

General Certificate of Education
June 2005
Advanced Subsidiary Examination



ECONOMICS **ECN1/2**
Unit 1 Part 2 Data Response: Markets and Market Failure

Friday 10 June 2005 Afternoon Session

In addition to this paper you will require:

- an 8-page answer book;
- the question paper for Part 1 (ECN1/1).

You may use a calculator.

Time allowed: 1 hour for papers ECN1/1 and ECN1/2 together

Instructions

- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN1/2.
- Answer **EITHER** Question 1 **OR** Question 2.

Information

- The maximum mark for this paper is 25.
- Mark allocations are shown in brackets.
- You will be assessed on your ability to use an appropriate form and style of writing, to organise relevant information clearly and coherently, and to use specialist vocabulary where appropriate. The degree of legibility of your handwriting and the level of accuracy of your spelling, punctuation and grammar will also be taken into account.

Advice

- You are advised to spend at least 45 minutes on paper ECN1/2.

Answer **EITHER** Question 1 **OR** Question 2.

EITHER

1

Total for this question: 25 marks

Study **Extracts A, B and C**, and then answer **all** parts of Question 1 which follows.

Extract A: The price elasticity of supply of new housing in selected countries

Country	Price elasticity of supply
Netherlands	+ 0.3
UK	+ 0.5
Denmark	+ 0.7
France	+ 1.1
USA	+ 1.4
Germany	+ 2.1

Source: adapted from KATE BARKER, *Review of Housing Supply*, published by The Treasury, December 2003

Extract B: Housing market elasticities in the UK

UK households have an income elasticity of demand for housing that exceeds +1. However, demand for housing is price inelastic. These demand elasticities, combined with a low price elasticity of supply for housing, push the UK's housing market towards long-term rising prices. New housing would need to have a price elasticity of supply of +10 for supply to equal demand in the long term. But if the price elasticity of supply for new housing remains low, as Extract A shows, house prices will never be stable in the UK when the demand for housing is increasing.	1 5
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Extract C: The benefits and costs of building more houses

Whilst a higher rate of housebuilding produces benefits for the UK economy, particularly for younger households, it also produces negative externalities. These include pollution and congestion. Leisure facilities, such as country paths, are lost. Also lost are external benefits, such as the visual amenity of a more natural landscape and the diversity of wildlife that open spaces support. There is also the cost of infrastructure requirements, such as the need to build more schools. 1 5

Not all housebuilding produces the same benefits and costs. Newcastle has more houses than households, but the quality of the surplus housing stock is poor and concentrated in deprived areas. By contrast, the quantity of high quality housing is lower than the national average. In recent years, the shortage of desirable family housing has caused faster rises in house prices in Newcastle than in the rest of north east England. The city council has noticed that households priced out of the Newcastle market were moving to other communities in the north east. 10

To stem the outward movement of higher income families, Newcastle city council decided that some green belt land on the edge of the city should be used for housing. Green belts, which are areas of land that cannot be used for housing or industry, are meant to prevent urban sprawl. Newcastle city council argues that the benefit of building houses on some, but not all, green belt land exceeds costs such as the loss of amenity caused by housebuilding. 15

Source: adapted from KATE BARKER, Review of Housing Supply, published by The Treasury, December 2003

Question 1

- (a) (i) Define price elasticity of supply. (2 marks)
- (ii) Compare the price elasticities of supply for new housing in the countries shown in **Extract A**. (2 marks)
- (b) With the help of a supply and demand diagram and the information on elasticities in **Extract B**, explain how an increase in household income affects the price of housing in the United Kingdom. (6 marks)
- (c) In the light of the possible effects on the environment and on leisure activities, evaluate the view that all government controls on new housebuilding should be removed. (15 marks)

TURN OVER FOR THE NEXT QUESTION

Turn over ►

OR

2

Total for this question: 25 marks

Study **Extracts D and E**, and then answer **all** parts of Question 2 which follows.

Extract D: Index of metal prices, 2003 (1995 = 100)*

February	74.5
April	69.3
June	71.9
August	76.9
October	82.9
December	91.3

* Note: The figures are taken from *The Economist Metal Price Index*, which measures the average price of metals, such as iron and nickel, but excludes precious metals such as gold.

Extract E: The price of nickel

During 2003, the price of nickel rose from under \$8000 to over \$14 000 a tonne. Two thirds of the world output of nickel goes into the production of stainless steel, used for products such as cutlery and kitchen sinks. The factors that influenced the price of nickel included: 1

- A strike by workers at a large nickel mine in Canada. The mine normally produces 9 per cent of the world output of nickel. 9000 tonnes of nickel production was lost each month for several months. 5
- Early in 2003, Russian producers sold 36 000 tonnes of nickel from their stockpile, which was the largest in the world. In June 2003, the Russians sold a further 24 000 tonnes to offset supply concerns caused by the strike in Canada.
- Output of manufactured goods grew throughout the world in 2003. In China, surging output of stainless steel affected the nickel market. 10
- Speculative demand also affected the market. When speculators believe prices are going to rise, they buy the commodity in order to make a profit by selling at a higher price in the future. In the nickel market, changing demand conditions and running down of stocks led to speculative activity in 2003. Stocks had been the only buffer in the market stabilising the price of nickel. 15

Market traders expect the price of nickel to grow in 2004, as the world economy continues to grow and production falls due to the lack of new mines and dwindling supply from existing ones. In the 1990s, mining companies bet on new technology lowering the cost of extracting nickel from ores found in tropical soils. But innovation failed to live up to expectations and the new mines in developing countries are not expected to start production for at least another two years, leaving the market short of nickel in 2004 and 2005. Steel makers are also seeking alternatives to nickel in an effort to deal with rising prices and undersupply. 20

Source: adapted from KEVIN MORRISON, *Financial Times*, 14 June, 23 August and 18 December 2003

Question 2

- (a) Using **Extract D**, calculate the percentage change in the price of metals:
- (i) from 1995 to December 2003; *(2 marks)*
 - (ii) from February 2003 to December 2003. *(2 marks)*
- (b) With the help of a supply and demand diagram and the information in **Extract E**, explain **two** factors that caused the price of nickel to rise in 2003. *(6 marks)*
- (c) It is often argued that buffer stock schemes should be used to control the prices of industrial raw materials such as nickel and tin.
- Assess the possible **advantages** and **disadvantages** of using a buffer stock scheme to control the price of an industrial raw material. *(15 marks)*

END OF QUESTIONS

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