Pearson College Economics First Year: Block Week Paper 1 (45 minutes)

Section A

Answer **one** question from this section.

Microeconomics

Question 1

(a) Explain why governments provide subsidies for some goods and services. [10]

(b) Discuss the consequences of providing a subsidy for goods such as agricultural products. [15]

Question 2

(a) Explain how an increase in the price of air travel might affect the demand for its complements **and** its substitutes. [10]

(b) Evaluate the view that the use of regulation is the most effective way to reduce negative externalities. [15]

Question 3

(a) Using a production possibilities curve (PPC) diagram, explain why choices have to be made in all economies. [10]

(b) Discuss the view that governments should not intervene in housing markets. [15]

Question 4

(a) Suggest reasons why the price elasticity of demand for cigarettes might have a different value from the price elasticity of demand for foreign holidays. *[10 marks]*

(b) Examine the usefulness of a knowledge of price elasticity of demand to firms and governments. *[15 marks]*

Jerry Jiang

100% 25/25

Question 3.

(a)

The basic economics question is about scarcity. This is caused by limited factors of production (land, labour, capital, entrepreneneship), also known as limited resource, failed to satisfy all human being's needs and wants.

Opportunity cost is the sacrifice of production of one good when one other type is produced more because of scarcity.

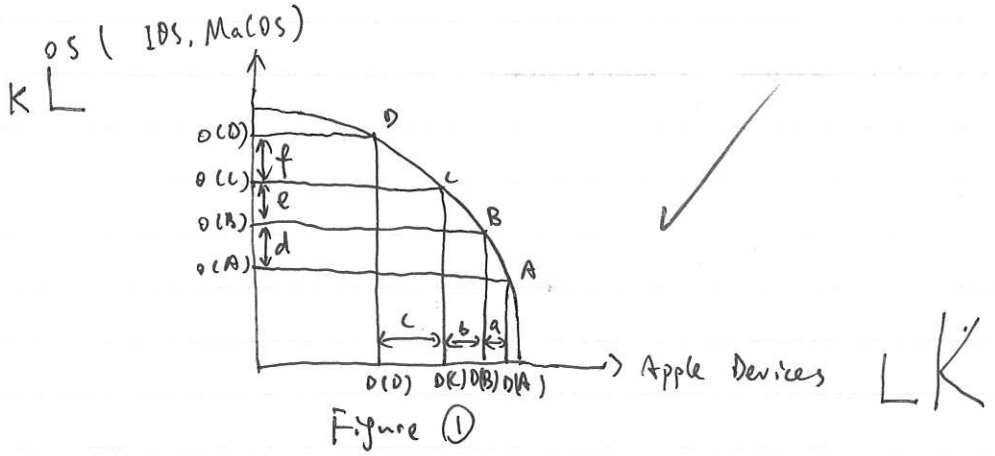


Figure ①

In Figure ①, we can see a production possibilities curve inside Apple company. It's well known that Apple company are famous for its hardwares (iPhones, Macbooks) and its operating systems (IOS, MacOs). However, the resources inside Apple company is limitted, typically in capital (K) and labour (L).

When the company want to move the production state A to B, as you can see in the graph, can gain production of OS by d, with the opportunity cost of a of Devices. However, when you are trying to move from B to C, C to D, you with find out that the increased production of OS is e, f, which is equal to d, while the opportunity cost of devices are increasing since $c > b > a$. This is called increasing opportunity cost, because production of OS requires resources including a little capital and a lot of labour, while the production of devices needs alot of capital and a little bit of labour.

Once you are on the PPC curve, you can't increase the production on one curve ~~when you are trying to~~ without sacrificing another, which is choices.
Unless investments are made, or technology are revolutionized. the curve itself won't move.

(10)

excellent answer

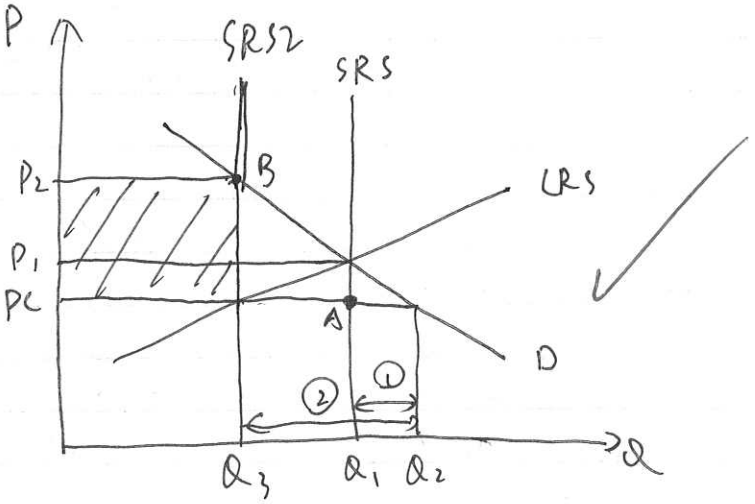
- good example

(b).

Price ceilings are a type of government intervention in rent controls. The government set a price that housing agents can't charge beyond, which is the price ceiling.

Subsidies are the amount of money provided by the government that move the supply curve out so that more people can consume a certain type of good.

Figure ②



In Figure ②, you can find the situation of what happen in the San Francisco's housing market when the government impose a price ceiling (PC).

SRS stands for short run supply curve. This is a vertical line because you need time to build houseses and the ammount of houses in SF is fixed.

LRS is long run supply curve, this is like the long term supply curve of the market viewed from decades of time.

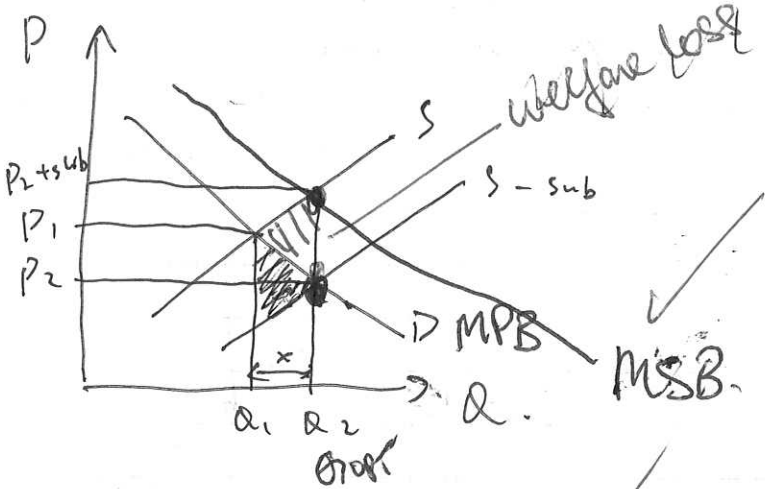
When the PC is post, the max legal price is at PC, so the short run excess demand is $Q_2 - Q_1$, that is ①.

Viewed from long run, the excess demand is $Q_2 - Q_3$, which is ②.

Since the A is where the market is and it's below the supply curve, cost is larger than revenue, so producers tend to change some of the rent houses into condos or office building and shift the S curve to SRS 2. Since SRS2 intersect D at B, consumers are ready to pay price at P_2, so that producers start to charge more illegal fees, which is the shaded box in Figure ①.

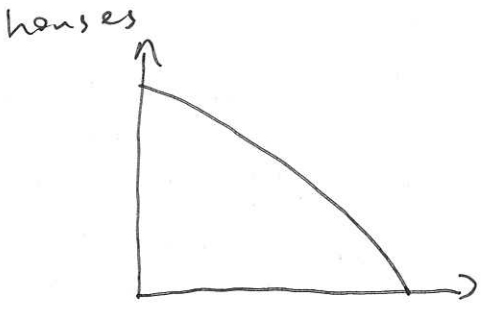
This is not a fun thing for government to control, so they tend to cancel the price ceiling.

Figure 9



Graph

Now common b policy is to post a subsidy. The original S curve is shifted out to S - sub, so that quantity demanded shift from Q_1 to Q_2, with a market distortion of $Q_2 - Q_1$, which is X. Revenue producers get now is $(P_2 + sub) \times Q_2$ while the consumers only need to pay P_2, so more people have house to live in. The shaded triangle is the welfare loss.



However, the subsidy are frequently used to build public houses, but building these houses requires land and Capital. So here's a PPC curve between houses and trees. Deforestation might occur when houses arre built, which might lead to a bad environment influence.

(15) excellent!