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Edexcel GCE

Economics

Advanced Subsidiary

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

Thursday 12 January 2012 – Morning Time: 1 hour 30 minutes	Paper Reference 6EC01/01
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You do not need any other materials.	Total Marks
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Instructions

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

Information

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

Advice

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

Turn over ►

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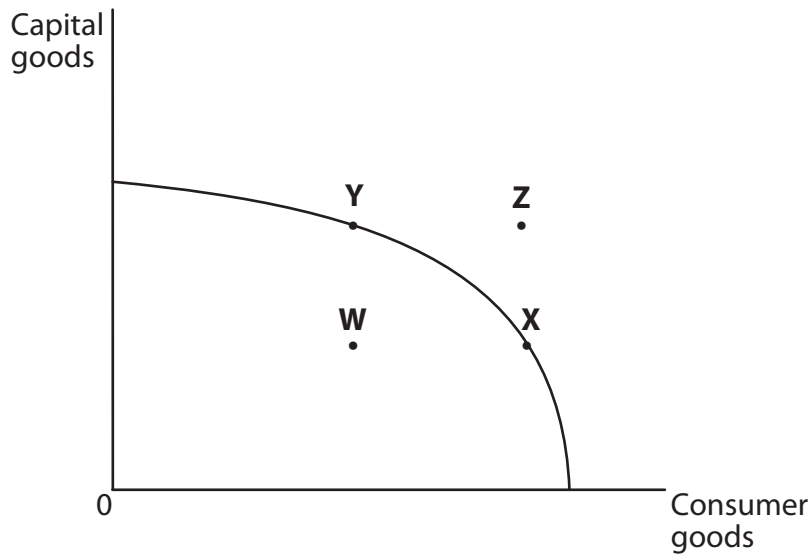


PEARSON

Section A: Answer all the questions in this section

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

1



The diagram shows a production possibility frontier for an economy. Which of the following is true?

(1)

- A There is full employment of resources at W.
- B Economic growth is likely to be higher at X than Y.
- C Z is currently unattainable.
- D There is a constant rate of opportunity cost between X and Y.

Answer



Explanation

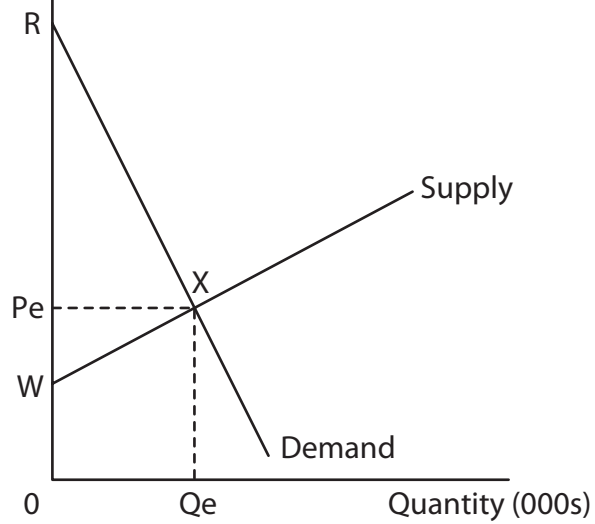
(3)

Area with horizontal dotted lines for writing the explanation.

(Total for Question 1 = 4 marks)



2 Price per pair of sports shoes (£)



The diagram shows the market for sports shoes. Which of the following is true?

(1)

- A The supply of sports shoes is price inelastic.
- B The area of consumer surplus is greater than the area of producer surplus.
- C There is constant price elasticity of demand along the length of the demand curve.
- D There is an inverse relationship between the price and quantity supplied of sports shoes.

Answer



Explanation

(3)

Area with horizontal dotted lines for writing the explanation.

(Total for Question 2 = 4 marks)



3 The table below shows UK estimates of the percentage changes in price and quantity demanded for fresh fruit and fresh vegetables between 2007 and 2008. You may use the last column for your workings.

Type of food	Price change (%)	Quantity demanded (%)	
Fresh fruit	7.0	-7.7	
Fresh vegetables	8.0	-9.6	

(Source: © Crown Copyright 2008)

Other things being equal the data in the table suggest that:

(1)

- A Demand is more price elastic for fresh vegetables than fresh fruit.
- B Total revenue has increased for producers of both fresh fruit and fresh vegetables.
- C Demand is price inelastic for both fresh fruit and fresh vegetables.
- D There is a negative income elasticity of demand for fresh fruit and fresh vegetables.

Answer

Explanation

(3)

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(Total for Question 3 = 4 marks)



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- 4 The table below shows UK average weekly income and selected transport statistics 2002–2008.

Year	2002	2008
Average gross weekly household income (in real terms at 2002 prices)	£552	£604
<i>Billion passenger kilometres travelled by:</i>		
Cars and taxis	393	402
Buses and coaches	5.2	5.2
Bicycles	4.4	4.7
Rail	48	61

(Source: © Crown Copyright, adapted from Figures 8.3 and 17.3 in the Annual Abstract of Statistics and Social Trends 2010)

The data in the table suggest that over the period

(1)

- A The income elasticity of demand for bus and coach travel is equal to 1.0.
- B The income elasticity of demand for travel by bicycle is negative.
- C The price elasticity of demand for rail travel is positive.
- D The income elasticity of demand for travel by cars and taxis is positive.

Answer



Explanation

(3)

Area with horizontal dotted lines for writing the explanation.

(Total for Question 4 = 4 marks)



5 In 2010 the Scottish Government proposed a legal minimum price per unit of alcoholic drink. Other things being equal, a minimum price set above the market equilibrium price is likely to cause

(1)

- A** an excess supply
- B** a fall in price
- C** an increase in consumption
- D** no effect in the market

Answer

Explanation

(3)

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(Total for Question 5 = 4 marks)



6 A free market economy fails to allocate resources efficiently to the production of public goods because

(1)

- A No opportunity cost is involved in the provision of public goods.
- B Providing public goods can result in a free rider problem.
- C Public goods can only be provided by the private sector.
- D The prices of public goods may be set at too high a level.

Answer

Explanation

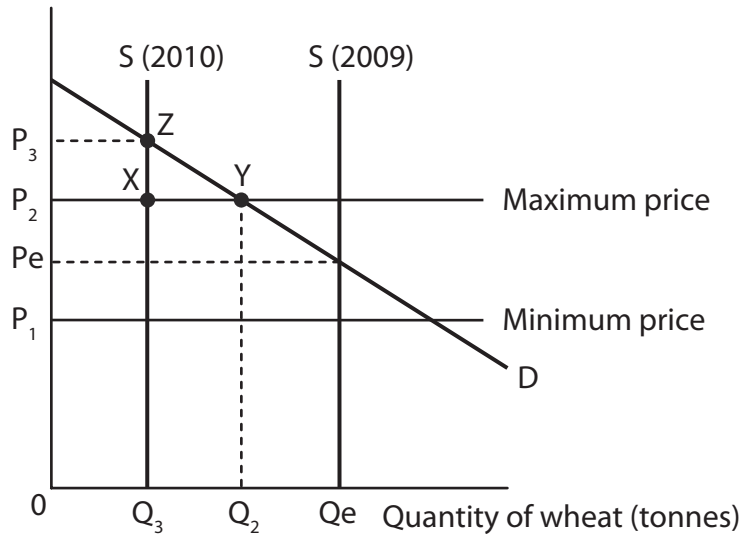
(3)

(Total for Question 6 = 4 marks)



7

Price of wheat per tonne (\$)



The diagram shows the operation of a buffer stock scheme in the wheat market where a government agency intervenes to ensure the price remains between P_1 and P_2 . The 2010 harvest led to

(1)

- A An excess supply of wheat
- B The government agency buying wheat and adding to its stockpile
- C Price decreasing to P_1
- D The government agency selling wheat from its stockpile

Answer



Explanation

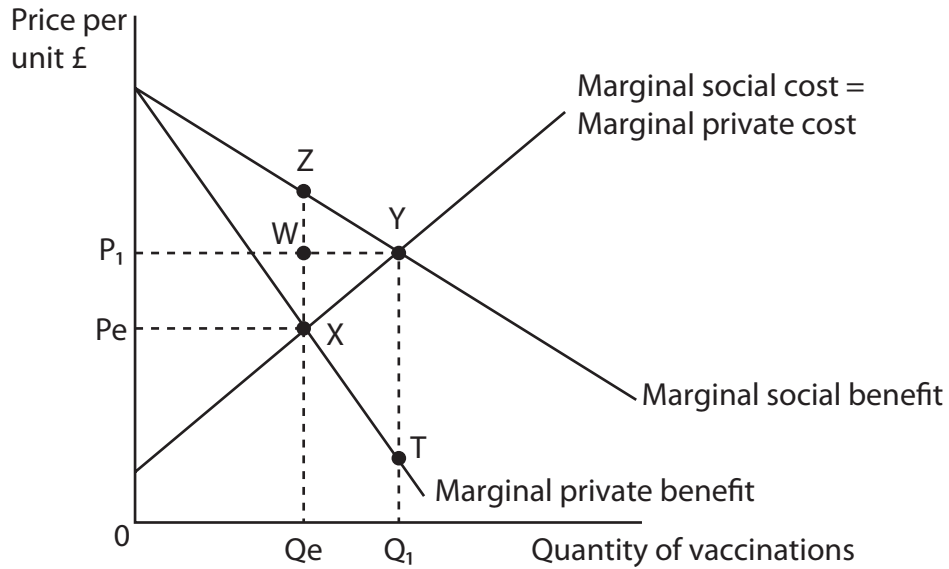
(3)

Area with horizontal dotted lines for writing the explanation.

(Total for Question 7 = 4 marks)



8



The diagram shows the market for vaccinations. Assume there are no external costs. Which of the following is true?

(1)

- A The free market equilibrium quantity exceeds the social optimum quantity.
- B The area of welfare loss is XTYZ.
- C An increase in quantity from the free market equilibrium will lead to a net welfare gain.
- D At the free market equilibrium quantity, marginal social cost exceeds marginal social benefit.

Answer



Explanation

(3)

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(Total for Question 8 = 4 marks)

TOTAL FOR SECTION A = 32 MARKS



Section B: Answer either Question 9 or Question 10.

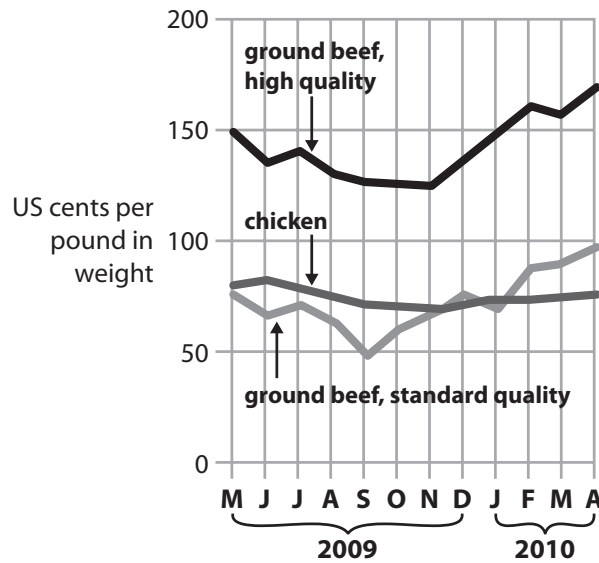
If you answer Question 9 put a cross in this box .

Question 10 starts on page 28.

You should spend 55 minutes on this section.

9 The price of beef

Figure 1 The price of beef and chicken for fast food restaurants 2009 – 2010



Extract 1 Rising price of beef

It is **not** a happy time in American fast food restaurants. Rising beef prices have reduced profit margins at the McDonalds, Burger King and Wendy chains. They have found it difficult to pass on higher beef prices to their customers through the sale of burgers such as the 'Big Mac' and 'Whopper'. Instead, the fast food restaurants have responded by promoting sales of chicken burgers and fish fillets.

5

Beef prices have risen due to higher costs for cattle feed and severe drought conditions in Australia and New Zealand (the main suppliers of beef for American fast food restaurants).

However, there is some good news. The fast food restaurants have benefited from the recession as consumers made savings by switching from eating at expensive restaurants to cheaper burger bars.

10

(Source: © *The Times* 'Increase in meat prices has burger lovers asking: where's the beef?', Alexandra Freaan, 24th May 2010)



Extract 2 Cattle farms damaging the rainforest

Deforestation in Brazil releases an estimated 400 million tonnes of carbon dioxide into the atmosphere every year, making the country one of the biggest emitters of the gas in the world. An average of 7,330 square miles of rainforest has been lost each year since 1995. The destruction of rainforest has accelerated over the past few years due to soaring beef and soya prices. Farmers are burning more rainforest to turn land into cattle ranches and into fields for growing crops. 5

However, the President of Brazil announced plans to reduce deforestation by subsidising sustainable development projects. These include replanting trees and creating eco-friendly tourism as alternative means of providing employment and income for local communities. The amount of funds made available has not been revealed. 10

The proposals also include an increase in the policing of forested areas and severe penalties for those breaking the law through illegal logging and farming.

(Source: © Guardian News & Media Ltd 2008, adapted from 'Brazil sets target to slow Amazon deforestation', by David Ljunggren)

- (a) With reference to Figure 1 and the second paragraph of Extract 1, explain the causes of the increase in price of beef. Use a supply and demand diagram in your answer. (6)
- (b) Using cross elasticity of demand, discuss the likely relationship between the price of beef and the demand for chicken and fish. (6)
- (c) Assess whether beef and beef burgers are likely to be normal goods or inferior goods. (8)
- *(d) Using the concepts of external costs and market failure, examine the possible economic effects of farmers 'burning more rainforest to turn land into cattle ranches and into fields for growing crops'. (Extract 2, lines 5–6). Use an appropriate diagram in your answer. (14)
- *(e) Discuss the possible economic effects of the government providing subsidies to support sustainable development projects such as those referred to in Extract 2. (14)



(b) Using cross elasticity of demand, discuss the likely relationship between the price of beef and the demand for chicken and fish.

(6)

Area with horizontal dotted lines for writing the answer.



(c) Assess whether beef and beef burgers are likely to be normal goods or inferior goods. (8)

Handwriting practice area consisting of multiple horizontal dotted lines.



*(d) Using the concepts of external costs and market failure, examine the possible economic effects of farmers 'burning more rainforest to turn land into cattle ranches and into fields for growing crops'. (Extract 2, lines 5–6). Use an appropriate diagram in your answer.

(14)

Area with horizontal dotted lines for writing the answer.



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*(e) Discuss the possible economic effects of the government providing subsidies to support sustainable development projects such as those referred to in Extract 2.

(14)



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(Total for Question 9 = 48 marks)



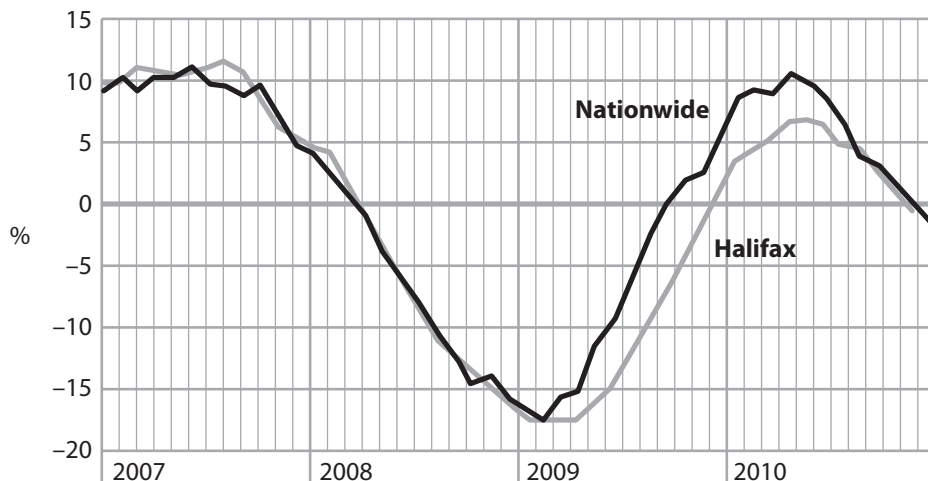
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If you answer Question 10 put a cross in this box .

10 Difficult times for house builders and first time buyers

Figure 1 UK house prices, year on year % change



(Source: © Halifax & © Nationwide Building Society)

Figure 2 Share prices of the seven largest UK house builders, percentage change

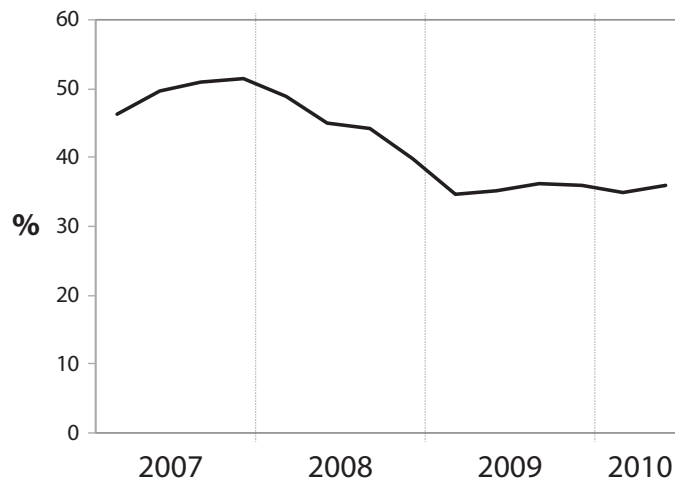
Company	% change (Jan 1st–Nov 5th 2010)
Berkeley Group	+2.9
Redrow	-16.2
Bovis Homes Group	-18.8
Persimmon	-23.0
Bellway	-31.7
Barratt Developments	-32.9
Taylor Wimpey	-32.9

(Source: Investing 5th November 2010

<http://www.fool.co.uk/news/investing/2010/11/05/a-harsh-winter-for-housebuilders.aspx>)



Figure 3 Affordability of UK property for first-time buyers
Mortgage payments as a % of average take home pay for first-time buyers



(Source: © Nationwide Building Society)

Extract 1 Falling house prices

There are fears of a housing market crash following the largest ever recorded monthly fall in house prices in September 2010. According to Halifax Bank, over £6000 (3.6%) was wiped off the average house price.

More than £1 billion has been knocked off the stock market value of Britain’s seven leading house building firms between January and November 2010, over a period when share prices generally have increased by nearly 20%. The fall in house prices has caused the supply of new housing to fall sharply. Builders’ profits and employment have suffered.

5

Howard Archer, Chief economist at Global Insight, believes house prices will continue to fall by 10% in 2011. He added that a combination of factors was affecting house prices, including: high (and rising) unemployment, limited wage growth, deteriorating consumer confidence and difficulties in getting a mortgage.

10

(Source: © Guardian News & Media Ltd 2010)



Extract 2 First-time buyers

The number of new mortgages (loans which enable people to buy a property) dropped in September to its lowest level for more than a decade. Despite falling house prices, there are immense challenges for first-time buyers to get on to the property ladder. Lenders have increased the cash deposit required to gain a mortgage and refused to pass on interest rate cuts to this group of buyers due to the risk involved. The outlook is further worsened by rising unemployment and soaring student debt. A 30% cut in government subsidies for new-build affordable homes was also announced in the government spending review.

5

However, Figure 3 shows that housing has become more affordable for first-time buyers over recent years if they can provide a cash deposit. The alternative is to rent property. The Royal Institution of Chartered Surveyors report an increase in demand for rental properties and in rents charged over the latter part of 2010.

10

(Source: © Guardian News & Media Ltd 2010 adapted from 'Clouds over the housing market create a perfect storm for first-time buyers', by Simon Bowers)

- (a) With reference to the last paragraph of Extract 1, explain why house prices fell in September 2010. Illustrate your answer with a supply and demand diagram. (6)
- (b) With reference to Extract 1 and Figure 2, assess the likely impact of falling house prices on house-building firms. (8)
- (c) Discuss whether the supply of **new** housing is likely to be price elastic or price inelastic. (6)
- *(d) To what extent might falling house prices help 'first-time buyers to get on to the property ladder' (Extract 2, lines 3 and 4)? (14)
- *(e) Discuss the likely economic effects of 'a 30% cut in government subsidies for new-build affordable homes' (Extract 2, line 7). Use an appropriate diagram in your answer. (14)



(a) With reference to the last paragraph of Extract 1, explain why house prices fell in September 2010. Illustrate your answer with a supply and demand diagram.

(6)

Area with horizontal dotted lines for writing the answer.



(b) With reference to Extract 1 and Figure 2, assess the likely impact of falling house prices on house-building firms.

(8)

Area with horizontal dotted lines for writing the answer.



(c) Discuss whether the supply of **new** housing is likely to be price elastic or price inelastic.

(6)

Area with horizontal dotted lines for writing the answer.



*(d) To what extent might falling house prices help 'first-time buyers to get on to the property ladder' (Extract 2, lines 3 and 4)?

(14)

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(Total for Question 10 = 48 marks)

TOTAL FOR SECTION B = 48 MARKS
TOTAL FOR PAPER = 80 MARKS



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