

Pearson College: First Year Economics Exam 10 December 2018

N13/3/ECONO/SP1/ENG/TZ0/XX

1. (a) Using a diagram, explain why demerit goods are considered to be an example of market failure. [10 marks]
- (b) Evaluate two possible government responses that could be used to address the problem of demerit goods. [15 marks]

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2. (a) Analyse the consumption externalities which might arise from the provision of education and health care for the citizens of a country. [10 marks]
- (b) Evaluate the use of government policies to increase the consumption of health care. [15 marks]

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3. (a) Using a price ceiling diagram, analyse the impact a maximum price might have on the market for food. [10 marks]
- (b) Discuss the policies a government might use to make food more affordable to low income groups. [15 marks]

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4. (a) Explain why common access resources, such as fishing grounds, might become depleted in the absence of a price mechanism. [10 marks]
- (b) Evaluate the view that carbon taxes represent the most effective government response to the threat to sustainability posed by the use of fossil fuels. [15 marks]

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5. (a) Using diagrams, explain how a change in one of the determinants of demand might increase the price of rice and how a change in one of the determinants of supply might decrease the price of rice. [10 marks]
- (b) Discuss the consequences of providing a subsidy on the production of rice for producers, consumers and the government. [15 marks]

Question ①. N13 T20.

- (a). Using a diagram, explain why demerit goods are considered to be an example of market failure. Please do not repeat question

Demerit goods: If the consumption of a good cause significant negative externalities, then these type of good is referred as demerit goods.

Negative externality: Negative externality arises when economic activities, production or consumption ~~imposes~~ ^{utilizes} cost from a third party, while these are not compensated.

Market Failure: Market Failure describes the state of ~~an~~ inefficiency allocation of scarce resources, meaning too much or not enough of a good consumed or produced.

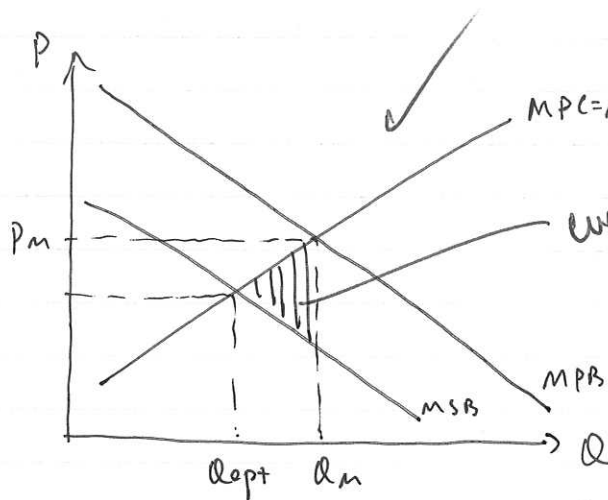


Figure ①.

In Figure ①, you can find the diagram.

In this case, since we are talking about demerit goods, the ~~marginal social cost~~ discussion is on the consumers' side. So, the marginal social cost is equal to marginal private cost ($MPC = MSC$). Because the consumption of demerit good cause negative externality, ~~we~~ as stated in the definition above, we have ~~MPB~~ marginal private benefit (MPB) greater than marginal social benefit (MSB), as shown in the graph.

The current market condition is at Q_m and P_m , while the optimal level or state is when the quantity ~~demanded~~ equals to Q_{opt} . As Q_m is ~~no~~ away from the Q_{opt} , we can find MPB bigger than MSB. This difference cause welfare loss, the shaded region in Figure ①.

It's important to point out that ceteris paribus is being considered when analysis are being done.

For demerit good, there's a trend of over-provided in the currently market, because demerit good are mainly addictive. so ~~that~~ it is very inelastic.

In China, several millions of people drink. Their action causes ~~for~~ domestic abuses and car accidents, while leading millions of family to poverty. Among all accidents, drunk driving is responsible of 40 - 50 percent of them. It's very clear that this is not a proper situation and something should be fixed.

B. Evaluate two possible government responses that could be used to address the problem of demerit goods.

Indirect Tax: Indirect tax are consumption tax instead of income tax, ~~which is only taxed when goods are consumed~~. Please refer to the definition of demerit goods and negative externality is part A.

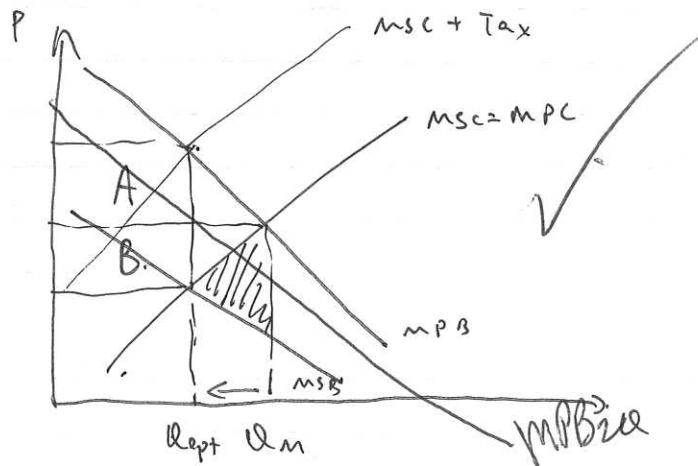


Figure ②.

The two type of possible responses ~~to~~ ^{are} going to ^{be} talk about is indirect tax and government regulations.

① Indirect tax.

In Figure ②, we can find $MSC = MPC$, MSB lying below MPB , while the welfare loss triangle, shaded, is pointing towards Q_{opt} . The mechanism behind this is already stated in part A.

Our goal is to try to move Q_m back to Q_{opt} , so ~~we~~ government can impose indirect tax. Since Q_m is the x-coordinate of the intersection between MPB and $(MSC + Tax)$, Q_m is being moved to the left when $(MSC + Tax)$ is rising, thus decreasing the welfare loss. ~~Part A~~ Area A is consumer's share of the tax, ~~part~~ Area B is producer's share of the tax, so the government's ~~is~~ revenue of the tax is Area (A plus B).

②. government regulation.

With the income by the indirect tax, government can use them to carry out regulation policies in order to make the measurement more efficient. what policies?

Regulations can include constructing law towards the situation, giving fines to parties that have violation, etc.

what regulation are you suggesting?

In China, women's exposure to smoke (cigarette gas) ranks high in the world. Teenagers from 13-15 years old More than 50%.

are exposed to passive smoking weekly in a sealed public facility. 0.7 billion population are regularly exposed to cigarette smoke and 100 k deaths are caused by passive smoking a year.

In a report of WHO and UNDP in 2017, they pointed out two possible solutions: If the price of cigarette is increased 50% through indirect tax, then in 50 years, 20 million people can be prevented from death and 5 million from poverty; while completely restricting smoking in public area can prevent 6 million death and 2 million people from poverty.

Now I want to talk about these two solutions.

Demerit goods are usually addictive, overprovided and inelastic, for instance, the cigarette. It takes huge amount of tax to fix the problem if it's the only measure. However, business will go underground if the price is too high. So it's important to combine the other regulation the taxes, so the second solution makes more sense and seem more practible. It would be great if these two solutions can be combines and effective.

Please answer the question. You need to

explain that regulation shifts the MPB to the left. That ~~lowers~~ lowers the tax needed.

This is description

not analysis nor

examples of reducing smoking.

8/15