



**ADVANCED SUBSIDIARY GCE**  
**ECONOMICS**  
Markets in Action

**F581**

Candidates answer on the question paper

**OCR Supplied Materials:**  
None

**Other Materials Required:**  
None

**Wednesday 3 June 2009**  
**Afternoon**

**Duration: 1 hour 30 minutes**



Candidate Forename		Candidate Surname	
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Centre Number						Candidate Number				
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**INSTRUCTIONS TO CANDIDATES**

- Write your name clearly in capital letters, your Centre Number and Candidate Number in the boxes above.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- Write your answer to each question in the space provided, however additional paper may be used if necessary.

**INFORMATION FOR CANDIDATES**

- The number of marks is given in brackets [ ] at the end of each question or part question.
- The total number of marks for this paper is **60**.
- This document consists of **12** pages. Any blank pages are indicated.

## Should we really be flying?

To fly or not to fly? This is a question that should be increasingly asked by the ever-growing numbers of air passengers, particularly leisure travellers and 'binge flyers', the term used to describe those who frequently book ridiculously cheap fares with the growing numbers of low cost airlines in Europe. Flying creates negative externalities. These include substantial CO<sub>2</sub> emissions, excessive noise disturbance for people unfortunate enough to live on a flight path and congestion around major airports. One economic solution to these examples of market failure is to introduce an additional 'green tax'.

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Air Passenger Duty (APD) is a flat rate tax on passengers who fly from UK airports. It is collected by the airlines who add the tax onto ticket prices. In February 2007 the tax rates for economy and higher classes of passenger doubled. This is shown in Fig. 1.

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**Fig. 1. Rates of APD per passenger flying from UK airports, February 2007**

	<b>Economy Class</b>	<b>Business and First Classes</b>
Inside European Union tax rate per passenger	£10 (was £5)	£20 (was £10)
Outside European Union tax rate per passenger	£40 (was £20)	£80 (was £40)

Most passengers travelling for leisure reasons use economy class. A recent study by the Civil Aviation Authority has shown that any increase in APD, in its current form, is likely to reduce the numbers of leisure passengers travelling ... but only if the rate is increased to a much higher level. The study also showed that business travellers would be largely unaffected by any increases in ticket prices. Fig. 2 below summarises the likely effects of increases in APD on a £73 fare that includes £5 APD.

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**Fig. 2. The likely effects of an increase in APD on leisure travel**

Inside European Union tax rate per passenger (economy class)	£10	£15	£25	£35
% change in ticket prices	7%	14%	28%	42%
% change in quantity demanded	-5%	-15%	-40%	-66%

In October 2007 it was announced that from November 2009 APD would be replaced by a tax on each flight irrespective of the number of passengers carried. This new tax will be based on the estimated emissions for each flight made. Older aircraft that generate higher emissions will be expected to pay more than newer aircraft that tend to be more environmentally efficient. There was, however, no commitment to use revenue from this new tax to fund environmental improvements for those who are affected by the negative externalities arising from the increased use of air transport.

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Answer **all** questions.

1 Using an example in each case, state **two** factors of production which are required to provide air transport services.

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2 (a) State and explain **two** determinants of demand for air travel for leisure purposes.

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**(b)** Using a demand and supply diagram, explain how the growing number of low cost flights has affected the market for air travel in Europe.

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3 (a) Define the term 'consumer surplus.'

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(b) Using a diagram, comment on how the increase in ticket prices in February 2007 might have affected the consumer surplus of EU air passengers.

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4 (a) Fig. 2 shows that a 28% increase in ticket prices leads to a 40% decrease in the quantity demanded. Calculate the price elasticity of demand.

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(b) Explain the meaning of the price elasticity of demand figure you have calculated.

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(c) Suppose the government aims to reduce demand from 'binge flyers'. Comment on how it might use the information in Fig. 2 to achieve this objective.

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5 (a) Define the term 'negative externalities'.

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(b) Explain why negative externalities arising from an increase in air transport are an example of market failure.

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6 Discuss whether taxation is the most effective solution to the market failures arising from negative externalities.

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