

AS Economics Unit 2 Markets - why they fail? 05 Jan Mark scheme

Q 1 (a)(i) What is meant by the term 'external costs'? (2)
A cost experienced by a third party i.e. by a producer or consumer not directly involved in an economic activity.
OR allow social cost minus private cost. Cost to society one mark only.

(a)(ii) Outline two external costs of overfishing. (4)

Possible external costs:

Loss of other species of fish.

Loss of jobs in supporting industries.

Lower incomes for local businesses in towns dependent on fishing. NB: Allow any example which shows impact on a third party. NB: External costs must be related to overfishing.

2 x 2 marks (2 marks for identification and 2 for application to fishing)

(a)(iii) Illustrating your answer with a diagram, briefly explain the difference between the free market and socially optimal level of fishing.

2 marks for correctly labelled diagram.

Application/Explanation 4 marks as follows: Free market level of fishing: X (1 mark) where $PMC = PMB/SMB$ (1 mark) Socially optimal level of fishing: Y (1 mark) where

$SMC = 5MB$ If no application to fishing maximum 4/6.
(6)

(b) Using the concept of property rights, explain how overfishing can occur. (4)

Definition of property rights (1 mark)

Application in the context of fishing (1 mark)

With high fixed costs and with limited restrictions on fisherman from other countries, incentive to maximise current revenues (2 marks)

(cii) Examine the advantages and disadvantages of a system of tradable fish quotas as a means of preventing overfishing.

Advantages:

Application of market forces

Revenue to government

External costs internalised

Disadvantages:

Problems of monitoring fish catches

Difficulty of setting appropriate quota level

Costs might be passed on to consumers

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2 marks for identification of any two points or knowledge of tradable quotas. 4 marks for explanation / analysis of the advantages and disadvantages. Up to 2 marks for anyone evaluation point e.g. coming to a conclusion; or comment on relative significance of points (8)

(c)(ii) Discuss the effectiveness of one other method of preserving fish stocks

Possible methods:

Complete ban or key area ban

Subsidising decommissioning of fishing boats

Limited season

1 mark for identification, 3 for explanation and analysis.

Evaluation points could include:

Difficulty of enforcing a ban

Costs involved in subsidising decommissioning

Up to 2 marks for anyone evaluation point

(d) To what extent does the fall in fish stocks illustrate government failure? (6)

Definition of government failure:

Intervention by the government which leads to a net loss in economic welfare (2 marks) Only 1 out of 2 if intervention "makes situation worse".

Explanation and analysis of government failure in context of fishing industry:

Cost of subsidies to fishing industry aimed at expanding fishing industry (line 9)

Lack of finance for recovery plans for fish stocks .

Inefficient operation of system of tradeable fish quotas .

Depletion of fish stocks - with reference to Figure 1. .

Information failure. (4 marks)

Evaluation:

Consideration of whether situation would be worse under a free market

Jobs dependent on fishing industry might be saved in short run (or might consider long run impact).

Difficulty for government of preserving fish stocks

Significance of other factors (eg climate changes) which could be partly responsible for fall in fish stocks

Up to 4 marks for evaluation. Anyone point could be worth up to 3 marks.

(10)

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Q 2 (a)(i) What is a 'national minimum wage'?

A wage set by the government below which employers must not pay their workers. Usually set as an hourly rate.

(2)

(a)(ii) Outline two possible reasons why the government decided to increase the national minimum wage. (4)

Possible reasons include: .

To reduce poverty

To take account of inflation and changes in average earnings

To reduce spending on social security benefits 2 marks for identification, 2 for application

(b) Explain why the increase in the national minimum wage might have different effects on businesses: (i) in different sectors of the economy. (ii) in different regions of the country. (6)

Some sectors have a preponderance of lowly paid, unskilled workers e.g. hotel workers, cleaners. Therefore, they will be more affected than sectors employing highly skilled workers whose wages are above the NMW.

1 mark for identification, 1 mark for example, 1 mark for explanation.

Businesses in London and the South East are more likely to be paying wages above the NMW because the cost of living and wages are generally much higher than in other areas of the country.

1 mark for identification, 1 mark for example, 1 mark for explanation.

(c)(i) How might an increase in the minimum wage act as a barrier to entry into the hotel industry? (4)

Potential businesses, firms faced with the prospect of higher labour costs might be deterred from entering the industry especially since hotels employ a large number of workers at the low levels of pay e.g. waiters, cleaners, kitchen staff.

1 mark for understanding of 'barriers to entry'; 1 mark for application to hotel industry , 2 marks for analysis

(c)(ii) Examine the significance of one other barrier to the entry of new firms into the hotel industry. (6)

Possible barriers include:

Cost of buying hotel

Legal barriers e.g. need to secure planning permission

Costs of meeting health and safety requirements Allow

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credit for limit pricing.

1 mark for identification of any relevant barrier; 3 for explanation and analysis.

Evaluation points might include: Hotel could be leased reducing start up costs
Relative significance of the barriers

Up to 2 marks for anyone evaluation point.

(c)(iii) Using supply and demand analysis, examine the likely effect of raising the national minimum wage on the price of a haircut. (6)

Explanation and analysis of impact of increase in NMW on supply curve (due to an increase in costs) and subsequently on price and output. 2 marks for correctly labelled diagram and 4 marks for explanation OR 6 marks for clear explanation without diagram. Maximum 4 out of 6 with no reference to context.

Evaluation points might include:

Effect will depend on PED

How much wage rates must be increased

Proportion of total costs accounted for by wage costs

Degree of competition in the industry

Up to 2 marks for anyone evaluation point

(d) To what extent might the introduction of a minimum wage for 16 to 18 year olds lead to job losses? Illustrate your answer with an appropriate diagram.

Diagram: 2 marks
Explanation: If the minimum wage is above the equilibrium wage then the demand for workers will be X but the supply of workers will be Y. Therefore, there will be unemployment of XY of 16 to 18 year olds.

(4)

Evaluation points could include: .

The level of NMW in relation to free market level

The elasticity of demand for labour

The significance of wage costs as a proportion of total costs in affected by the minimum wage for 16 18 year olds industries

Up to 4 marks for evaluation. Anyone point could be worth up to 3 marks. (10)