Edexcel AS/A-level Year 1 Economics A exam practice answers

3 Market failure

1 (a) Private costs are costs to owners of oil freighters: wages of workers; cost of freighter; energy to power freighter.

External costs are costs to third parties not part of the transaction, e.g. lost revenue to hotel owners; lost revenues to other firms dependent on tourism. [3]

(b) Correct answer D: social costs are greater than private costs. [1]

2 (a) Correct answer C: public goods are under-provided by the private sector. [1]

(b) Two characteristics of public goods: non-excludability and non-rivalrous.

Private goods are excludable, i.e. people can be excluded from buying them because of the price charged. Also, consumption by one person limits consumption by others. [3]

3 Outline answers:

(a) Definition of opportunity cost. Possible examples include new hospitals; new infrastructure, e.g. roads, rail links. [4]

(b) University education is excludable, i.e. it is possible to prevent people from using this service through, for example, entrance requirements and the requirement to pay fees. Further, it is rivalrous, i.e. use by one person restricts use by others. [5]

(c) Definition of private costs. Examples include tuition fees; books; internet connection; living costs; transport costs. [6]

(d) Definitions of private and external benefits. Private benefits include higher potential earnings and more job satisfaction. External benefits include higher economic growth, higher levels of employment, higher profits for firms and increased tax revenue for the government. External benefits diagram including welfare triangle.

Evaluation: uncertainty of value of private benefits, e.g. because of high graduate unemployment; type of degree. Difficult to quantify external benefits in monetary terms, danger of brain drain, impact of improvements in university education in other countries. [15]

(e) Definition of price elasticity of demand.

Calculation of PED = 10 ÷ 166.67 = 0.06.

This suggests that demand is price inelastic, i.e. the price change has caused a less than proportionate fall in quantity demanded. However, elasticity of demand may vary between different income groups and from different countries. Further, the PED may change over time. [10]

(f) Case for increased tuition fees:

* high private benefits
* incentive for universities to be more responsive to the market e.g. by providing more places on courses which are in high demand
* the universities can use the revenue to improve facilities, employ better-quality staff
* government will have more resources to reduce the budget deficit or to spend in other areas in the economy
* students can demand more contact time

However:

* increased tuition fees might deter people from applying to university
* they might lead to significant decline in applications from low-income families
* some universities might go bankrupt if they fail to attract enough students
* the range of courses might be reduced if they are uneconomic [20]

(g) Information gaps include difficulty of:

* knowing for which degree course to apply
* knowing the quality of the education provided
* knowing the future value of the degree
* knowing the earnings lost by going to university
* estimating total costs of going to university

However:

* more information is available about courses, especially on the internet
* information on the quality of courses is more readily available
* research has been conducted to estimate the future value of a degree [20]