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Edexcel GCE

Economics
Advanced Subsidiary
Markets: How they work and why they fail

Wednesday 3 June 2009 – 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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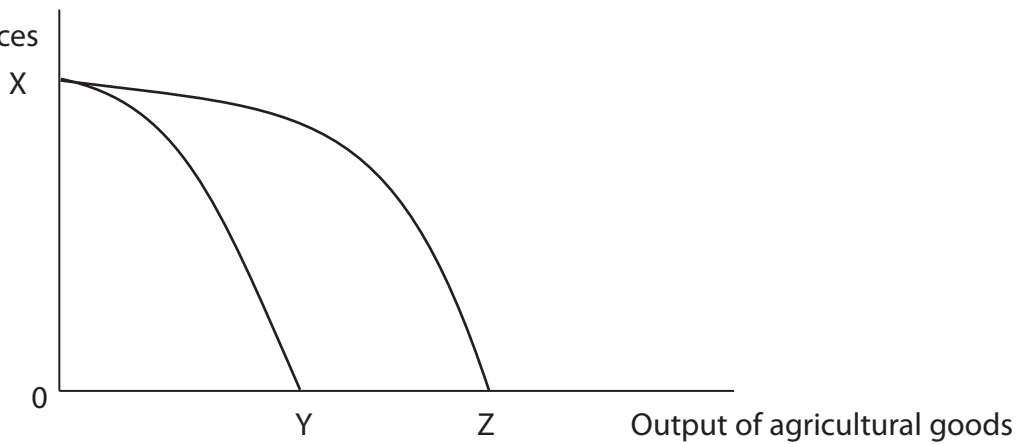


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Section A: Answer all the questions in this section

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 Output of tourist services



The diagram refers to a small Caribbean island producing agricultural goods and tourist services. Initially the economy has production possibilities shown by XY. The production possibility line then moves to XZ. This change is most likely to have been caused by:

(1)

- A** An increase in the demand for agricultural goods
- B** A rise in the cost of producing agricultural goods in terms of tourist services
- C** A decrease in the demand for agricultural goods
- D** Technological improvements in the agricultural industry

Answer

Explanation

(3)

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(Total for Question 1 = 4 marks)



2 Which of the following is the most likely consequence of an increase in the division of labour in the production of beauty products?

(1)

- A A decrease in the total revenue of beauty product manufacturers
- B Decreased use of specialised manufacturing equipment
- C A decrease in the cost per unit of beauty products
- D A shift in demand for beauty products

Answer

Explanation

(3)

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(Total for Question 2 = 4 marks)



3 UK Household Expenditure (Index numbers 1971 = 100)

Year	1991	2005	% change
Real household disposable income	170	239	+40.5%
Expenditure on food and soft drinks	117	147	
Expenditure on clothing and footwear	187	460	

(Source: Social Trends 37, 2007 edition)

It can be deduced that between 1991 and 2005:

(1)

- A** Food and soft drinks were inferior goods
- B** Income elasticity of demand for food and soft drinks was greater than +1.0
- C** Food and soft drinks had a positive cross elasticity of demand with respect to clothing and footwear
- D** Income elasticity of demand for clothing and footwear was greater than that for food and soft drinks

Answer

Explanation

(3)

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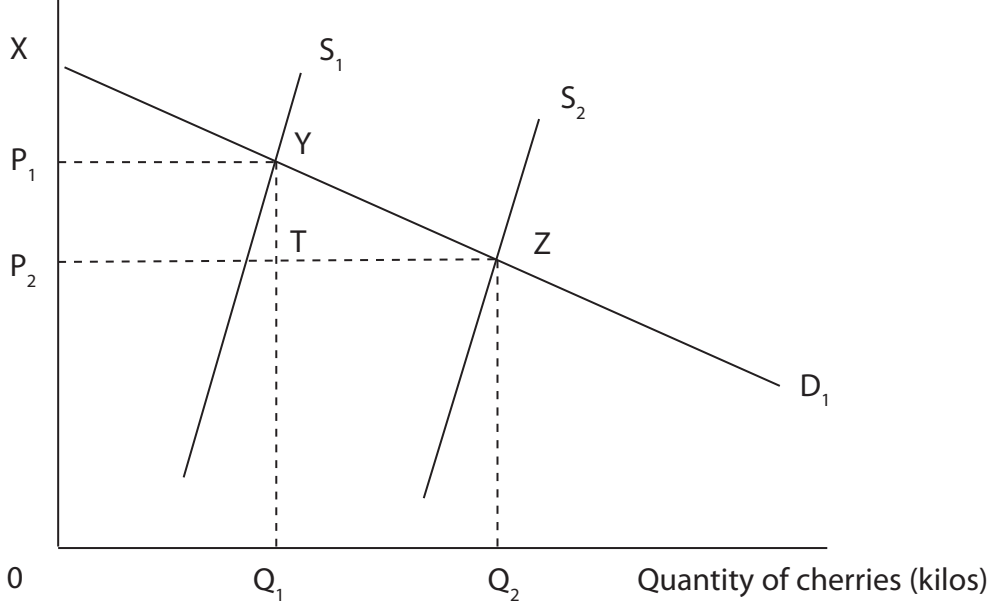
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(Total for Question 3 = 4 marks)



4 Price of cherries per kilo £



The diagram shows the market for cherries. In year 1 demand is represented by D_1 and supply by S_1 . In year 2, the supply of cherries increases to S_2 . This causes consumer surplus to increase to the area:

(1)

- A XYP_1
- B $Y TZ$
- C P_1YTP_2
- D XZP_2

Answer

Explanation

(3)

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(Total for Question 4 = 4 marks)



5 With reference to the functions of the price mechanism in a free market economy, which of the following statements is true? (1)

- A** Falling prices will encourage businesses to enter a market
- B** The price mechanism is used by a government to create production targets
- C** Excess supply of a good can be eliminated by allowing its price to rise
- D** The price mechanism acts as a rationing device

Answer

Explanation (3)

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(Total for Question 5 = 4 marks)



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

(1)

- A Motor vehicles and rail travel
- B Beef and leather
- C Motor vehicles and petrol
- D Beef and animal feed

Answer

Explanation

(3)

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(Total for Question 6 = 4 marks)



- 7** In 2007, a packet of cigarettes priced at £5.30 included £4.13 of tax. The high level of tax on cigarettes may lead to **government failure** if:
- (1)
- A** some people continue to purchase cigarettes
 - B** the tax revenue generated from cigarettes meets the cost of treating smokers on the National Health Service
 - C** cigarette smuggling is encouraged
 - D** the marginal social cost exceeds the marginal private cost from cigarette smoking

Answer

Explanation (3)

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(Total for Question 7 = 4 marks)



8 The European Union Carbon Emissions Trading Scheme permitted the power, cement, steel, oil and paper industries to emit up to 1.9 billion tonnes of carbon dioxide in 2008. The purpose of the scheme is to:

(1)

- A** fine companies which pollute up to their allowances
- B** reduce market failure from the major carbon polluting industries
- C** tax companies which pollute up to their allowances
- D** prevent industries from buying and selling carbon permits between themselves

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 20.

You should spend 55 minutes on this section.

9 The Housing Market

Extract 1 Record fall in house prices

House prices fell by 13.4% between October 2007 and September 2008, the fastest rate for more than 50 years, according to Halifax Bank, Britain’s biggest mortgage lender. The average price of a house fell from £198,533 to £172,108 over the period. Rising unemployment has reduced consumer confidence and new mortgages (house purchase loans) have become difficult to obtain. Banks have become very cautious over whom they lend to after experiencing losses from bad debtors.

5

Howard Archer, economist at Global Insight, predicted that the average house price will continue to fall to around £134,000 by 2010 due to concerns over the length of the economic downturn. The recent cuts in interest rates may have little impact as housing remains unaffordable for many people.

10

(Source: adapted from: ‘House prices falling at fastest rate for 50 years, says the Halifax’ by Myra Butterworth, *The Telegraph*, 10th October 2008.)

Figure 1: Average house prices and weekly earnings by selected region in England

Region	Average house price	Average annual earnings (i)	Unemployment rate (%) (ii)
Yorks and Humber	£128 591	£22 932	6.2
North West	£137 487	£23 411	6.6
West Midlands	£162 861	£23 343	6.4
East Anglia	£169 788	£24 342	4.8
South East	£233 086	£25 990	4.5
Greater London	£269 723	£31 861	7.5
National	£172 108	£24 888	5.7

(Source: HBOS.co.uk; ONS regional earnings survey, November 2008; Labour Force Survey (June-August 2008).)

- (i) Annual gross earnings per adult in employment by region – median figures, April 2008.
- (ii) Unemployment rate is the percentage of a region’s workforce who are unemployed.



Extract 2 First-time buyers priced out of housing market

The number of first-time buyers has fallen dramatically over recent years according to Halifax Bank. It estimated that just 300,000 first-time buyers entered the housing market in 2007, down from 532,000 in 2002. Difficulties remain in obtaining mortgages and larger cash deposits are often required for these buyers, exceeding 10 per cent of the property value. First-time buyers are now more likely to be in their thirties than their twenties and to buy flats rather than terraced houses. 5

However, the Royal Institution of Chartered Surveyors believes that conditions for first-time buyers should improve over the next two years. Simon Rubinsohn, chief economist, said "there is huge pent-up demand from first-time buyers and should house prices continue to drop, many will be ready to enter the market." 10

(Source: adapted from 'First-time buyers priced out of market' by Patrick Collinson, *The Guardian*, 22nd December 2007.)

Extract 3 Regional house prices

Despite falling house prices, regional differentials are expected to remain. Average house prices in Greater London are much higher than for other regions. This appears to be caused by several factors, for example, variations in regional earnings and availability of land to build on. Differences in regional unemployment may also be a factor.

The government intends to permit the building of more than 1.1 million homes in the south-east by 2016, despite strong opposition from local councils and environmental groups. 5

(Source: adapted from 'The housing crisis hits home' by Alexander Frean & Alexandra Blair, *The Times*, 21st May 2005)

- (a) With reference to Extract 1, explain **two** reasons why property prices fell by 13.4% between October 2007 and September 2008. Illustrate your answer with a supply and demand diagram. (7)
- (b) With reference to Extract 2, discuss the possible effects of falling house prices on first-time buyers. (6)
- (c) With reference to Figure 1 and Extract 3,
- * (i) Examine **two** factors which might account for house price differences between any two regions. (12)
- (ii) Examine the likely impact of regional house price differences on the geographical mobility of labour. (7)
- (d) There is likely to be a major house building programme in South-East England over the next few years.
- (i) Define the terms private costs and external costs. (4)
- * (ii) Using examples, evaluate the likely private costs and external costs of this house-building programme. Illustrate your answer with a diagram. (12)



(a) With reference to Extract 1, explain **two** reasons why house prices fell by 13.4% between October 2007 and September 2008. Illustrate your answer with a supply and demand diagram.

(7)

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(b) With reference to Extract 2, discuss the possible effects of falling house prices on first-time buyers.

(6)

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(d) There is likely to be a major house building programme in South-East England over the next few years.

(i) Define the terms private costs and external costs.

(4)

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M 3 4 4 7 9 R R A 0 1 7 3 2

*(ii) Using examples, evaluate the likely private costs and external costs of this house-building programme. Illustrate your answer with a diagram.

(12)

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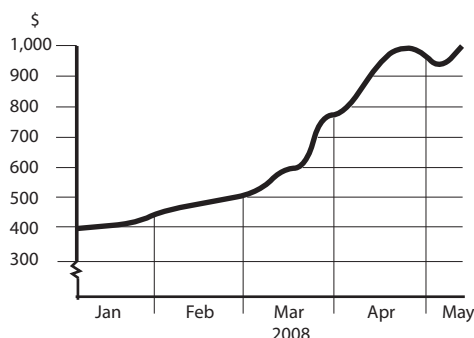
(Total for Question 9 = 48 marks)



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

10 The rice market

Figure 1: The price of rice, January to May 2008 (price per tonne US\$)



Extract 1 Soaring rice prices

The price of rice increased dramatically from \$400 to \$1,000 per tonne between January and May 2008, sparking food riots and protests in many countries, ranging from Haiti in the Caribbean to Pakistan in Asia.

The soaring price of rice is due to rising incomes in developing countries such as China, and population growth in India and Indonesia; severe flooding and droughts in rice growing regions have also had an effect – the most recent example being a cyclone which devastated Myanmar in May 2008.

5

In Thailand, one of the world’s largest rice producers, farmers have responded by raising supply. Fields which have been unused for many years are now being ploughed and rice seed planted. Farmers are even contemplating three or four harvests a year rather than the usual one or two. Many have given up jobs in towns and cities to return to the countryside and cash in from growing rice.

10

(Source: ‘Fear of rice riots as surge in demand hits nations across the Far East’ by Leo Lewis, *The Times*, 8th April 2008.)

Extract 2 Government intervention in the rice market

Governments in several rice growing countries such as India, Vietnam, Egypt and Cambodia have imposed restrictions on rice exports in order to switch supplies to their own domestic consumers. This should make rice more affordable. However, it could cause problems in the long term since rice farmers will not benefit from the high global price that consumers in developed countries are prepared to pay. It will affect the incentive to produce.

5

The governments are also considering a buffer stock scheme which aims to adjust market supply between good and poor harvests and so guarantee rice at an affordable price. However, buffer stock schemes have failed spectacularly in other commodity markets, for example, coffee, cocoa and tin. These have reflected problems in funding and excess production. The millions of rice growers in Asia could make it unworkable.

10

(Source: ‘Thai cartel idea outrages rice consumers’ by Carl Mortishead, *The Times*, 3rd May 2008.)



- (a) (i) With reference to Figure 1 and Extract 1, explain why the price of rice increased dramatically from \$400 to \$1,000 per tonne between January and May 2008. Use a supply and demand diagram in your answer. (8)
- (a) (ii) Outline **one** demand factor and **one** supply factor, **apart** from those mentioned in the extracts, which may have contributed to the increase in the price of rice. (4)
- (b) Assess whether the demand for rice is likely to be price elastic or price inelastic. (5)
- (c) With reference to Extract 1, discuss whether the price elasticity of the supply of rice in Thailand is likely to change over time. (9)
- * (d) To what extent might restrictions on rice exports lead to government failure? (10)
- * (e) Assess the likely success of a buffer stock scheme for stabilising the price and supply of rice. (Use an appropriate diagram in your answer.) (12)



(a) (i) With reference to Extract 1 and Figure 1, explain why the price of rice increased dramatically from \$400 to \$1,000 per tonne between January and May 2008. Use a supply and demand diagram in your answer.

(8)

Dotted lines for writing the answer.



(a) (ii) Outline **one** demand factor and **one** supply factor, **apart** from those mentioned in the extracts, which may have contributed to the increase in the price of rice.

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(b) Assess whether the demand for rice is likely to be price elastic or price inelastic.

(5)

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(c) With reference to Extract 1, discuss whether the price elasticity of the supply of rice in Thailand is likely to change over time.

(9)

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*(d) To what extent might restrictions on rice exports lead to government failure?

(10)

Area with horizontal dotted lines for writing the answer.



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*(e) Assess the likely success of a buffer stock scheme for stabilising the price and supply of rice. (Use an appropriate diagram in your answer.)

(12)

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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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