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Edexcel GCE

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

Friday 28 May 2010 – 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** 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 A production possibility frontier can be used to illustrate the concept of: (1)

- A** External cost
- B** Producer surplus
- C** Opportunity cost
- D** Equilibrium price.

Answer

Explanation

(3)

(Total for Question 1 = 4 marks)



2 Which of the following factors is most likely to cause the price of gold to fall without a shift in the demand curve?

(1)

- A An increase in national income
- B A decrease in the price of silver
- C An increase in the wages of gold miners
- D A decrease in the cost of machinery used in gold mining.

Answer

Explanation

(3)

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(Total for Question 2 = 4 marks)



3 Neringa is prepared to pay £2,500 for a luxury cruise to the Caribbean. If the current price is actually £2,000, which of the following might cause her consumer surplus to increase?

(1)

- A An increase in wages paid to cruise holiday workers by £500 per year
- B A decrease in value added tax placed on luxury cruise holidays
- C An increase in the price of the cruise to £3,000
- D A decrease in the number of companies offering luxury Caribbean cruises.

Answer

Explanation

(3)

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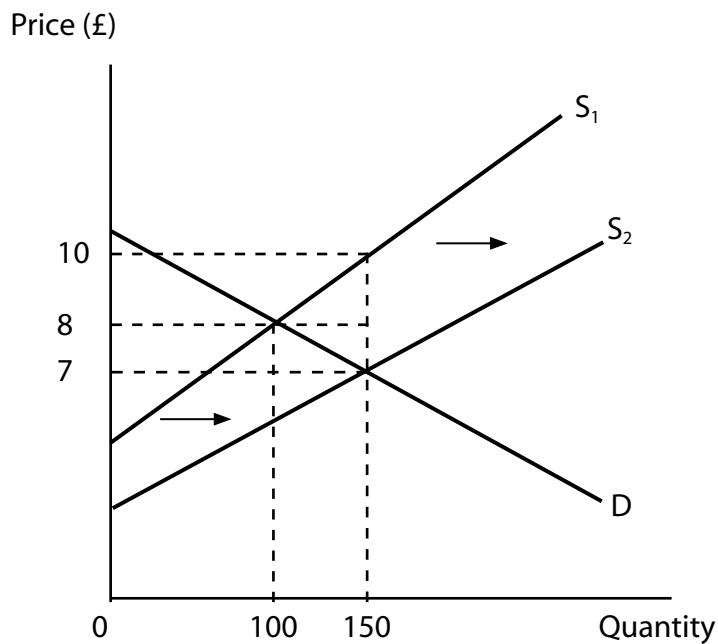
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(Total for Question 3 = 4 marks)



4



The diagram illustrates the effect of a government subsidy on a good. The total government expenditure on the subsidy will be:

(1)

- A £100
- B £150
- C £450
- D £1,050.

Answer

Explanation

(3)

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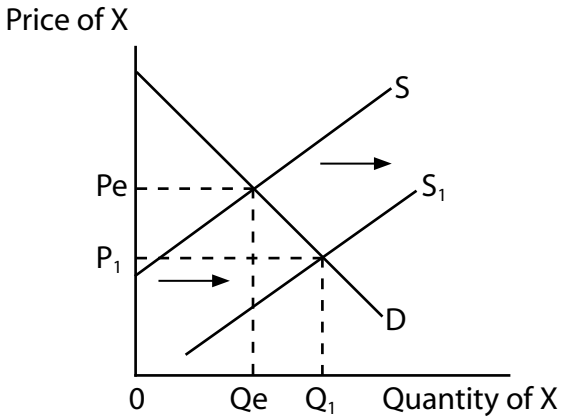
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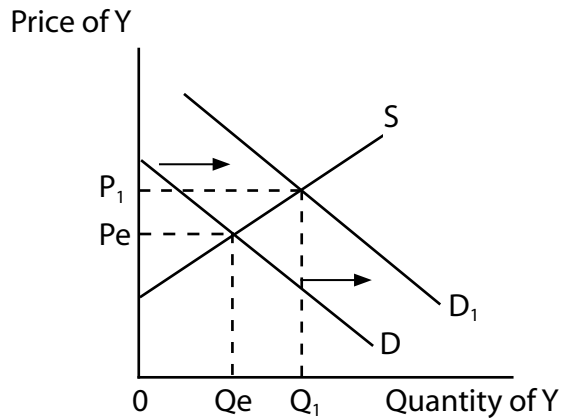
(Total for Question 4 = 4 marks)



5 Market for X



Market for Y



The diagrams show the effects of an increase in supply of good X on the demand and price of good Y. Which of the following is most likely to be represented by good X and good Y?

(1)

- A** Lamb and chicken
- B** Bus travel and potatoes
- C** Computer games consoles and computer games software
- D** Leather and beef.

Answer

Explanation

(3)

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(Total for Question 5 = 4 marks)



6 Tradable pollution permits would be more effective in reducing carbon dioxide emissions within the European Union (EU) if: (1)

- A** There is an excess supply of pollution permits
- B** Major polluting industries such as air travel are excluded from the carbon trading system
- C** It is difficult to monitor and prosecute firms for exceeding their pollution permits
- D** The EU is prepared to decrease the supply of pollution permits if the price falls too low.

Answer

Explanation

(3)

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(Total for Question 6 = 4 marks)



M 3 5 0 0 5 A 0 7 3 6

7 Which of the following forms of government intervention could help to solve the free rider problem?

(1)

- A Provision of public goods
- B Taxation on the consumption of public goods
- C Banning the consumption of luxury goods
- D Granting of subsidies to goods which yield high external costs.

Answer

Explanation

(3)

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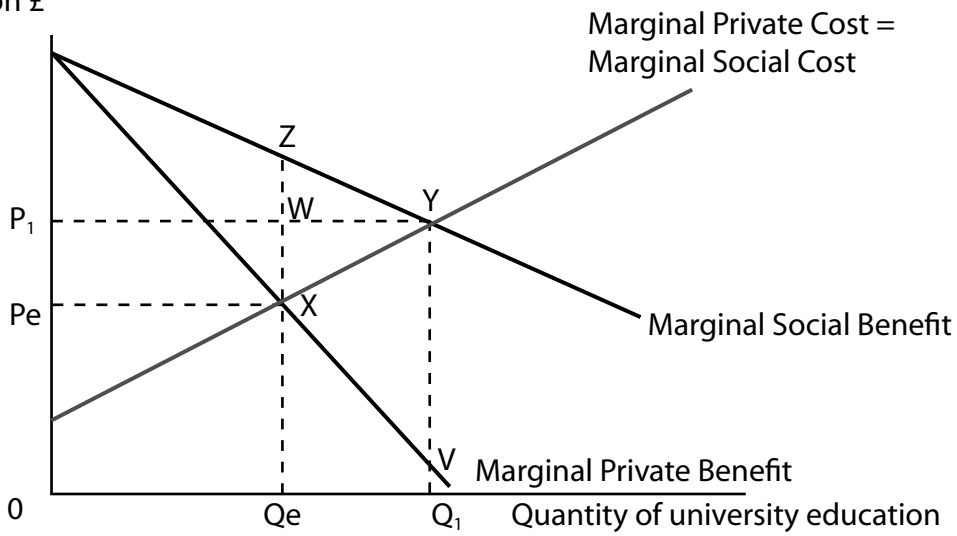
(Total for Question 7 = 4 marks)



8

Market for university education

Price of university education £



The diagram shows the market for university education. 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 There is market failure at quantity Q_e
- C The triangle of welfare gain is XYV
- D The marginal external benefit remains constant at all quantities.

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.

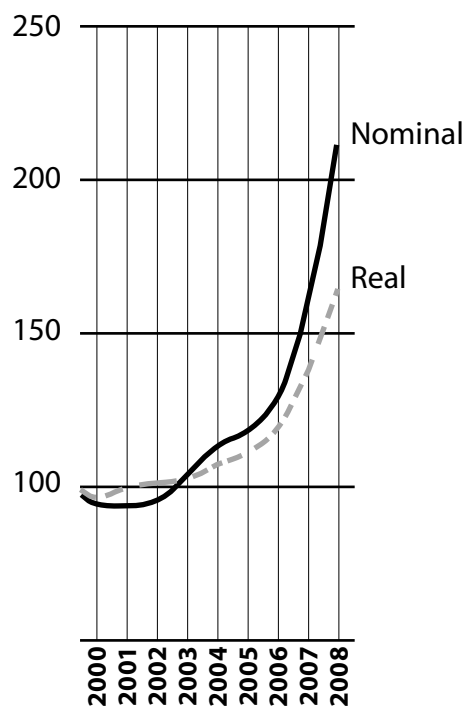
If you answer Question 9 put a cross in this box .

Question 10 starts on page 20.

You should spend 55 minutes on this section.

9 Rising Food Prices

Figure 1 Food and Agricultural Organisation (FAO) Food Price Indices, 2000–2008



Source: <ftp://ftp.fao.org/docrep/fao/meeting/013/k2414e.pdf>

Extract 1 Food Prices

The UK faces a major food crisis unless urgent steps are taken to support its agricultural sector, warns a report by Chatham House, an influential research organisation. The report suggests that UK consumers must expect to pay significantly more for food to ensure long term security. It warns that developed countries have tended to take their food supply for granted and that recent sharp rises in commodity prices will occur more frequently in the future. 5

The rapid rise in food prices is linked to the growth in global population and rising incomes in the developing world, along with increased costs of agricultural production.

The report warns of the limited availability of land for agricultural expansion in the UK and recommends a discussion of using intensive farming methods and genetically modified crops to increase output. However, this could reduce quality and bio-diversity while increasing the risk of crop diseases. 10



The UK produces just 48% of the food it consumes. Around 30% comes from the rest of Europe and the remaining 22% from non-European countries. A crisis could develop through some form of external shock, such as animal or crop disease, or extreme weather events leading to a shortage of affordable food. It is households on low incomes which are hit the hardest by rising food prices.

15

The report calls for government funding to expand agricultural production, innovation and skills. This includes guaranteed minimum prices to encourage more domestic agricultural production.

20

The report also indicates the need for consumer attitudes to change. Around one third of all food purchased is thrown away, some 6.7 million tonnes a year, most of which is edible.

Source: 'Britain must revive farms to avoid grave food crisis', by Jamie Doward, *The Observer*, 1st February 2009.

- (a) With reference to Extract 1 and Figure 1, explain the causes of the increase in the price of food. Use a supply and demand diagram in your answer. (8)
- (b) To what extent are households on low incomes 'hit the hardest by rising food prices' (*Extract 1, line 18*)? (6)
- (c) Assess whether the demand for food is likely to be price elastic or price inelastic. (6)
- *(d) Evaluate the likely economic effects of the introduction of 'guaranteed minimum prices to encourage more domestic agricultural production' (*Extract 1, lines 20 and 21*). Use an appropriate diagram in your answer. (12)
- (e) (i) Distinguish between *private costs* and *external costs*. (4)
- *(e) (ii) With reference to the concepts of private costs and external costs, assess the possible economic effects of 'using intensive farming methods and genetically modified crops' (*Extract 1, lines 11 and 12*). Use an appropriate diagram in your answer. (12)



(a) With reference to Extract 1 and Figure 1, explain the causes of the increase in the price of food. Use a supply and demand diagram in your answer.

(8)

A large rectangular area with rounded corners, enclosed by a thin grey border. It contains 20 horizontal dotted lines for writing the answer.



(b) To what extent are households on low incomes 'hit the hardest by rising food prices' (*Extract 1, line 18*)?

(6)

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

(6)

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Question 9 continues on the next page.



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(e) (i) Distinguish between *private costs* and *external costs*.

(4)

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**(e) (ii)* With reference to the concepts of private costs and external costs, assess the possible economic effects of 'using intensive farming methods and genetically modified crops' (*Extract 1, lines 11 and 12*). Use an appropriate diagram in your answer.

(12)

Area with horizontal dotted lines for writing the answer.



Handwriting practice area with 25 horizontal dotted lines.

(Total for Question 9 = 48 marks)



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

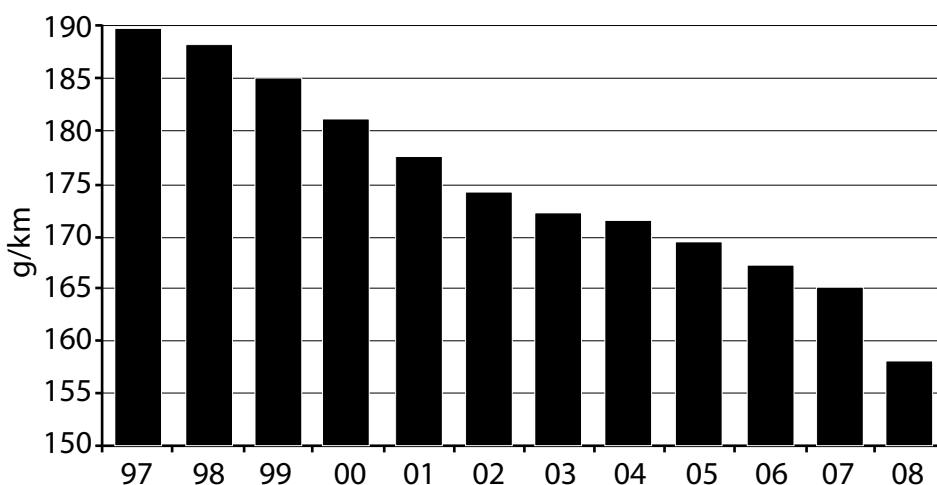
10 The Motor vehicle market

Figure 1: UK new car sales

Year	UK new car sales (million)
2003	2.58
2004	2.57
2005	2.44
2006	2.35
2007	2.40
2008	2.26
2009 (forecast)	2.16

Source: Society of Motor Manufacturers and Traders fact sheet 2009; www.smmmt.co.uk

Figure 2: Carbon dioxide emissions for new cars (grams per kilometre)



Source: Society of Motor Manufacturers and Traders fact sheet 2009; www.smmmt.co.uk



Extract 1 Impact of the economic downturn on the UK car market

The purchase of a car is the second largest expenditure item for consumers after buying a house. Not surprisingly, the economic downturn has caused a drastic fall in demand for new cars. New car sales fell by 21.8% in the first three months of 2009 in response to a 1% fall in real income over the same period.

Thousands of UK motor vehicle manufacturing jobs are likely to be lost this year. Nissan announced 1,200 redundancies in January and Toyota halved the number of shifts on its production lines. Several car companies have reduced wages, for example, Honda has reduced wage rates by 10%. Other companies have frozen pay to avoid compulsory redundancies. BMW and Ford closed their motor vehicle factories temporarily to reduce stockpiles of cars. General Motors, the owner of Vauxhall, may close its two UK plants in Luton and Ellesmere Port unless significant government grants or loans are provided. These factories are in areas of relatively high unemployment. 5

Source: Adapted from 'Fears for 40,000 jobs in British car trade as Toyota goes into red', by Leo Lewis and Tom Bawden, *The Times*, 23rd December 2008 and SMMT fact sheet smmt.co.uk

Extract 2 Government car scrappage scheme

In the 2009 Budget, Chancellor Alistair Darling announced that motorists who scrap a car more than ten years old will receive a £2,000 grant when purchasing a new vehicle. The scheme follows similar moves by major European countries, including France and Germany.

However, the motor vehicle companies have to contribute £1,000 to the subsidy and the remaining £1,000 is paid by the government. The UK scheme will cost just £300 million and will end when the money runs out. By contrast, the German government has allocated £4.49 billion, boosting new car sales by 40%. 5

The car scrappage scheme is likely to boost the sale of smaller models such as the Toyota Yaris, but will be of little benefit to larger and more expensive vehicles such as Jaguar. The scheme has also been criticised for benefiting foreign manufacturers since eight out of ten cars bought in the UK are imported. However, the government claims that many of these imported cars have UK-made parts and the scheme will help UK car retailers. 10

The Society of Motor Manufacturers and Traders urged the government to provide more help for the industry by reducing fuel taxes and making it easier for consumers to get car loans. 15

(Source: 'Budget 2009: car industry welcomes scrappage scheme', by Dan Milmo, *The Guardian*, 22 April 2009.)



- (a) (i) With reference to Extract 1 and Figure 1, explain the likely effect on total revenue for car manufacturers following the decrease in demand for new cars between 2007 and 2009. Use a supply and demand diagram in your answer. (6)
- (a) (ii) Assess the likely impact of the decrease in demand for new cars on the labour market for car workers. (6)
- (b) Explain why labour immobility might be a problem following the closure of car factories. (6)
- (c) With reference to Extract 1, discuss whether the demand for all cars is likely to be income elastic. (6)
- *(d) With reference to Extract 2 and Figure 2, assess the possible economic effects of the UK government car scrappage scheme. (12)
- *(e) Evaluate the possible economic effects of a decrease in fuel taxes, as recommended by The Society of Motor Manufacturers and Traders. Use an appropriate diagram in your answer. (12)



- (a) (i) With reference to Extract 1 and Figure 1, explain the likely effect on total revenue for car manufacturers following the decrease in demand for new cars between 2007 and 2009. Use a supply and demand diagram in your answer.

(6)

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(a) (ii) Assess the likely impact of the decrease in demand for new cars on the labour market for car workers.

(6)



(b) Explain why labour immobility might be a problem following the closure of car factories.

(6)

Dotted lines for writing the answer.



(c) With reference to Extract 1, discuss whether the demand for all cars is likely to be income elastic.

(6)

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Question 10 continues on the next page.



*(d) With reference to Extract 2 and Figure 2, assess the possible economic effects of the UK government car scrappage scheme.

(12)

Area with horizontal dotted lines for writing the answer.



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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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