Edexcel (A) Economics A-level

AS-level Paper 1: Markets and Market Failure

Example answers

Specimen paper

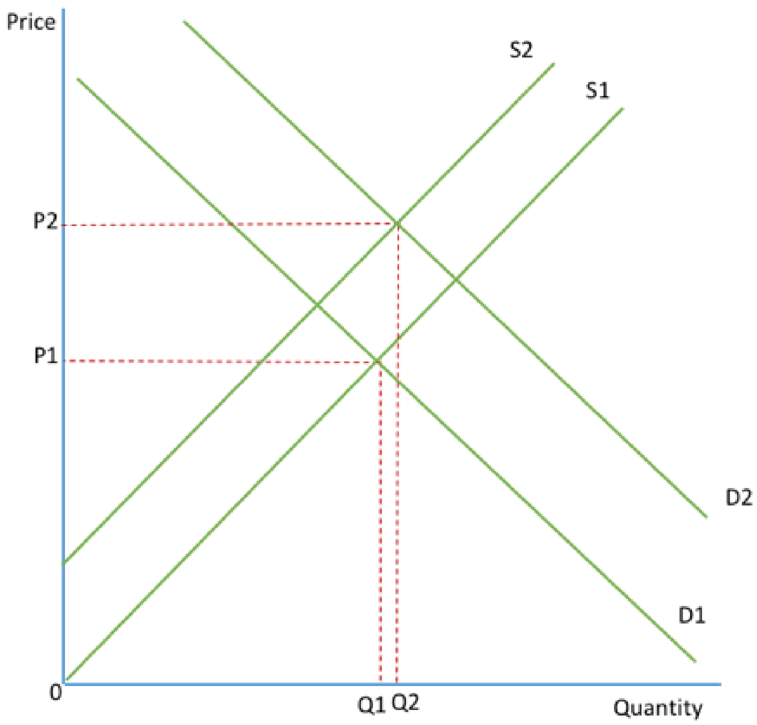
6a) Explain why 'the prices farmers received for beef in the UK rose by 3%' in 2013 (Extract A, lines 7 and 8). Include a supply and demand diagram in your answer. (5)

The prices farmers received for beef rose from P1 to P2 because of increased demand. Demand is the ability and willingness to buy a good at a specific price at a specific moment in time. It increased from D1 to D2 due to the horsemeat scandal. This meant that consumers were more willing to buy beef from UK farmers rather than overseas farmers as they felt UK farmers were more reliable and didn't want horsemeat, which was found in beef from overseas suppliers. This meant that British beef sold in shops went from 81% of all beef sold in shops to 83%. Also, there is increased demand due to higher incomes in other countries, like China and so they want more beef. They may buy it from the UK as there is better quality compared to China.

Teacher's comments: 5/5

b) Assess the likely impact of a 3% increase in the price of UK beef on the market for lamb. (10)

Firstly, there will be an increase in demand for lamb. Because the price of beef rises and lamb and beef are substitutes, there will be more people who buy lamb because it is cheaper. This could lead to a rise in the price of lamb from P1 to P2 as demand grows. However, this depends on the price elasticity of beef. If beef is relatively price inelastic then people may not swap to lamb, but if it is price elastic then people will. As there are many substitutes for beef, it is likely to be elastic and so a change in price will have quite a large effect on quantity demanded. However, it is only a 3% increase and so it may not have that large of effect on demand for lamb as some consumers may not even notice the difference



On top of this, there may be a decrease in supply of lamb. Lamb and beef are in competitive supply as it is unlikely that farmers rear both cows or sheep. Therefore, if there is an increase in the price of beef, they may stop rearing sheep and begin rearing cows as they will produce a higher profit. However, it will depend on the price elasticity of supply for beef. If beef is inelastic then it won't have much impact but if it is elastic it could have a large impact. It is likely to be inelastic as there are large start up costs e.g. buying the cows and so farmers may continue to supply sheep.

Overall, it may increase demand of lamb slightly and decrease supply of lamb slightly but not by too much.

Teacher's comments: 6/10
Talk about XED and how close they are as substitutes. I think the competitive supply goes further into depth than the question requires- it would be possible but only in the long term.

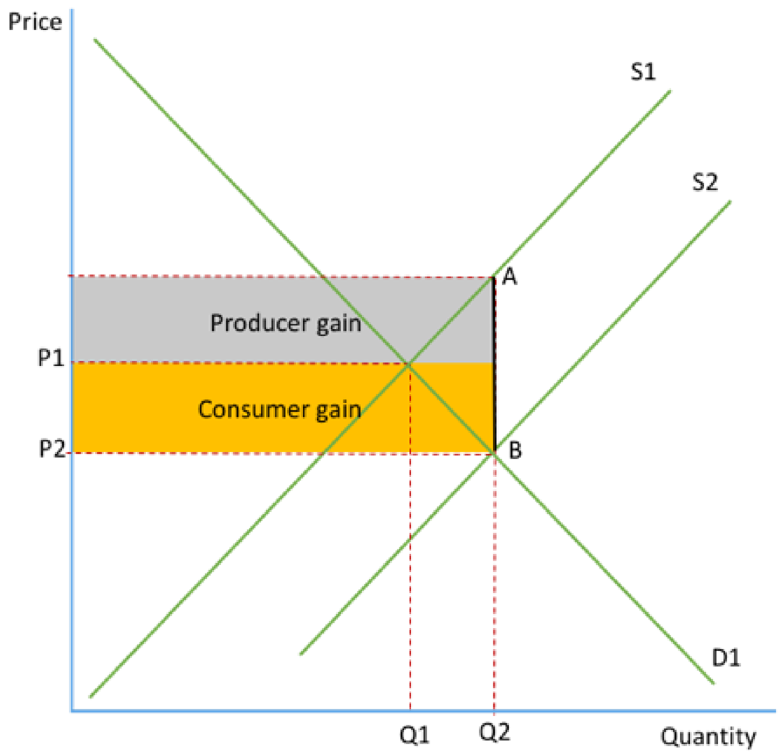
c) Explain two likely impacts on dairy farmers in the UK of the growth in the middle classes in emerging markets such as China. (6)

One impact on dairy farmers in the UK is that they will make a higher profit. Demand has increased from D1 to D2 and as a result price and quantity have both increased. The farmer is selling more goods at a higher price and so therefore they are making more money.

Moreover, they have higher producer surplus. Because demand has increased, producer surplus has increased from 0AP1 to 0BP2 and so therefore they are getting more than they wanted.

Teacher's comments: 4/6

e) With reference to Figure 1, Extract 2 and your own knowledge, discuss the reasons for subsidies being paid to Scottish farmers. (15)



A subsidy is a government grant given to increase production. One reason that subsidies are being paid to farmers is because it increase the production of farming goods from Q1 to Q2 and decreases the price from P1 to P2. It is important to provide subsidies in order to keep production high as farming is vital to the rural economy. If the farmers were unable to produce their goods, they would become unemployed and this would have a negative impact on the rural economy. A large amount of those in rural areas are farmers and if they were unemployed they would stop spending in local shops etc. so therefore these would be forced to close down causing further unemployment and so on. This would cause large economic decline in these areas and so the government would have to put the money in in other ways.

Moreover, another reason for giving subsidies is that it lowers the price of the goods for UK consumers. This is good as it means that, despite rising prices, lower income families can still afford the agricultural goods. There is increased consumer surplus.

Another benefit of the lower prices is that it prevents consumers from buying from overseas. Scottish farmers are competitive with the overseas producers and so people will buy from them which will help to keep the farms from making a profit. On top of this, it lowers the carbon footprint as Scottish goods don't travel as far so these subsidies provide a positive externality.

However, there is an opportunity cost of giving farmers subsidies. Because of this, the government can't put this money into the NHS/education etc. which are all merit goods. Some will say this would help society more than the subsidies.

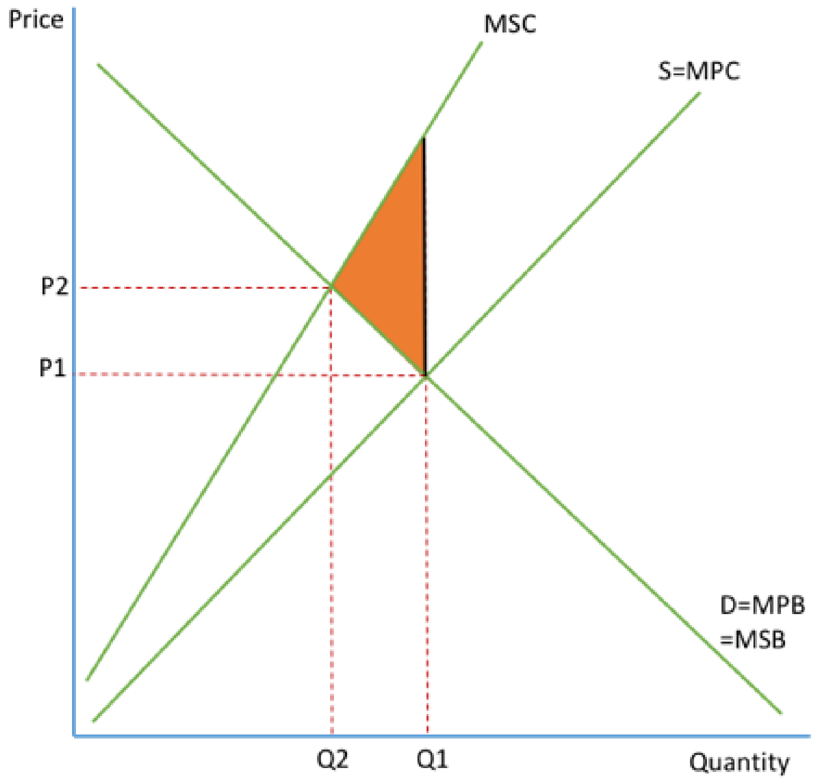
Moreover, some people may suggest that it is not good as farmers are too reliant on government subsidies. In 2012, 79% of Scottish farmers' incomes came from subsidies. People would suggest that these farmers should just be left to make a living from the free market.

Overall, it is important in order to keep the farms running.

Teacher's comments: 14/15
Excellent answer

f) Using the concept of external costs, evaluate the possible economic effects of increased beef production. Use an appropriate diagram in your answer.

Beef is currently produced at P1Q1 where MPC=MPB (marginal private cost equals marginal private benefit) but should be produced at the social optimum position of P2Q2 where MSC=MSB. The external costs are the difference between private costs (to the individual) and to society, so are the costs to a third party not involved in the economic activity, such as the negative effects to those not eating meat. The effect of this is a social welfare loss of the shaded area.



One economic effect of increasing production of beef is that it already takes 30% of the world's land to raise livestock and so even more would have to be used. This is a negative effect and would mean it couldn't be used for other things, such as housing, so there is a large opportunity cost for producing this extra beef. Another negative economic effect would be the negative environmental impacts which will lead to global warming, causing loss of land etc. and therefore loss of money.

One positive effect of increased production is decreased prices for beef. This will lead to an increase in consumer surplus and mean more consumers can afford beef, which is good as it means they can afford food. It may affect the producers revenue. If beef is inelastic then it will decrease producer revenue will if it is elastic it will increase revenue.

The effects will depend on the size of the increase. If there is only a small increase then it will be a small effect but if there is a large increase then it will have a large effect.

Overall, the short term effects will mainly be positive as there are lower prices but the long term effects will have a bad impact on the environment and welfare loss, which is negative. The size of these effects will depend on the size of the increased production.

Teacher's comments: 16/20
Could do with a little more evaluation e.g. difficulty of measurement of size of externality.