

**ADVANCED SUBSIDIARY GCE  
ECONOMICS**

**2882**

Market Failure and Government Intervention

**THURSDAY 17 JANUARY 2008**

Morning  
Time: 1 hour

**Additional materials:** Designated Answer Booklet [2882/AB]



**INSTRUCTIONS TO CANDIDATES**

- Write your name in capital letters, your Centre Number and Candidate Number in the spaces provided in the Answer Booklet.
- Read each question carefully and make sure you know what you have to do before starting your answer.
- Answer **all** the questions.
- Write all your answers in the separate answer booklet provided.
- The space should be sufficient for your answers but if you require more space use the lined pages at the end of the answer booklet and number your answers carefully.

**INFORMATION FOR CANDIDATES**

- The number of marks for each question is given in brackets [ ] at the end of each question or part question.
- The total number of marks for this paper is **45**.
- The quality of your written communication will be taken into account in marking your answer to the question labelled with an asterisk (\*).

This document consists of **4** printed pages.

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

## **Education and Competition Policy**

In a free market economy, the existence of positive externalities leads to market failure. For this reason, the government often steps in to protect these products through subsidies funded from tax revenue. One example of such a product is education.

In the UK, education is provided by both the government and the private sector, with private schools charging fees instead of relying on government funding. This system may save the government money because it does not have to fund the education of thousands of pupils in the private sector. There has, however, recently been criticism of the way in which some private schools set their fees, as considered in the following article. 5  
10

### **‘Fifty private schools fined for fixing their fees’**

Fifty leading private schools have been fined a total of £3.5 million by the Office of Fair Trading (OFT) for fixing their fees. Each school will pay a fine of £10,000 and make an additional payment averaging £60,000 to an educational charity.

Under the agreement reached between the schools and the OFT, the schools have admitted that they shared detailed information about fee increases which had the effect of ‘distorting competition’ and breached the law set out in the Competition Act of 1998. 15

The OFT investigation found that between February and June of each year the information about proposed fee increases was shared between the schools. Documents seen by the OFT showed that some schools used this information to push up their fees but that others, in fact, lowered fees when they saw what their competitors planned to charge. 20

In total, the investigation lasted for more than two years, produced over 130,000 pages of documents and was the first such investigation to result in a negotiated settlement with the OFT. That said, the ruling has been controversial. On the one hand, some claim that the schools have got off too lightly, whilst others question whether such a detailed investigation was necessary at all. These people claim that the investigation was very expensive and that, in this case, the OFT has used a sledgehammer to crack a nut. 25  
30

Adapted from *The Daily Telegraph*, 25 February 2006.

- (a) (i) Identify **two** characteristics of a 'public good'. [2]
- (ii) Explain **two** reasons why education is not a 'public good'. [4]
- (b) (i) Explain what is meant by an externality. [2]
- (ii) Identify **one** possible example of a positive externality arising from education. Explain why this is a positive externality. [3]
- (iii) Define the term 'market failure'. [2]
- (iv) Using a diagram, explain how the existence of positive externalities can lead to market failure. [10]
- (c) The article looks at the role played by the Office of Fair Trading (OFT) in regulating competition policy in the UK.
- (i) Explain why market dominance can lead to economic inefficiency. [3]
- (ii) Explain how competition policy can be used to stop firms abusing their market dominance. [3]
- (iii) With reference to the article, comment upon the effectiveness of competition policy in this case. [4]
- \* (d)** The information provided states that the government may subsidise the supply of products which generate positive externalities.

Discuss the effectiveness of subsidies as a solution to market failure arising from positive externalities. [12]

[Total: 45 marks]

---

*Copyright Acknowledgements:*

Text: Adapted from John Clare, *50 public schools fined for fixing their fees*; John Clare, *Why did OFT take a pile-driver to crack a nut?*, The Daily Telegraph, 25 February, 2006.

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (OCR) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

OCR is part of the Cambridge Assessment Group. Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.