

ECONOMICS

45 minutes



INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
 - You are not permitted access to any calculator for this paper.
 - Answer *the one* question.
 - Use fully labeled diagrams and real-world examples where appropriate.
 - The maximum mark for this examination paper is *[25 marks]*.
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a. Diagram and explain the difference between positive and negative externalities of consumption.

[10 marks]

b. Evaluate which government policy is most effective in increasing consumption of preventative healthcare (direct provision, advertising or subsidizing). [15 marks]

Assessment Criteria

Part (a) 10 marks		Marks
Level 0	Completely inappropriate answer.	0
1	Little understanding of the specific demands of the question. Very little recognition of relevant economic theory. Relevant terms not defined. Significant errors.	1–3
2	Some understanding of the specific demands of the question. Some recognition of relevant economic theory. Some relevant terms defined. Some errors.	4–6
3	Understanding of the specific demands of the question. Relevant economic theory explained and developed. Relevant economic terms defined. Few errors. Where appropriate, diagrams included.	7–8
4	Clear understanding of the specific demands of the question. Relevant economic theory clearly explained and developed. Relevant economic terms clearly defined. No major errors. Where appropriate, diagrams included and explained. Where appropriate, examples used.	9–10

Part (b) 15 marks

Level		Marks
0	Completely inappropriate answer.	0
1	Little understanding of the specific demands of the question. Very little recognition of relevant economic theory. Relevant terms not defined. Significant errors.	1–5
2	Some understanding of the specific demands of the question. Some recognition of relevant economic theory. Some relevant terms defined. Some errors.	6–9
3	Understanding of the specific demands of the question. Relevant economic theory explained and developed. Relevant economic terms defined. Few errors. Where appropriate, diagrams included. An attempt at evaluation.	10–12
4	Clear understanding of the specific demands of the question. Relevant economic theory clearly explained and developed. Relevant economic terms clearly defined. No major errors. Where appropriate, diagrams included and explained. Where appropriate, examples used. Evidence of appropriate evaluation.	13–15

Component grade boundaries

Grade:	1	2	3	4	5	6	7
Mark range:	0 - 3	4 – 6	7 - 9	10 - 12	13 - 15	16 -18	19 - 25

Key

a. Diagram and explain the difference between positive and negative externalities of consumption.

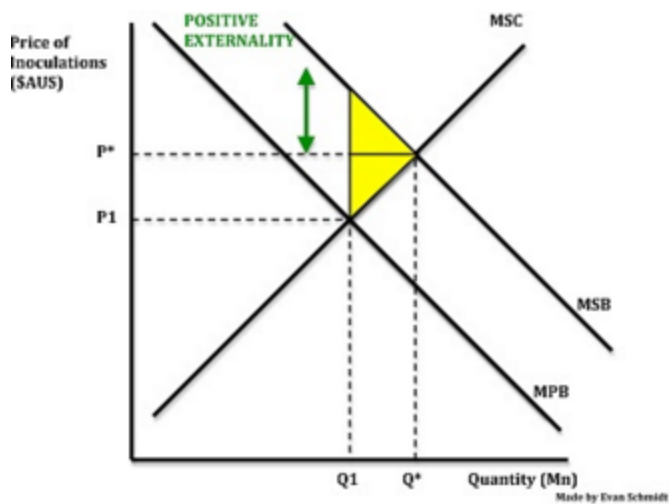
The difference between and positive and negative externality of consumption is that the consumption of a good or service that creates a positive externality should be consumed MORE because it benefits 3rd party members of society. On the other hand, the consumption of a product that creates a NEGATIVE externality of consumption should be consumed LEDD because it HURTS 3rd party members of society that don't produce or consume it. An example of a service that creates positive externality of consumption is education and an example of a good that creates a negative externality of consumption is cigarettes.

"Externalities," in economic terms, are costs or benefits imposed on third parties during the normal course of economic activity.

Externalities of consumption occur when the consumption of a good or service by an individual, adds additional benefits to or damages society as a whole.

A Positive Externality of Consumption is when the consumption of a good or service by an individual creates benefits for third parties. An example of this is education .

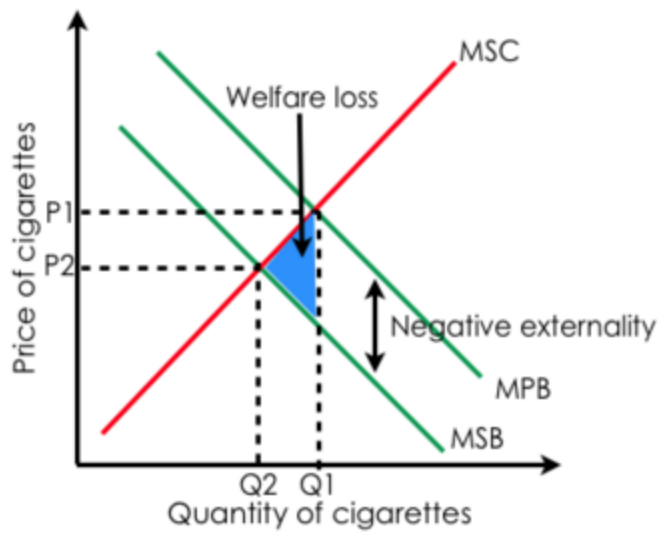
"With more education, an individual person is more likely to be a skilled and productive member of the workforce, Their income will provide tax revenue, and they are relatively less likely to engage in criminal activity. Since these are benefits potentially enjoyed by the whole of society, we can say that the social benefits of education exceed the private benefits. MSB will be greater than MPB "(Welker). See diagram below:



Triangle is potential welfare gain to society.

P^* and Q^* are the socially optimal price and quantity for the consumption of education.

A Negative externality of consumption is when a person's use of a product affects others (3rd parties) adversely. One example of this is the smoking of cigarettes. The Marginal Social Benefits of a person's Consumption of a cigarette is lower than that person's individual Marginal Private Benefit. "In other words, the benefit of a cigarette that is enjoyed by the smoker is greater than society's benefit. This is because the smoker is a part of society, so their enjoyment is part of the total. But, others will eventually pay some of the costs of this smoking (in higher insurance premiums or taxes for government health programs. This cost to others actually reduces the overall benefit to society" (Welker).



Part (a) 10 marks

Level	Marks
0 The work does not reach a standard described by the descriptors below.	0
1 There is little understanding of the specific demands of the question. Relevant economic terms are not defined. There is very little knowledge of relevant economic theory. There are significant errors.	1–3
2 There is some understanding of the specific demands of the question. Some relevant economic terms are defined. There is some knowledge of relevant economic theory. There are some errors.	4–6
3 There is understanding of the specific demands of the question. Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There are few errors.	7–8
4 There is clear understanding of the specific demands of the question. Relevant economic terms are clearly defined. Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively. Where appropriate, examples are used effectively. There are no significant errors.	9–10

b. Evaluate which government policy is most effective in increasing consumption of preventative healthcare (direct provision, advertising or subsidizing)

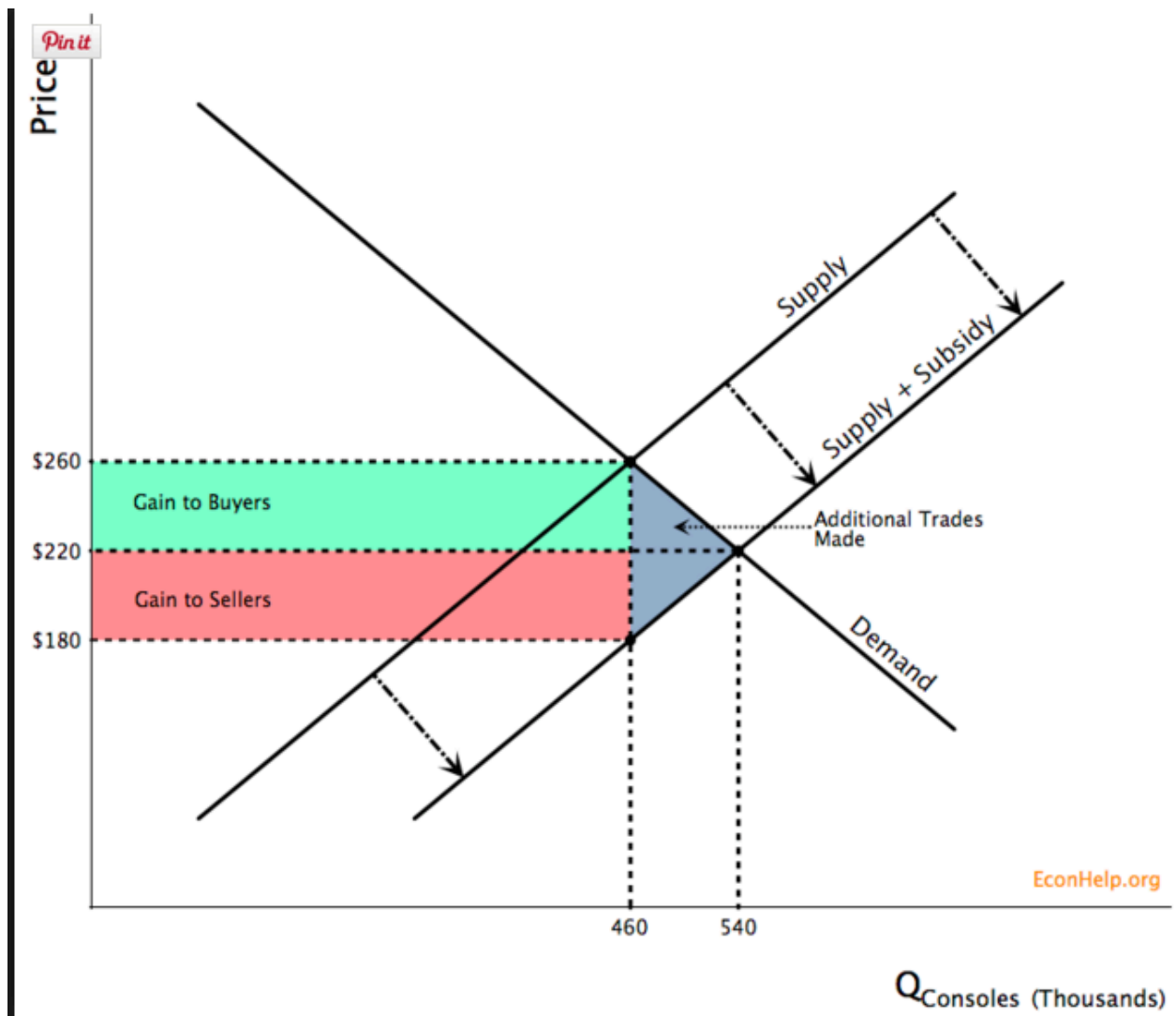
[15

marks]

The consumption of preventative healthcare by individuals creates a positive externality or benefit to society as a whole because it makes each person who consumes it, less likely to get sick or have to be in the hospital later in life which adds an additional cost to society as a whole. Taxes and insurance premiums for all will go up to cover the additional treatment costs for sick people. Getting preventative care, can prevent them from having to seek more expensive treatment in the future which benefits all of society.

Subsidies: When the government gives producers or consumers money or tax breaks for providing or consuming a good or service. This is usually per unit. The government

can give healthcare providers money to make their services more affordable which would increase the level of consumption to be closer to the socially optimal level. They could also give consumers tax breaks or money for going to the doctor or getting inoculations (examples of preventative healthcare). This would lower the cost of the consumption of preventative healthcare, this increasing QD of healthcare. See graph below:

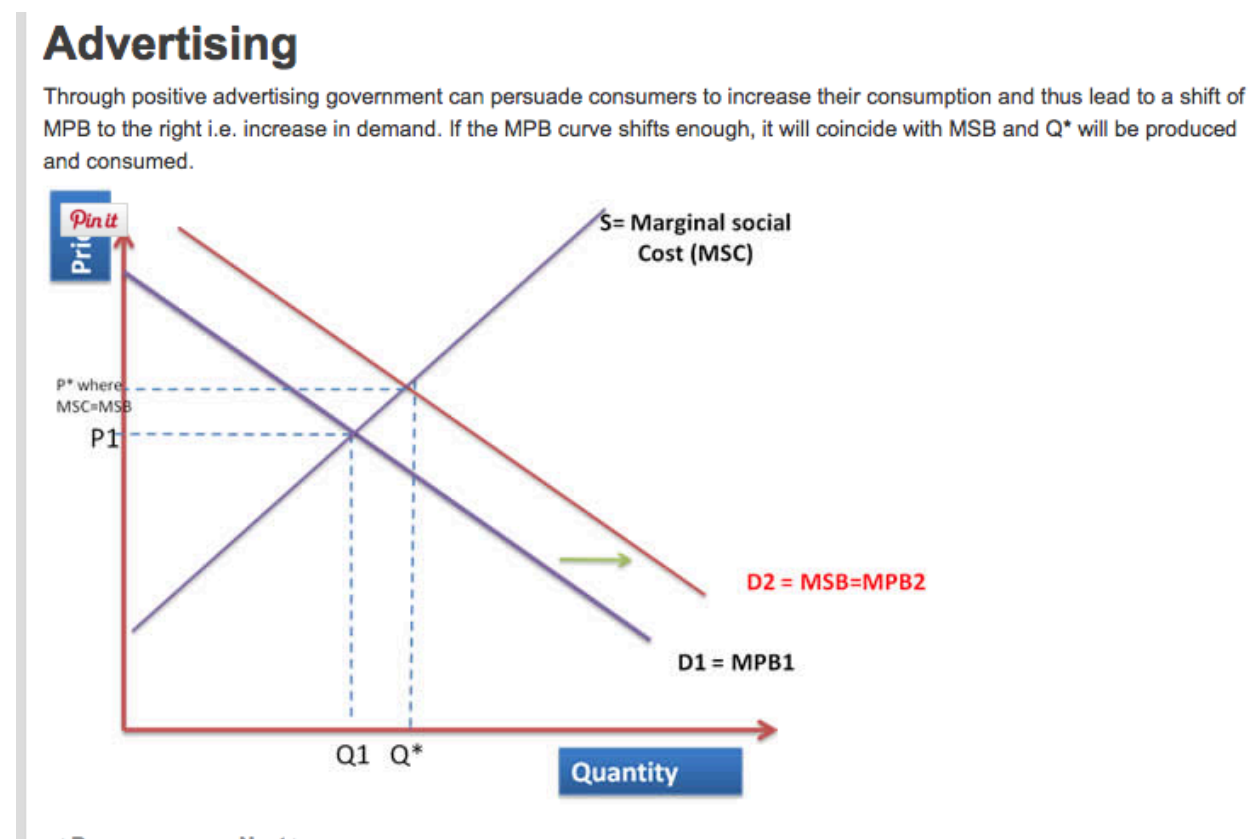


Advertising: To encourage consumption, governments can advertise the benefits of positive consumption externality goods. Governments can attempt to persuade the public to use condoms or get vaccines through advertising and public campaigns. The effect would be to change consumer tastes, shifting MPB to the right, with the goal of pushing it nearer to the socially efficient quantity. With private demand increasing,

society reduces the size of the externality in effect absorbing or enjoying at least part of the potential welfare gain.

For instance, the consumption of most healthcare goods tends to benefit the rest of society. This is most acutely true in the area of communicable disease and illness, but society also benefits from increased overall general health levels by raising productivity. More specifically, vaccinations against diseases such as polio offer dramatic benefits to third parties by reducing the spread of disease even to those who are not vaccinated.

The effects of such advertising vary considerably depending on the type of good being advocated and the strength of cultural attitudes. ie: vaccinations cause autism?



Direct Provision:

The government could also pay the full cost of healthcare to its people.

In the case of vaccinations, they could give them away for free at schools and work places, and hospitals to ensure that the most people are able to receive vaccinations. They just have to get to where the vaccinations are given away. The opportunity cost would be that the money to pay for such vaccinations would have to come from tax dollars and that means that they money could not be used for other purposes. Also, that money would come from the pockets of the people paying the tax which could have been used for other important things like education.

I would say that despite the opportunity costs, the best way to ensure that people get vaccines is to make it mandatory for school children to get them AND to provide them to the schools themselves. When I was in elementary school, I remember that there was a station set up at registration where nurses gave vaccines for free as a requirement for enrolling in public school. While this would only cover those kids that go to public school, this is still a majority of the population and it guarantees that they get vaccines if they want to go to school, which most people do. The government could also provide the same vaccines to health care providers for free to administer to those who don't go to public school. Even though this would be expensive and include an opportunity cost, it would overall save a great deal of healthcare costs in general in preventing the spread of dangerous diseases. There is less chance that people will opt out of getting the vaccine which could happen with both subsidies and advertising in the direct provision scenario. That is why direct provision at schools is the best option for providing preventative healthcare which has a huge positive externality.

(b) Evaluate the use of government policies to increase the consumption of health care.

[15 marks]

N.B. It should be noted that definitions, theory and examples that have already been given in part (a), and then referred to in part (b), should be rewarded.

Answers **may** include:

- explanation of health care as a merit good/service which is likely to be underprovided by the free market (market failure)
- diagrams to show under-provision of merit goods through the price mechanism
- identification and explanation of different government responses, *eg* direct provision, subsidies, legislation and advertising to influence consumer behaviour
- diagrams to show the use of subsidies and advertising
- synthesis or evaluation.

Evaluation **may** include: an assessment of the effectiveness of each of the relevant policies.

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and supported by appropriate examples.

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3	There is understanding of the specific demands of the question. Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There is an attempt at synthesis or evaluation. There are few errors.	10–12
4	There is clear understanding of the specific demands of the question. Relevant economic terms are clearly defined. Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively. Where appropriate, examples are used effectively. There is evidence of appropriate synthesis or evaluation. There are no significant errors.	13–15

Marks/grade breakdown:

0-3: 1 = 35-49

4-6: 2 = 50-59

7-9: 3 = 60-66

10-12: 4 = 67-72

13-15: 5 = 73-82

16-18: 6 = 83-89

19-25: 7 = 90-100