

Edexcel (A) Economics A-level

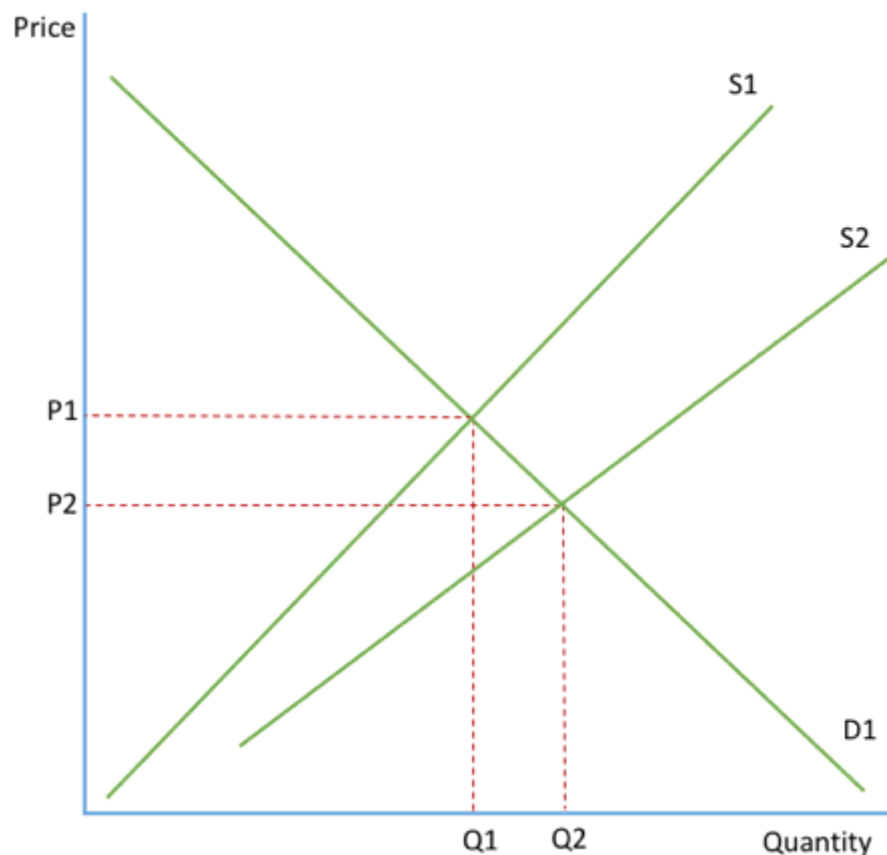
AS-level Paper 1: Markets and Market Failure

Example answers

Evaluate the impact on the market for electric cars in China of the removal of the 10% sales tax on electric cars.



The removal of the tax will increase supply from S_1 to S_2 . The tax is an ad valorem tax so supply will increase more per good. This will result in an increase in quantity demanded from Q_1 to Q_2 and a fall in price from P_1 to P_2 . This has contributed to the sale of electric cars being 30 times higher in December 2014 than January 2014. Other factors have also played a part in this increase, so the impact of the tax removal alone is unknown.



Firstly, the impact will depend on the price elasticity of demand for the car: the responsive of demand to a change in price. If the electric cars relatively inelastic (unresponsive) then there will be little impact of the removal of the tax and quantity demanded will not increase by much. One thing that the price elasticity depends on is the availability of substitutes- the more substitutes a good has, the more elastic it is. If there are lots of substitutes for an electric car, then the removal of the tax may mean that output increases by a lot. However, if these substitutes are cheaper than the electric car still, it is unlikely output of the electric car will increase.

Moreover, the impact will depend on the quality of the electric car compared to other cars. The text says that the quality of Chinese electric cars has increased, and so therefore this may have had a bigger effect on the market than the removal of the tax. The text also says that the sales of other cars are falling so this may suggest that the quality of the electric cars are higher than the quality of the normal cars.

On top of this, the impact of the removal of the tax will also depend on changes to the tax on normal cars. If normal cars have also had a 10% tax removal then there will be very little impact of the removal of the tax. However, the text says sales of other cars are slowing which suggests their tax has not been removed or may even have risen.



Moreover, the impact of the removal of the tax will depend on whether the electric cars are 'fashionable'. If those with electric cars are looked down on or people think it is weird, then there may be little effect of the tax removal. Since sales of electric cars are 30 times higher in December than January, this suggests they are becoming more popular.

It will also depend on the access to charging points. Although sales are rising, only 27,000 are bought each month which is small compared to the amount of people in China so access to charging points may be quite difficult. Therefore, the impact may be small.

Overall, the removal of the tax is likely to decrease price and increase output, but the size of this increase depends on a range of factors.

Teacher's comments: 15/20

A basically good answer. Evaluation is strong but analysis needs development.

