

Tom Furber - Economics Practice Papers

Practice Paper 1K Microeconomics

In the style of Paper 1 Edexcel A Economics: Markets and Market Failure

Time allowed: 2 hours

For Section A and Section B, answer all questions.
For Section C, answer one question only.

Section A has 25 marks available
Section B has 50 marks available.
Section C has 25 marks available

Total marks available: 100.

This paper was written by Tom Furber.

You can find more economics resources on my website tfurber.com.

SECTION A

Answer ALL questions

1. Graduate schemes offer extra training while on the job for students who have recently graduated from university. Examples of graduate schemes include the Civil Service Fast Stream, the Deloitte Graduate Programme and the Aldi Graduate Area Manager Programme. As firms pay for extra training for these workers and often offer quicker advancement through the ranks, the application process for these schemes can be very competitive. If a worker leaves after or during their graduate training, other firms may benefit.

(a) Explain how there may be market failure in the form of an externality in the market for graduate job training. Refer to the information provided in your answer.

(4)

(b) Which **one** of the following is **not** a positive private benefit to the worker from being part of a graduate scheme?

(1)

A Possibility of quicker promotion when being part of the graduate scheme.

B Training costs the firm money.

C Greater non monetary benefits when part of the scheme.

D Higher pay when part of the graduate scheme.

(Total for Question 1 = 5 marks)

2. Consider a market for restaurants that has many firms selling similar but differentiated products.

(a) Draw a revenue-cost diagram for a typical firm in this market.

(4)

(b) Which property is this restaurant market most likely to have?

(1)

A Firms are price takers.

B There are low barriers to entry.

C The firm's average revenue does not vary with the firm's level of output.

D There can be supernormal profits in the long run.

(Total for Question 2 = 5 marks)

3. In July 2022, GSK plc separated its consumer healthcare business from the GSK Group. GSK Group planned to focus on biopharmaceuticals including vaccines, while the consumer healthcare business, named Haleon, covers brands for consumer healthcare products including toothpastes, supplements and pain relief.

(a) Referring to the information provided, explain **one** possible reason for the demerger.

(4)

(b) Which **one** of the following is **not** a constraint on business growth?

(1)

A Difficulty accessing loans from banks.

B Regulations.

C Small market size.

D Capital and labour are substitutes in production for the business.

(Total for Question 3 = 5 marks)

4. Consider a small town where a coal mining firm is the dominant employer of workers. The coal mining firm originally pays £15 an hour. The trade union of coal workers demands a wage of £20 per hour for their workers, citing that the wage in more competitive coal labour markets is £20 per hour.

(a) Referring to the information provided, explain **one** reason why an increase in wage could lead to higher employment.

(4)

(b) Which **one** of the following is **not** a market failure in the labour market?

(1)

A House price differentials between regions make it more difficult for workers to move to a new job.

B A lack of transferable skills makes it difficult for some workers to move from an industry in structural decline into a new line of work.

C Unemployment caused by a high minimum wage.

D Unemployment as workers quit low paying jobs to find higher paying jobs.

(Total for Question 4 = 5 marks)

5. Consider the following data on vehicle prices and quantities in a particular country:

Year	Average price of electric vehicle	Quantity of petrol vehicles bought	Quantity of electric vehicles bought
2019	£50,000	106,000	10,000
2020	£45,000	103,000	12,000

(a) Calculate the cross elasticity of demand for petrol vehicles with respect to electric vehicle prices.

(2)

The government is considering cutting back the subsidy on electric vehicles. This decision may influence the market for petrol vehicles.

(b) Explain how the effect of the cut in subsidy depends on the cross price elasticity of demand calculated in part (a).

(2)

(c) **One** assumption behind estimating the cross elasticity of demand in part (a) is

(1)

A *Ceteris paribus*.

B Petrol and electric vehicles are complements.

C The government has not used subsidies to reduce the price of electric vehicles.

D Firms maximise profits.

(Total for Question 5 = 5 marks)

TOTAL FOR SECTION A = 25 MARKS

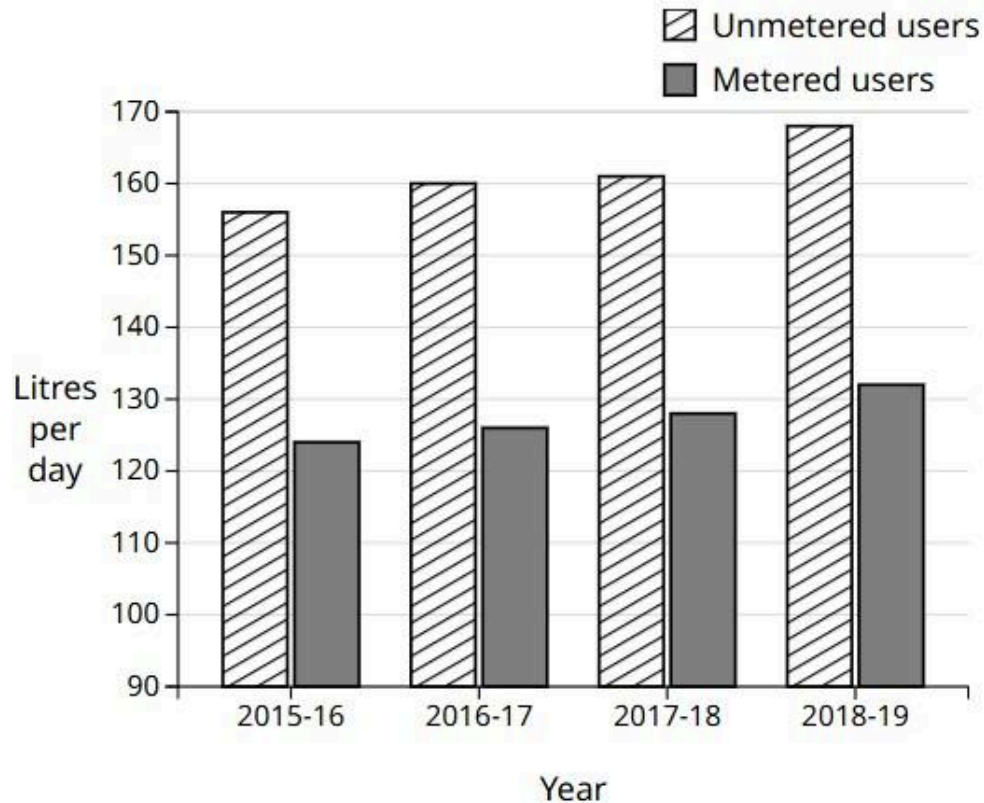
SECTION B

Question 6

The water industry

Figure 1: Average daily water consumption per person.

Divided into unmetered and metered users.



(Sources: Figure 1 from Statista, Figure 2 from Ofwat)

Extract A: Background to the water industry and current issues

Water is a privatised industry in the UK having been privatised in 1989. In England there are about 100,000 kilometres of combined sewers. There are also large networks of pipes bringing water to and out of homes and businesses. As a result, most water and sewage companies are regional monopolies, so consumers cannot switch to another provider.

In the summer of 2022, parts of the UK suffered from drought. Drought can cause consequences in terms of the extinction of species, challenges for crop production, water supplies for businesses and households. Indeed the drought led to a hosepipe ban in some areas of the UK. Droughts could reflect a failure to invest in new water reservoirs, the impact of climate change and water prices not taking into account the consequences of consuming too much water.

There have been reports of increased leakage of untreated sewage into rivers and other water bodies. This can make surfers or swimmers using rivers sick and cause other health risks. Spillages of sewage can also damage the environment and wildlife.

These problems have led to water companies facing accusations of poor management all while reportedly receiving high salaries. Water companies in the UK made £2.8 billion in profits in 2021, with bosses at water and sewage companies seeing a salary rise of 27% compared to 2020. Some of the companies implicated have justified pay rises because CEOs are judged on their performance using several metrics, including customer service and environmental progress.

Extract B: Intervention in water and sewage

Should the UK Government intervene further in the water market? One option is to nationalise the water industry. There is debate as to whether privatisation has worked. Private firms may face greater competition which may drive efficiency gains however private firms may be less likely to consider external effects on third parties. A nationalised water industry may set a different objective than profit maximisation, instead taking into account the effects of its actions both on third parties and on long term water security.

Between 1991 and 2019, dividends paid to shareholders totalled £57 billion. This was almost half the amount spent on investment in water pipes and treatment over the same time frame. However yearly investment in water and wastewater sectors has nearly doubled following water privatisation in 1989.

There are other less drastic options for intervention. There could be stricter regulation of water companies. For example larger fines for water companies who pollute, based on the 'polluter pays' principle. Currently fines can be imposed up to a maximum of 10% of a firm's turnover. Penalties need to be sufficient to make sure that firms comply. Others,

such as the Institute of Economic Affairs, suggest that over-regulation has contributed to higher water bills by discouraging firm entry.

In October 2022 eleven water companies received penalties for sewage flooding, missing pollution targets and supply interruptions. The penalties are that water companies must reduce future bills for consumers and apply to companies such as Thames Water, the largest water company in England. Companies that scored well on these measures are allowed to increase their future bills by more relative to their competitors.

Currently water and sewerage services face price controls that are set every five years by the regulator Ofwat. Such price controls must allow companies enough money to invest and make a "reasonable rate of return" for investors. Sewage faces regulation from the Environment Agency and Ofwat.

(Sources: UK Government, Lords Library Parliament, The Guardian, Financial Times, IEA. miscellaneous.)

6 (a) Explain **one** possible reason for the trend in average daily water consumption in Figure 1.

(5)

(b) With reference to Extract A, assess the market failures in the water and sewage industry.

(10)

(c) Examine the determinants of pay of the "bosses at water and sewage companies" (Extract A, paragraph 3).

(8)

(d) Referring to the information provided, assess the effect of nationalising water and sewage companies.

(12)

(e) Apart from nationalisation, evaluate other policy options to improve outcomes in the water and sewage industry. Refer to Extract B in your answer.

(15)

(Total for Question 6 = 50 marks)

TOTAL FOR SECTION B = 50 MARKS

SECTION C

Answer ONE question from this section.

EITHER

7. The five largest supermarkets in the UK have a five firm concentration ratio (combined market share) of 66%. However the industry has witnessed the growth of new entrants such as discount chains Aldi and Lidl. Some supermarkets were fined a sum of £50 million back in 2011 for fixing dairy prices. The CMA has been investigating loyalty schemes, such as Clubcard and Nectar.

Evaluate the microeconomic consequences of oligopolies.

(Total for Question 7 = 25 marks)

OR

8. Since leaving the European Union, the UK Government has replaced the EU Emissions Trading Scheme with the UK Emissions Trading Scheme (ETS). This covers power generation, industry and aviation, though some sectors do receive free permits. For the UK firms that participated in the EU ETS before the UK left the EU, pollution fell from 236 million tonnes per CO₂ equivalent to just under 130 million tonnes per CO₂ equivalent.

Evaluate the microeconomic consequences of tradable pollution permits.

(Total for Question 8 = 25 marks)

TOTAL FOR SECTION C = 25 MARKS

TOTAL FOR PAPER = 100 MARKS