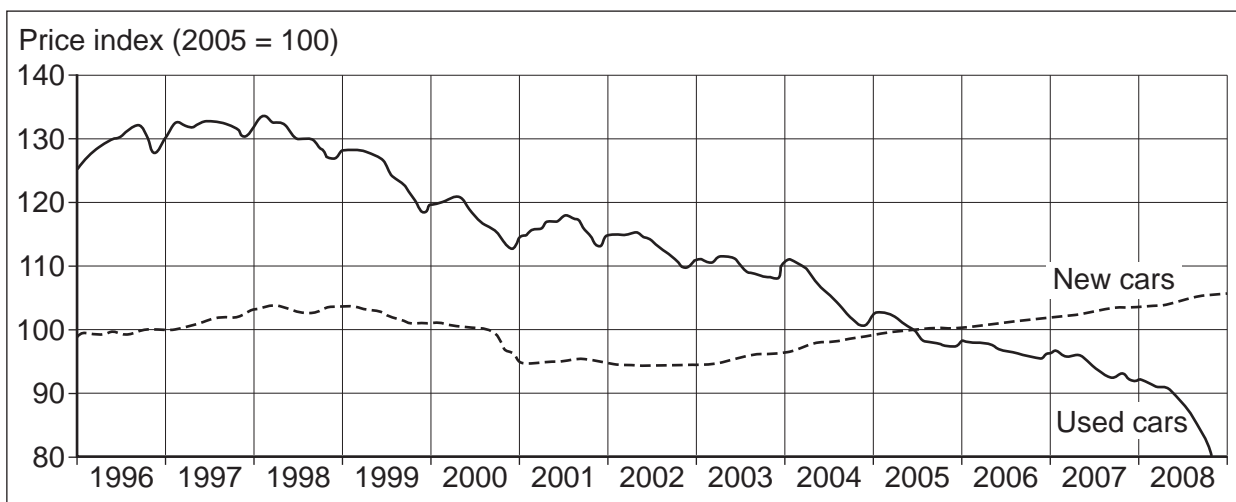
Total for this Context: 50 marks

**CONTEXT 1**

**MARKETS FOR CARS**

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

**Extract A: Average prices of new and used cars in the UK, 1996 to 2008 (2005=100)**



**Extract B: Why used-car prices have fallen**

The Rolls-Royce offered for second-hand sale at a London auction is only two years old, but it is as immaculate as a new model costing more than £265 000. Within seconds, it has been sold for £135 000. All the cars that follow, including scores of Audi, BMW and Mercedes models, are suffering the indignity of a collapse in used-car prices.	1          5
In November 2008, sales of new luxury cars in the USA were 39% lower than in the same month in 2007. The same was true in Europe and Asia. In response, car manufacturers are cutting back by closing factories, at least for a few weeks or months.	
The lack of readily available finance has reduced the demand for luxury cars. Many customers are trading down to buy less expensive cars or keeping them longer. To attract buyers for new luxury cars, some manufacturers have been offering discounts and incentives that average more than £15 000. With such big discounts available on new models, people expect to pay even less for second-hand ones. Second-hand prices are not expected to improve until the surplus of new and used cars has been eliminated.	10          15

Source: news reports, 2008

**Extract C: The market for electric cars**

US carmakers are betting billions of dollars on producing electric cars at a time when they can ill afford it. The bet is risky. For all their stated concerns about global warming, dependence on foreign oil and unpredictable petrol prices, consumers may not buy enough electric cars. But President Obama is committed to promoting cleaner cars. He wishes to create incentives for consumers and businesses to buy electric cars through the introduction of subsidies.	1 5
It is unclear whether motorists will be comfortable with the idea of buying an electric car, or whether these vehicles will be priced to compete with comparable petrol- and diesel-powered models. Competitive pricing requires manufacturers to benefit from economies of scale, both in the production of the cars themselves and in the production of the complex batteries needed to power the cars on the road. Strong consumer demand is essential if economies of scale are to be achieved.	10
So far, motorists have not shown that they care that much about the environment. When UK petrol prices soared above £1.20 a litre last year, sales of Toyota's part-electric powered, market-leading Prius car surged so quickly that Toyota could not build them fast enough. But demand dropped sharply when petrol prices dropped below £1.00 a litre.	15

Source: news reports, 2009

- 0 1** Define the term 'economies of scale' (**Extract C**, line 10). (5 marks)
- 0 2** Using **Extract A**, identify **two** significant points of comparison between the average prices of new and used cars over the period shown by the data. (8 marks)
- 0 3** With the help of a demand and supply diagram and the information in **Extract B**, explain the reasons for the falling prices of used cars in 2008. (12 marks)
- 0 4** Using the data and your economic knowledge, evaluate the economic case **for** and **against** government intervention in car markets. (25 marks)

Turn over ►

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

OR

**Total for this Context: 50 marks**

**CONTEXT 2**

**THE NEED FOR SPORT AND EXERCISE**

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

**Extract D: Percentages of men and women participating in selected physical activities in the UK, 2002**

Activity	Men	Women
Badminton	2	1
Bowls	2	1
Cycling	12	6
Football	10	1
Golf	9	1
Keep fit and yoga	7	16
Running and jogging	7	3
Snooker, pool, billiards	15	4
Swimming	12	15
Tennis	2	2
Tenpin bowling and skittles	4	3
Walking	36	34
Weight training	9	3

Source: General Household Survey, 2003

**Extract E: The decline of exercise among schoolchildren**

Access to good facilities, including playing-fields, is the key to inspiring more young people to take up sport. Some people argue that the government should subsidise the provision of sports facilities such as swimming pools, or even provide them for free, because they generate the positive externality arising from a fitter and healthier population.	1 5
However, figures show there has been a steady loss of land on which children can play, despite government promises to protect playing-fields. All over England, school playing-fields have been sold off to help pay for the costs of education. Supermarkets, petrol stations, office buildings, houses and blocks of flats now stand where children used to play.	10
The sale of playing-fields and the closing of swimming pools have both contributed to the fact that the youth of Britain has never been so unfit. Everywhere, teachers have been giving up the struggle to coach games in cramped, inadequate and, in some cases, virtually non-existent facilities.	

Government health advisers are calling on local councils to use 'non-traditional settings' to raise children's activity levels. For example, youngsters are being encouraged to play in office car parks outside work hours in an effort to encourage more exercise.	15
Parents could also be paid to get their children to cycle to school. However, parents' groups have raised concerns over children's safety when cycling on the road. They have also criticised the plan for 'sending the wrong message' by offering a cash incentive, rather than explaining to the young the health dangers of a lack of exercise. Liverpool Council said it was considering giving free bikes to children. Currently, only around one in fifty children cycles to school.	20
Margaret Morrissey, spokeswoman for the National Confederation of Parent Teacher Associations, said: "Taxpayers will probably be a little uncomfortable with paying parents to get children to school. What we should be teaching them is that they need to exercise."	25

Source: news reports, 2006-8

- 0 5** Define the term 'positive externality' (**Extract E**, line 4). (5 marks)
- 0 6** Using **Extract D**, identify **two** significant points of comparison between the percentages of men and women participating in selected physical activities in the UK in 2002. (8 marks)
- 0 7** 'Supermarkets, petrol stations, office buildings, houses and blocks of flats now stand where children used to play' (**Extract E**, lines 8-10).  
  
With the help of a supply and demand diagram, explain how the sale of school playing-fields may affect house prices. (12 marks)
- 0 8** Using the data and your economic knowledge, evaluate different economic policies that could be used to encourage schoolchildren to undertake more exercise. (25 marks)

**END OF QUESTIONS**

**There are no questions printed on this page**