

OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Advanced Subsidiary GCE

ECONOMICS

2882

MARKET FAILURE AND GOVERNMENT INTERVENTION

Wednesday

18 JANUARY 2006

Morning

1 hour

Additional materials:

Designated Answer Booklet [2882/AB]

TIME 1 hour

INSTRUCTIONS TO CANDIDATES

Write your name, Centre number and candidate number in the spaces provided on the answer booklet.

Answer **all** the questions.

Write all your answers on the separate answer booklet provided.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets [] at the end of each question or part question.

The quality of your written communication will be taken into account in marking your answer to the question labelled with an asterisk (*).

This question paper consists of 3 printed pages and 1 blank page.

Answer **all** parts of this question in the accompanying answer booklet.

Monopoly and Market Failure

The government intervenes in the free market to limit the power of monopolies and to promote greater competition. It does this because economic theory suggests that there are substantial benefits to be gained from increased competition in terms of greater efficiency and lower prices.

‘Clothing take-over gets green light’

Derby based clothing group, Poseidon, has won a major victory in the heated battle to take over rival clothes manufacturer, Icarus. In doing so it has beaten the three biggest manufacturers in the clothing industry. 5

Yesterday, the Trade and Industry Secretary announced that take-over offers from the three leading clothing manufacturers had been blocked. It was argued that any one of these take-overs would ‘operate against the public interest and lead to greater market dominance’. The new combined Poseidon-Icarus group, with just under 14% of the market, will be the fourth largest clothing manufacturer in the UK. 10

Consumer groups welcomed the announcement as good news for shoppers. It is hoped that the combined Poseidon-Icarus group will put more competitive pressure on the leading three manufacturers. This should, in turn, lead to lower costs, lower prices and more choice for consumers. Poseidon Chairman, Sir Martin Fish, is already on record as saying that, whilst there may be some job losses at head office, there will be around 3,000–4,000 new jobs created as a result of the take-over. 15

- (a) (i) Define the term external benefit. [2]
(ii) Identify and explain **one** possible external benefit of the take-over of Icarus by Poseidon. [3]
- (b) (i) Identify **two** characteristics of a private good. [2]
(ii) Explain why clothing is a private good. [4]
- (c) 'There are substantial benefits to be gained from increased competition in terms of greater efficiency and lower prices' (lines 3–4).
(i) Describe what is meant by the term 'X inefficiency'. [2]
(ii) Using a Production Possibility Curve, show the effect of a rise in productive efficiency on an economy. [3]
- (d) The government decided that Poseidon's take-over of Icarus was not against the public interest.
(i) What factors might the government have taken into account when making this decision? [4]
(ii) Apart from encouraging greater competition, the government could reduce clothes prices by introducing a maximum price. Using a diagram, analyse the economic effects of such a policy. [10]
(iii) Comment upon the limitations of a maximum price policy in this case. [3]
- ***(e)** Three forms of market failure are:
- externalities
 - information failure
 - factor immobility
- Select **one** of these to discuss whether or not government intervention will always correct market failure. [12]

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