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

4 Government intervention

1 (a) Correct answer D: government failure. [1]

(b) Three sources of government failure are: high administrative costs; information gaps; unexpected consequences. [3]

2 (a) Correct answer B: an increase in producer surplus. [1]

(b) (i) £116 129 [1]

(ii) To reduce external costs from non-renewable energy sources such as coal. [2]

3 Outline answers:

(a) PED = % change in quantity demanded = –0.1 = –0.01 [4]

% change in price 10

Therefore, demand is price inelastic.

(b) XED = % change in quantity demanded for sugar [5]

% change in price of artificial sweeteners

These products are substitutes. Therefore, the XED will be positive.

(c) Producer surplus is the difference between the market price and the cost of supply.

* + The fall in demand for sugar will result in a fall in price.
  + Consequently, the producer surplus will fall.
  + This may be illustrated with a diagram. [6]

(d) The price of sugar has fallen because there is a decrease in demand (caused by falling consumption associated with adverse effects on health) and an increase in supply (following bumper harvests). Therefore, the demand curve will shift to the left while the supply curve will shift to the right.

Evaluation: the extent of the price fall will depend on the extent to which the demand and supply curves shift and also on the price elasticities of demand and supply. If supply and demand are both price elastic, then the impact on price will be less than if demand and supply are price inelastic. The price fall might be short run only, for example, if the next harvest is very low. [10]

(e) Definition of government failure. A government decision to ban sugar production in the UK could result in a misallocation of resources and increased imports. Also cost of enforcing the ban.

Evaluation: difficulty of determining the socially efficient output. Land formerly used to produce sugar may be put to more efficient uses. [15]

(f) Case for a ban on sugar production in the UK:

* reduction in obesity
* reduction in diabetes
* reduction in tooth decay
* lower costs for NHS
* less absenteeism
* higher productivity

Evaluation:

* Limited impact if it results in increased imports.
* Other factors might be more significant than sugar for health impact, e.g. lack of exercise.
* Increase in price of many foods may particularly affect those on lower incomes. [20]

(g) Definitions of private costs and external costs.

* Examples of private costs: rent of land; cost of seeds and fertiliser; wages of workers.
* Examples of external costs: loss of income for fishermen; loss of habitats for wildlife; impact on local homeowners e.g. danger of flooding.
* Diagram illustrating the external costs of production and identifying the free market output and the socially efficient output.

Evaluation:

* Difficulty of identifying the external costs.
* Difficulty of assessing the magnitude of the external costs.
* Private and external costs might change over time.
* Farmers might be able to change production methods to reduce external costs. [20]