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A Level · AQA · Economics

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Exam Questions

8. The Market Mechanism, Market Failure & Government Intervention

The Market (Price) Mechanism / An Introduction to Market Failure / Market Failure: Public, Private & Quasi Public Goods / Market Failure: Negative Externalities / Market Failure: Positive Externalities / Market Failure: Tragedy of the Commons / Market Failure: Merit & Demerit Goods / Market Failure: Market Imperfections / Government Intervention: An Introduction / Government Intervention: Indirect...

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Total Marks   **/229**

1 Which one of the following distinguishes a private good from a pure public good?

    A. A private good can only be provided by private firms and not the government

    B. Consumption of a private good creates negative externalities for other consumers

    C. Consumers of a private good have full knowledge of any externalities in its production

    D. One person's consumption of a private good reduces the amount available for other consumers

(1 mark)

2 Which one of the following government policies is most likely to reduce market failure and to improve the allocation of resources?

    A. A higher rate of tax on all firms earning profit

    B. A minimum price for demerit goods above their free market price

    C. Free market pricing for the provision of public goods

    D. Subsidies paid to all loss-making firms to maintain full employment

(1 mark)

3 **Figure 6** shows the marginal private and social benefit (MPB and MSB) curves and the marginal private and social cost (MPC and MSC) curves in the market for domestically

produced solar panels. The initial market equilibrium is at E1.

Figure 6
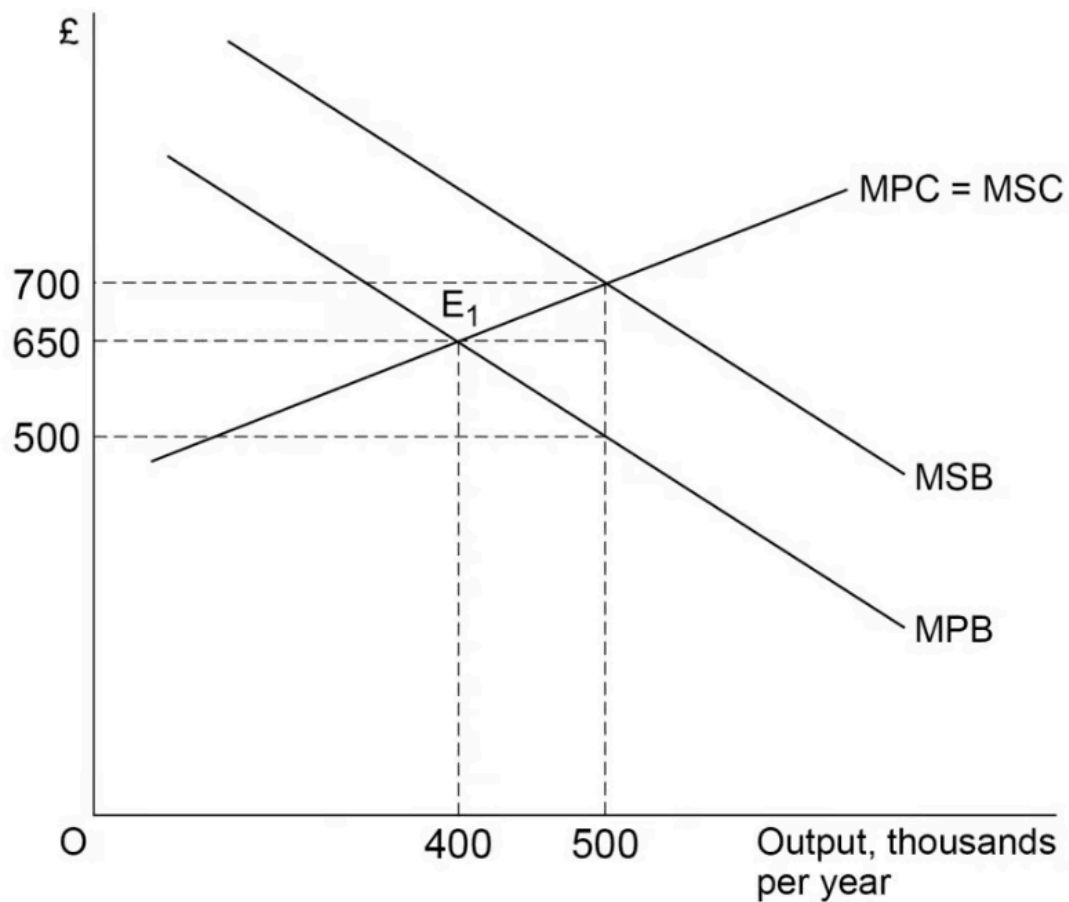
To correct the market failure, the government introduces a subsidy to domestic manufacturers of solar panels of £200 per unit produced. Which one of the following represents the total amount of subsidy payments made by the government in the first year of the scheme?

A. £20 million.

B. £25 million.

C. £75 million.

D. £100 million.

(1 mark)

4 Which one of the following is most likely to result in complete market failure?

A. Negative externalities in production and consumption

B. Non-excludability and no enforceable property rights

C. The existence of demerit goods in some markets

D. The government setting maximum prices for excludable and rival goods

(1 mark)

5 A rational, utility maximising consumer is considering the purchase of a used car. Her final choice is between two cars which are identical in **all** respects except for the differences shown below.

	Price	Period of guarantee against faults
Car 1	£8000	3 months
Car 2	£10000	12 months

Based on the above information, which one of the following is the most likely explanation for the customer's purchase of Car 2? She

A. has £10 000 of savings available to buy herself a used car

B. has a positive income elasticity of demand for used cars.

C. has a price inelastic demand curve for used cars.

D. wants to reduce the risks from asymmetric information.

(1 mark)

6 The existence of negative externalities in consumption results in a misallocation of resources. This is because at the free market level of output the

A. marginal private benefit is greater than the marginal private cost

B. marginal private cost is greater than the marginal social cost

C. marginal social benefit is less than the marginal social cost

D. marginal social cost is less than the marginal private benefit

(1 mark)

7 **Extract C: Selected indicators of the affordability of buying a house**

Figure 4

Average UK house price, average weekly earnings in nominal terms and their annual percentage changes, December 2007 to December 2017

Date	House Price	House price, annual percentage change	Weekly earnings	Weekly earnings, annual percentage change
December 2007	£189 193	7.0	£425	2.9
December 2008	£160 954	-14.9	£435	2.4
December 2009	£168 082	4.4	£439	0.9
December 2010	£168 703	0.4	£449	2.2
December 2011	£167 048	-1.0	£457	1.8
December 2012	£168 843	7.7	£462	1.0
December 2013	£177 971	5.4	£468	1.4
December 2014	£191 669	7.7	£480	2.5
December 2015	£204 919	6.9	£489	1.9
December 2016	£215 500	5.2	£498	1.9

December 2017	£226 756	5.2	£512	2.8

<div align="right">Source: ONS, February 2018</div>

To what extent, if at all, do the data suggest that houses in the UK were more affordable in 2017 than they were in 2007? You must use the data in **Extract C** to support your assessment.

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<div align="right">**(10 marks)**</div>

8 Which one of the following applies to merit goods?

A. Their marginal private benefit is greater than their marginal social benefit.

B. They are likely to be provided by the market.

C. They can only be supplied by the government.

D. They have the characteristics of non-excludability and non-rivalry

<div align="right">**(1 mark)**</div>

9 The diagram below shows the demand curve(D) and two supply curves (S$_1$ and S$_2$) in the market for renewable energy.
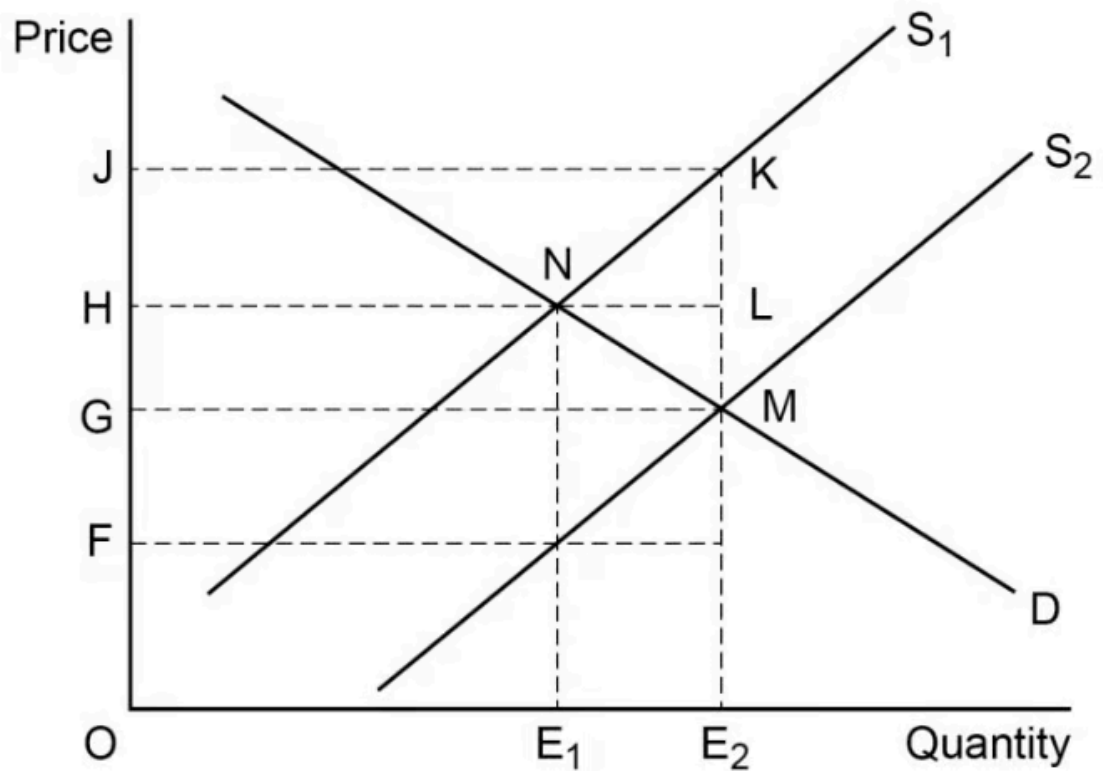
The renewable energy market is initially in equilibrium at a price of OH. The government then introduces a subsidy for renewable energy.

After the introduction of the subsidy, the total amount of money received by the producers from both consumers and the government is

A. OGME$_2$

B. OHLE$_2$

C. OHNME$_2$

D. OJKE$_2$

(1 mark)

10 Which one of the following provides a reason for government intervention in a market?

    A. Firms in an oligopolistic market may limit price competition.

    B. Market failures can only be corrected by using regulations.

    C. Monopolistically competitive firms earn abnormal profits in the long run.

    D. Public goods are excludable and rival.

<div align="right">

(1 mark)

</div>

11 Refer Insert

To what extent, if at all, do the data suggest that the reliance on fossil fuels to produce energy is falling? You must use the data in **Extract C** to support your assessment.

<div align="right">

(10 marks)

</div>

12 The diagram below shows the original market demand and supply curves (D and

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S) for loft insulation. Loft insulation reduces energy consumption.
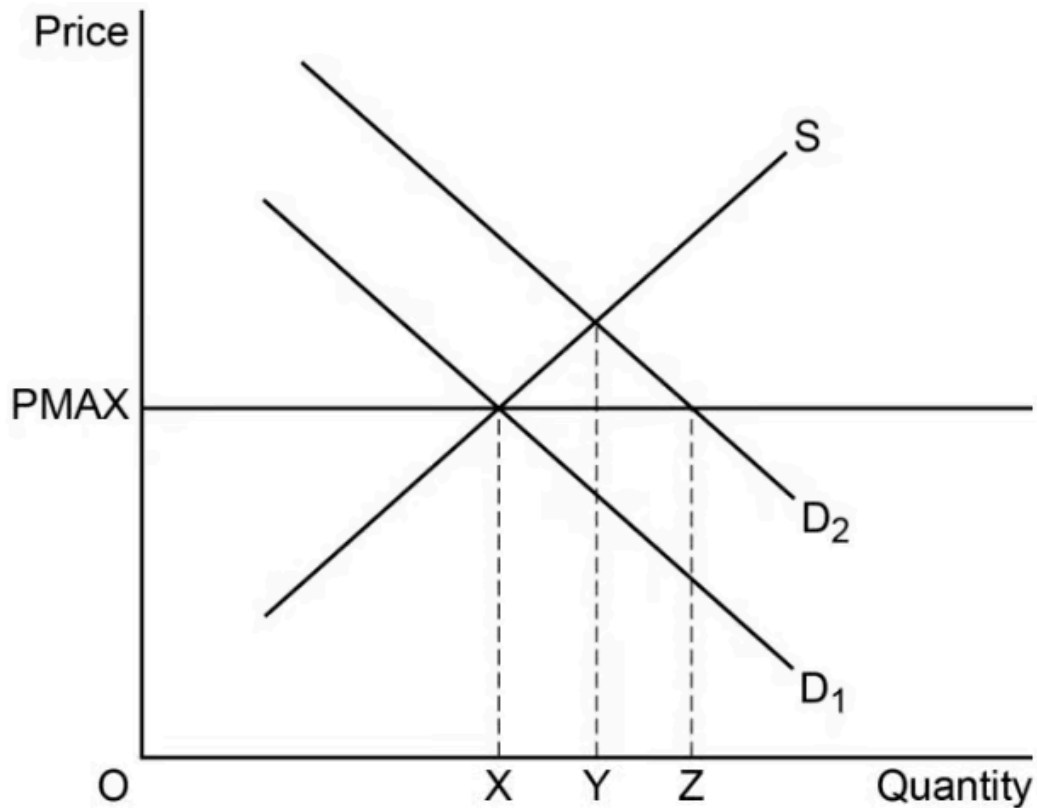
The government wishes to meet its energy efficiency target by shifting the market demand curve for loft insulation from D_1 to D_2. Which one of the following policies is most likely to enable the government to achieve its objective?

A. A decrease in the rate of VAT on domestic gas and electricity used for home heating

B. A 'nudge' to households to install loft insulation by offering to clear lofts of unwanted items if insulation is installed.

C. The introduction of a maximum price for loft insulation

D. The introduction of a subsidy paid to the firms installing loft insulation

(1 mark)

13 The tragedy of the commons can be applied to the fishing industry. What is the nature of this market failure?

    A. Over-fishing resulting in declining fish populations

    B. The imposition of fishing quotas by the European Union

    C. The positive externalities associated with fish consumption

    D. The third-party effects on dolphins as a result of tuna fishing

(1 mark)

14 Immobility of labour may lead to a misallocation of resources and market failure because

    A. a change in the pattern of demand results in structural unemployment.

    B. the education and training needed to reduce labour immobility is a public good.

    C. the government's target for the rate of inflation is too high.

    D. the immobility of factors of production is a negative externality in production

(1 mark)

15 The diagram below shows the marginal private and social benefit (MPB and MSB) curves and the marginal private and social cost (MPC and MSC) curves in a market

where there are positive externalities in production.
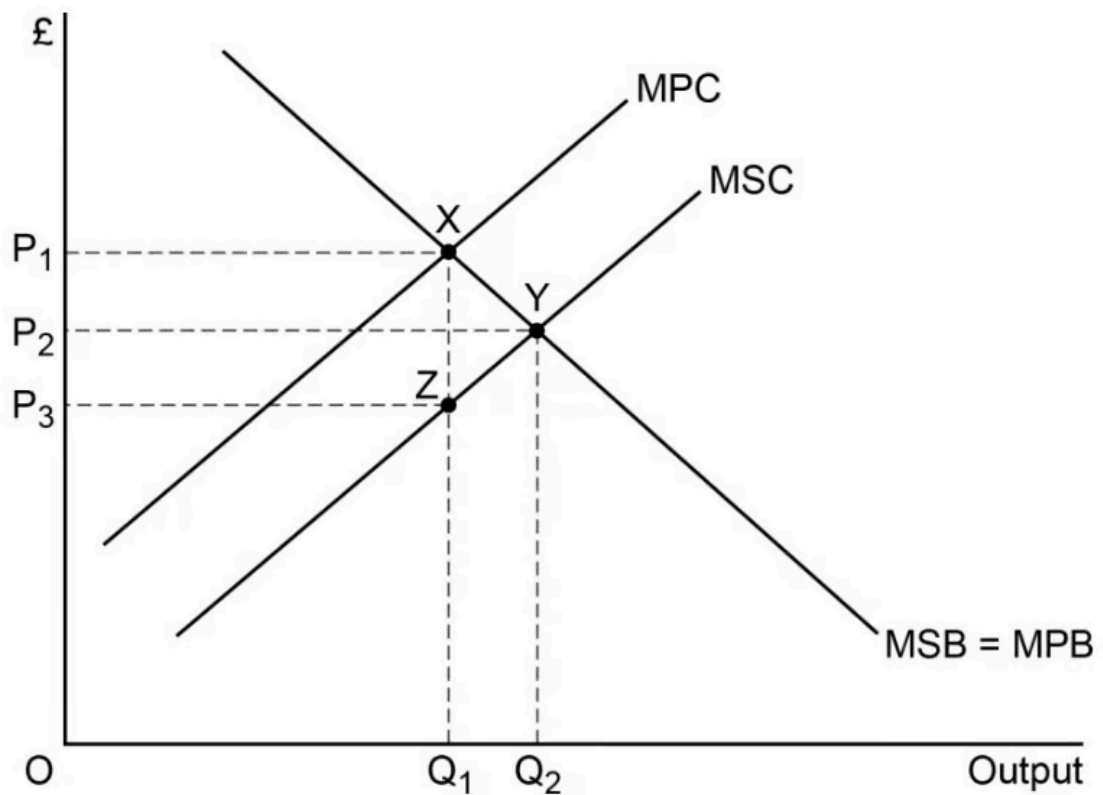
At the free market equilibrium, market failure occurs. Which one of the following is correct?

   A. As a result of this market failure, consumer surplus is reduced by ZXY

   B. As a result of this market failure, there is a deadweight loss to society of $P_3 P_1$ XZ

   C. P_1 minus P_3 is the subsidy per unit that is required to correct the market failure and achieve the social optimum

   D. The diagonal distance XY shows the amount by which marginal private cost exceeds marginal social cost at OQ_2

(1 mark)

16 Refer Insert

Taking into account **Extract D**, and the original evidence presented in **Extracts A, B** and **C**, would you recommend that the government should intervene to support the UK steel industry? Justify your recommendation.

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(25 marks)

17

Figure 1: Global plastic production and disposal, 1950–2015, million tonnes

Total primary plastic production: 8300

| Recycled: 500 | Still in use: 2500 | Landfill: 4600 | Incinerated: 700 |

| Still in use: 100 | Landfill: 300 | Incinerated: 100 |

Note: Incineration is disposal by burning.
Landfill is disposal by burying in the ground.
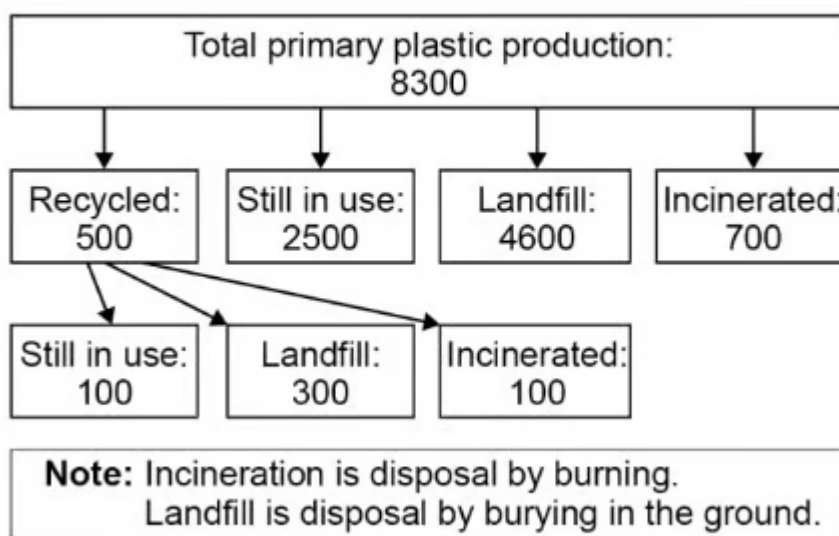
Source: Data from ourworldindata.org, 2018

Using the data in **Extract A (Figure 1)** calculate the percentage of all plastics produced in the period 1950–2015 which have either been sent to landfill or incinerated. Give your answer to **one** decimal place

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(2 marks)

18

Figure 2: Generation of waste and GDP per capita, 2016, selected countries
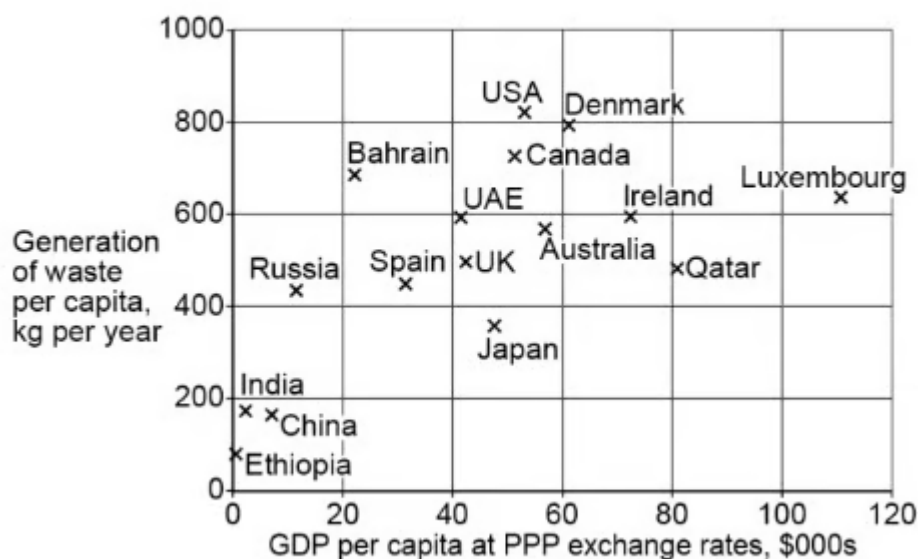
Source: World Bank, 2018

Explain how the data in **Extract A (Figure 2)** show that higher living standards lead to greater volumes of waste per capita being produced

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(4 marks)

19 **Extract B (lines 8–10)** states: 'many companies intentionally make it difficult to repair their products in order to increase sales. This is both economically inefficient and environmentally foolish; it imposes costs on the environment even though it may make sense for individual companies.'

With the help of a diagram, explain how the production of goods which are designed not to last long may result in market failure

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(9 marks)

20 Critics of the world's five most valuable multinational technology firms (Google, Amazon, Apple, Facebook and Microsoft) argue that there ought to be greater government intervention to protect consumers' interests. Several European governments are considering imposing new taxes on the revenues of such firms, rather than their profits.

Discuss whether governments should consider increasing the regulation and taxation of technology firms which have acquired significant global monopoly power

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(25 marks)

21 In December 2018, the Competition and Markets Authority (CMA) announced a range of policies to prevent firms charging existing customers more than new customers. Firms supplying financial services, mobile phones and broadband are no longer allowed to discriminate against loyal customers renewing their contracts

Explain why imperfect information can lead to market failure

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(15 marks)

22 **Extract B** states that the global trade in sand has been 'made possible by cheaper transportation'. With the help of a diagram, **explain** how cheaper transportation and a construction boom in East Asia have led to growth in the market for sand

Extract B: Is the world running out of sand?

Sand is in high demand. Sand accounts for up to 85% of all mining and the global depletion of sand is rapidly exceeding its natural renewal rate. Sand is mostly used in the construction industry to make concrete and asphalt. Chinese demand has risen significantly, reflecting the country's rapid pace of construction: it built 32.3 million houses and 4.5 million kilometres of road between 2011 and 2014. Sand also has industrial uses: it is used to make glass, electronics, and to help extract oil in the fracking industry. While market demand for industrial sand has tracked overall economic growth in the USA, the demand for fracking sand has been as volatile as oil prices

Vast quantities of sand are dumped into the sea to reclaim land: Singapore, for example, has expanded its land area by over 20% since the 1960s. Much of this sand originates from Indonesia, where sand miners have completely erased over 20 islands since 2005. The Maldives and Kiribati have used sand to shore up their islands against rising sea levels. The United Nations forecasts that, by 2030, there will be over 40 'megacities', home to more than 10 million inhabitants (up from 31 in 2016), which means more housing and infrastructure will need to be built. Also, sea levels will continue to rise and so sand will only become more sought after. But why is there a shortage when sand seems so abundant? Desert sand is too smooth, and so cannot be used for most commercial purposes. Australian sand was shipped to a faraway desert to build Dubai's Burj Khalifa tower, made possible by cheaper transportation. Most countries have rules in place about where, and how much, sand can be mined. However, surging demand has sparked a lucrative illegal trade in many rapidly developing countries which is damaging the environment, causing pollution and harming local biodiversity

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(9 marks)

23 For a long time, supermarkets and other commercial firms have understood the benefits of behavioural economic concepts such as choice architecture and framing. The public sector has been slow off the mark, but at last governments are now taking advantage of the opportunities provided by nudging

Using examples to illustrate your answer, **assess** the usefulness of behavioural economic theory compared to traditional economic policies in helping governments to correct market failures

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(25 marks)

24   'Each time the Government imposes a minimum price or wage, the result is almost always excess supply. What matters is the extent to which this is a problem.'

Explain how the impact of a minimum price for a good or service is affected by its price elasticity of demand and its price elasticity of supply

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(15 marks)

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Extract A: Customers switching personal bank accounts in 2016
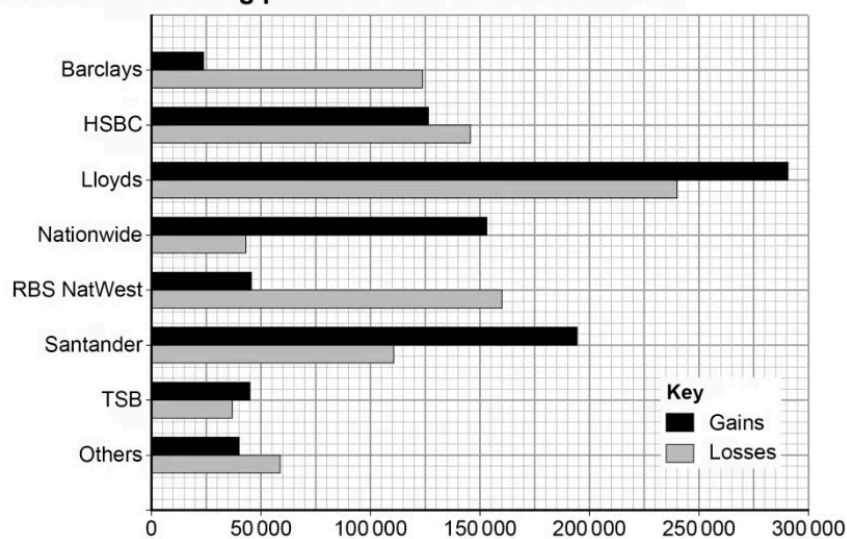
Source: BACS

Using **Extract A,** calculate the ratio of customers gained to customers lost by Nationwide. Give your answer correct to **one** decimal place

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(2 marks)

26 According to Public Health England, poor air quality is the largest environmental risk to public health in the UK. In particular, diesel cars are estimated to be responsible for 40 000 premature deaths each year. In response, the Government announced in 2017 that it would ban the sale of new petrol and diesel cars by 2040

Explain why the use of petrol and diesel cars may be a source of market failure

(15 marks)

27 According to Public Health England, poor air quality is the largest environmental risk to public health in the UK. In particular, diesel cars are estimated to be responsible for 40 000 premature deaths each year. In response, the Government announced in 2017 that it would ban the sale of new petrol and diesel cars by 2040

Assess the view that regulation is a better policy for dealing with the problem of air pollution than the allocation of property rights or taxation

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(25 marks)

28 Attempts by governments to equalise incomes are well-intentioned but counter-productive. They destroy incentives for people to lift themselves out of poverty

To what extent can the problem of poverty in the UK be solved through the operation of market forces? Justify your answer

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(25 marks)