

OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Advanced Subsidiary GCE

ECONOMICS

2882

MARKET FAILURE AND GOVERNMENT INTERVENTION

Tuesday

18 JANUARY 2005

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 4 printed pages.

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

Externalities and Market Failure

In a free market economy, firms often fail to take account of the full social costs of their actions. The negative externalities which may arise are an example of market failure.

The extract below considers criticisms of a water company relating to the loss of 'blue flag' status for beaches. A blue flag is only awarded to beaches where water is clean enough to pass the toughest tests set down by European law. The award of such status is thought to lead to significant external benefits for the surrounding areas.

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'WATER POLLUTION'



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Source: BBC News, June 2003 (adapted).

- (a) (i) Define the term 'external benefits' (line 7). [2]
- (ii) State and explain **one** possible external benefit to a local area that might arise from a beach having 'blue flag' status (line 5). [3]
- (b) (i) State **two** characteristics of a 'public good'. [2]
- (ii) Discuss the extent to which beaches can be considered to be public goods. [5]
- (c) Two approaches to controlling pollution are:
- regulations backed up by fines;
 - taxes on the level of pollution created.
- (i) The extract states that firms breaking the law can be fined up to £100,000 per day (line 19). Comment upon the effectiveness of using such regulation to control the problem of water pollution. [4]
- (ii) With the aid of a diagram, explain how a tax on firms in the water industry could be used to correct market failure. [10]
- (iii) One alternative to regulation would be to impose a tax on firms which are responsible for creating pollution.
- State and explain **two** arguments **against** using taxation to solve market failure. [4]
- (d) (i) Local water suppliers are regional monopolies. Outline the way in which government competition policy tries to tackle the problems caused by market dominance. [3]
- *(ii) Discuss the extent to which an increase in competition always leads to an increase in economic efficiency. [12]

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