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Edexcel GCE

Economics
Advanced Subsidiary
Unit 1: Competitive Markets: How they work and why they fail

Wednesday 12 January 2011 – Afternoon Time: 1 hour 30 minutes	Paper Reference 6EC01/01
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You do not need any other materials.

Total Marks

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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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 Statement 1: Bonuses to financial sector workers in the City of London exceeded £13 billion in 2009.

Statement 2: A 50% tax on bonuses above £25,000 is fair.

Which of the following best describes the two statements above?

(1)

- A** Statement 1 is normative and statement 2 is positive.
- B** Both statements are normative.
- C** Statement 1 is positive and statement 2 is normative.
- D** Both statements are positive.

Answer

Explanation

(3)

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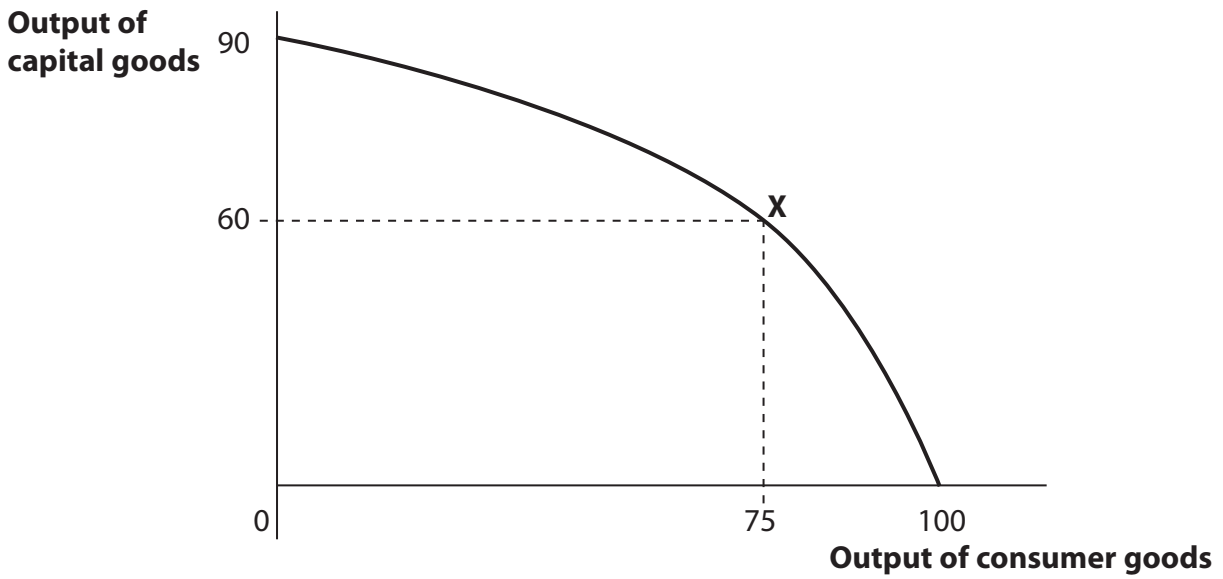
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(Total for Question 1 = 4 marks)



2



The diagram shows a production possibility frontier for an economy operating at point X. The opportunity cost of producing 75 units of consumer goods is:

(1)

- A 25 units of consumer goods
- B 30 units of capital goods
- C 60 units of capital goods
- D 75 units of consumer goods.

Answer

Explanation

(3)

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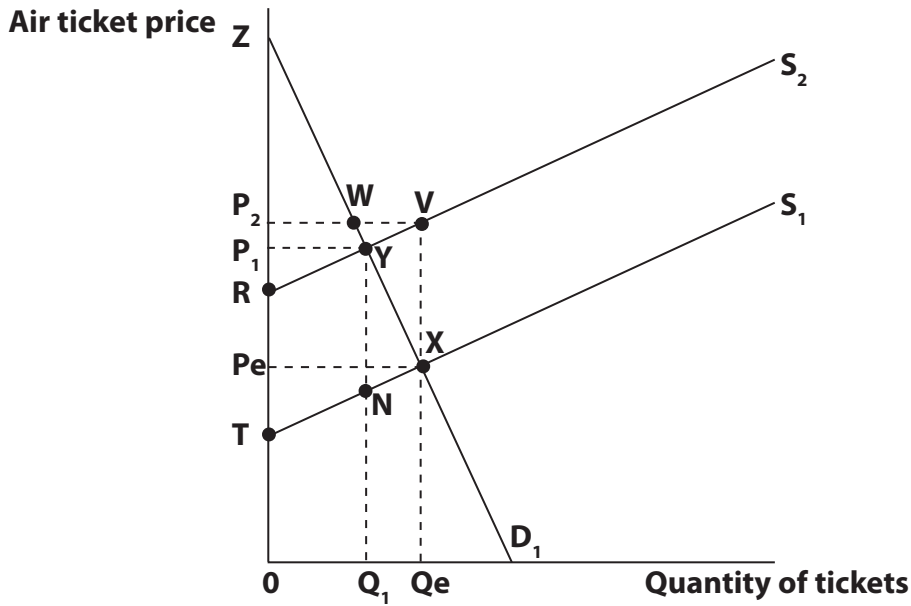
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(Total for Question 2 = 4 marks)



3



The diagram shows the impact of a specific tax placed on air travel. Which of the following is correct?

(1)

- A The total tax revenue is PeP_1YX
- B Producer surplus increases
- C The price of air tickets rises from Pe to P_2
- D Consumer surplus decreases

Answer

Explanation

(3)

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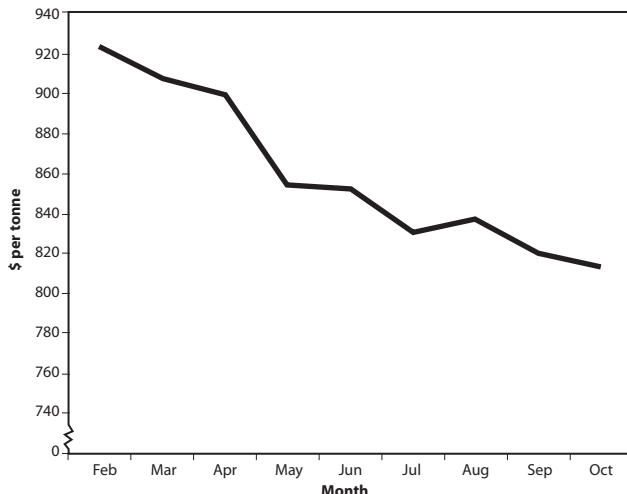
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(Total for Question 3 = 4 marks)



4

World market price of bananas 2009



(Source: www.indexmundi.com)

From the graph it can be deduced over the period that

(1)

- A the monthly total revenue for banana producers would have increased if demand was price inelastic
- B there is an excess demand for bananas
- C the monthly total revenue for banana producers would have decreased if demand was price inelastic
- D the trend in banana prices will encourage producers to increase output.

Answer

Explanation

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(Total for Question 4 = 4 marks)



5 Jackie's income decreases from £2 000 to £1 800 per month. As a result, the number of times Jackie goes to the cinema decreases from twice to once per month. Her income elasticity of demand for cinema visits is:

(1)

- A** -0.5
- B** 0.5
- C** -5.0
- D** 5.0

Answer

Explanation

(3)

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(Total for Question 5 = 4 marks)



6 Which of the following pairs of goods is likely to have a positive cross price elasticity of demand between them?

(1)

- A** Computer games consoles and computer games
- B** Lamb and wool
- C** Rail travel and private car use
- D** Bus travel and orange juice.

Answer

Explanation

(3)

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(Total for Question 6 = 4 marks)



7 Which of the following methods of government intervention could help correct market failure?

(1)

- A State provision of healthcare
- B Taxation of goods which yield high external benefits
- C Abolition of the tradable pollution permit scheme
- D Provision of subsidies to goods which yield high external costs.

Answer

Explanation

(3)

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(Total for Question 7 = 4 marks)



- 8** Which of the following is most likely to **reduce** the geographical mobility of labour? (1)
- A An improvement in the skill level of the workforce
 - B A shortage of affordable housing across the UK
 - C Relocation grants for key workers
 - D A reduction in petrol prices.

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 .

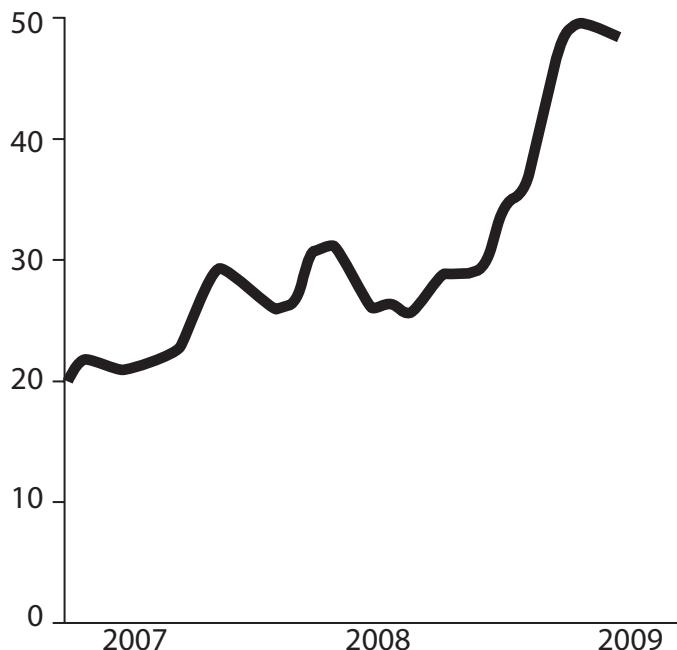
Question 10 starts on page 22.

You should spend 55 minutes on this section.

9 The Price of Sugar

Figure 1: World price of sugar

US cents per kilo



(Source: www.mongabay.com/images/commodities/charts/sugar.html)

Extract 1 Soaring price of sugar

Sugar prices around the world more than doubled over the last few years, reaching 50.8 US cents per kilo in 2009, a 28-year high.

Sugar production in Brazil, the world's largest producer, has been hit by heavy rain. Brazil is also diverting part of its sugar cane crop to making ethanol fuel for use by motor vehicles.

5

Speculative demand has also forced up sugar prices. Eugene Weinberg, an analyst at Commerzbank, pointed out that cash-rich speculators have purchased sugar stocks in anticipation of its price rising to even higher levels next year.

For much of the last decade, sugar has not been a very profitable crop compared to other types of farming. Recent high prices cannot result in an immediate increase in sugar production, as it may take up to two years for supply to respond. Destroying rainforests as a means to increase sugar production has a negative environmental and social impact.

10

(Source: adapted from 'Food groups say US is running out of sugar', by Alexandra Frean, *The Times*, 13th August, 2009 and 'Chasing a sugar rush: global deficit drives price rises', by Sean O'Grady, *The Independent*, 11th August, 2009.)



Extract 2 US faces sugar shortage

America's obesity problems may soon shrink amid fears that the makers of treats, such as Oreo cookies, Krispy Kreme doughnuts and Hershey bars, could run out of sugar. Leading food companies, including Kraft, Mars and Hershey, have warned the government that there may be a serious sugar shortage unless it allows more imports of the commodity into the country. The food companies blame the shortage on the government's policy of restricting imports of sugar in order to protect the incomes of US sugar farmers in the Midwest. 5

Rising sugar prices have affected the production costs of chocolate and other confectionery companies. However, there are many other costs to consider. At Mars, for example, sugar is third on its list of ingredient costs behind cocoa and milk. Moreover, the price of milk has been falling over recent years, helping to offset the increase in sugar costs. 10

Chocolate and other confectionery companies have experienced increased sales during the recession as people attempt to cheer themselves up by consuming more sugary treats. 15

(Source: adapted from 'Food groups say US is running out of sugar', by Alexandra Frean, *The Times*, 13th August, 2009 and 'Chasing a sugar rush: global deficit drives price rises', by Sean O'Grady, *The Independent*, 11th August, 2009.)

- (a) With reference to Extract 1, explain why the price elasticity of supply of sugar is likely to change over time. (4)
- (b) With reference to Figure 1 and Extract 1, explain why the price of sugar 'more than doubled over the last few years'. Use a supply and demand diagram in your answer. (6)
- (c) With reference to the last paragraph in Extract 2 and your own knowledge, discuss whether chocolate and other confectionery are likely to be normal or inferior goods. (10)
- *(d) With reference to Extract 2, evaluate the likely effects of the increase in the price of sugar on the producers of chocolates and other confectionery. Illustrate your answer with a supply and demand diagram. (14)
- *(e) To what extent is market failure likely to result from the consumption **and** production of sugar? (14)



(a) With reference to Extract 1, explain why the price elasticity of supply of sugar is likely to change over time.

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(b) With reference to Figure 1 and Extract 1, explain why the price of sugar 'more than doubled over the last few years'. Use a supply and demand diagram in your answer.

(6)

A series of horizontal dotted lines for writing the answer to the question.



M 3 7 9 5 9 A 0 1 3 3 6

(c) With reference to the last paragraph in Extract 2 and your own knowledge, discuss whether chocolate and other confectionery are likely to be normal or inferior goods.

(10)

Dotted lines for writing the answer.



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*(e) To what extent is market failure likely to result from the consumption **and** production of sugar?

(14)

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(Total for Question 9 = 48 marks)



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

10 The National Minimum Wage

Extract 1 A modest rise in the National Minimum Wage

The government announced today that the National Minimum Wage (NMW) will rise by 7p, or 1.2%, to £5.80 an hour, in October 2009. This rate applies to workers aged 22 and over. The rate for 18 to 21 year olds will rise from £4.77 to £4.83, while for those aged 16 and 17, the statutory rate will go up to £3.57 an hour from £3.53.

Brendan Barber, the Trade Union Council General Secretary, welcomed the rise in the NMW, especially at a time of increasing food and fuel prices which tend to hit the low paid hard. It is a positive step in reducing poverty. He believes employers could absorb the higher wage costs and reported that employment in low paid industries was holding up well. 5

However, Charles Cotton, of the Chartered Institute of Personnel and Development, said: "We are concerned that this decision will increase job losses in low-paid sectors. Our greatest concern at the moment is for younger workers and job-seekers." 10

(Source: Source: 'Miniumum wage to rise', by Kathryn Hopkins, *The Guardian*, 12th May 2009.)

Extract 2 Evidence from the National Hairdressers' Federation (an employers' organisation) to the Low Pay Commission

There are over 26,000 hairdressing salons in the UK. In 2008, employment rose in the industry by more than 5,000 to reach a total of 126,000. Hairdressing is labour intensive and around 89% of the workforce is female. Some 27% of employees are paid at the NMW. Many hairdressing employees specialise in services including cutting, styling, straightening, colouring and beauty treatments. 5

The National Hairdressers' Federation report that hairdressing salons have few options if faced with higher wages because customers are reluctant to pay more for haircuts in a depressed economic climate. It believes any increase in the NMW would lead to job losses, causing a decline in long-term employment opportunities in the industry. However, many staff are trainees, so the NMW does not apply to them. 10

Most new recruits to hairdressing are female and aged 16 to 19 years. However, the number of workers in this age group is decreasing in the UK labour market as many now stay in full-time education. Low pay, a long training period and the uncertainty of customer tips have also limited the supply of labour to the industry.

A considerable amount of informal work is undertaken in hairdressing. There are concerns that an increase in the NMW, which might lead to an increase in salon prices, would result in a growth in tax-evading activities in the industry, such as unrecorded cash payments. 15

(Source: Adapted from 'National Minimum Wage; report to the Low Pay Commission 2009')



- (a) Explain **one** reason why the government intervenes in labour markets by imposing a National Minimum Wage. (4)
- (b) With reference to the last paragraph of Extract 2, analyse why government failure might result from an increase in the National Minimum Wage. (6)
- (c) Assess the likely benefits of division of labour to hairdressing salons. (10)
- * (d) With reference to Extract 2, to what extent might an increase in the National Minimum Wage lead to job losses in hairdressing? Illustrate your answer with an appropriate labour market diagram. (14)
- * (e) Apart from the National Minimum Wage, discuss the factors which might influence the supply of labour to hairdressing **or** to another occupation of your choice. (14)



(a) Explain **one** reason why the government intervenes in labour markets by imposing a National Minimum Wage.

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(b) With reference to the last paragraph of Extract 2, analyse why government failure might result from an increase in the National Minimum Wage.

(6)

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(c) Assess the likely benefits of division of labour to hairdressing salons.

(10)

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*(e) Apart from the National Minimum Wage, discuss the factors which might influence the supply of labour to hairdressing **or** to another occupation of your choice.

(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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