

AS Economics Markets - why they fail January 2004 Mark Scheme

Question 1

(a) With reference to the information in Extract 1, explain two factors which might account for the rising demand for air transport. **6 marks**

Factors include:

Rising incomes; demand for air travel is income elastic

Increased congestion on roads makes air travel preferable for internal journeys

Cheap package holidays

Increased travel for business purposes

Increased trade with other countries

Increased availability of low cost airlines

Increase convenience and access.

2 x 3 marks (2 marks for identification; 4 for explanation) If no direct reference to extract 1, then maximum 4 marks.

(b) With reference to Extract 1, examine the external benefits of air transport to the UK economy. Illustrate your answer with a diagram.

Definition of external benefits

Employment creation

Helps to attract foreign inward investment Increased exports

Aids the tourist industry (2 x 2 marks)

3 marks for diagram.

Allow MPB and MSB drawn parallel.

Must make reference either to shaded area or to X and Y for 3/3 otherwise award 2 out of 3.

Up to 3 marks for any one evaluation point. Evaluation points might include:

Consideration of the relative significance of each factor; Air travel enables UK citizens to travel abroad;

Other transport industries might suffer job losses. External costs.

(c) Giving examples, distinguish between the private costs and external costs of air transport. Illustrate your answer with a diagram.

Private costs: those incurred by either producer or consumer (1 mark) e.g. cost of airline ticket. 1 mark for example(s)

External costs: those incurred by third parties not directly involved in the transaction (2 marks) e.g. pollution, noise, loss of countryside, global warming, 2 marks for example(s)

Diagram Allow MSC and MPC drawn parallel.

3 marks for correctly labelled diagram and explained in the context of air transport.

Must make reference either to shaded area or to X and Y for 3/3 otherwise award 2 out of 3.

Basic diagram only 1 mark. 9 marks

(ii) Assess the case for taxing air transport.

External costs of air transport.

At present air travel is under taxed

Need to take action to limit growth in demand

High growth rate of industry does not justify hidden subsidies

Revenue could be used to subsidise people living near airports, eg sound proofing or to finance other areas of government expenditure. 2 x 3 marks.

2 marks for identification; 4 marks for application and analysis.

Up to 3 marks for any *one* evaluation point.

Evaluation points might include:

Must consider external benefits of air transport

Tax might harm the whole economy

Other factors might result in a fall in demand for air transport

External costs difficult to quantify 9 marks

Significance of PED for government revenue and impact on demand.

(d) Apart from taxation, examine one other government measure which might reduce the forecast rise in demand for air transport.

Possible factors:

Improvements in rail investment

Stricter regulations governing pollution caused by aircraft

Tradable permits

Quotas.

1 mark for identification, 3 marks for explanation. 2 marks for one evaluation point.

Evaluation points might include:

Improvements in rail transport will not affect demand for overseas travel;

Face to face meetings are still important for businesses.

6 marks

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Q. 2a) With reference to Figure 1, how might the fluctuations in farm incomes be explained?

Analysis:

Inelastic demand, with supply side shocks e.g. weather

Inelastic supply with demand changes e.g. changes in tastes towards organic food

Cobweb analysis: this year's price determines next year's output

Reforms to CAP, leading to lower prices from mid 1990s

6 marks

Up to 2 marks for knowledge of inelastic D & S or Cobweb.

Up to 4 marks for application and analysis. Using either inelastic D&S or

Cobweb analysis.

No specific reference to data maximum 4/6 marks.

(b). Assess the case for government intervention in agriculture

Case for includes:

To stabilise farm prices, so enabling farmers to plan output and investment

To stabilise farm incomes

To maintain rural way of life and rural environment

To prevent relative fall in farm incomes (because of low income elasticity of demand for food products)

To prevent exploitation of farmers by food processors

Protection against cheap imports/self sufficiency.

2 marks for identification of factors; 4 marks for application and analysis;

4 marks for any 2 evaluation comments, eg:

However intervention has led to:

Inefficiency - government failure

Misallocation of resources

Inequity with reference to net contributions by EU member states

Inequity with regard to large farms in relation to small farms

High food prices for consumers

Higher taxes (10 marks)

(c) (i) Examine the factors which led to the development of "wine and milk 'lakes' and butter 'mountains' " (Extract 1, line 8). Illustrate your answer with a diagram.

Key points:

Subsidies (guaranteed minimum prices) encouraged over production

Technological progress e.g. better seeds, greater use of fertilisers led to greatly increased productivity

Taxes on imported food distorted the operation of market forces.

Diagram showing minimum guaranteed price

NB: Candidates might include a rightward shift of supply curve

2 marks for identification of any two reasons for development of surpluses; 2 marks for explanation and 2 marks for diagram. Up to 2 marks for any one evaluation point.

Evaluation points include:

Discussion of relative significance of each factor

Consideration of incentive effect of minimum guaranteed prices

8 marks

Assess two methods that might be used to reduce these surpluses.

Possible methods:

Use of quotas;

Set aside;

Linking subsidies to the environment rather than to production

Lowering the minimum guaranteed price

Dumping surpluses abroad.

2 marks for identification; 4 marks for application and analysis.

Up to 2 marks for any evaluation point.

Evaluation points include:

Difficulty of monitoring

Cost of set aside scheme

Inefficiency 8 marks

(d) Giving examples, distinguish between the private and external costs associated with modern farming methods.

Private costs: those incurred by farmers (2 marks) e.g. seeds, fertilisers, machinery, rent of land. 2 marks for examples.

External costs: those incurred by third parties not directly involved in the transaction (2 marks) e.g. pollution of rivers (pesticides and fertilisers); destruction of hedgerows and trees; loss of wildlife; loss of jobs in rural areas.

2 marks for examples.

2 x 4 marks 8 marks