1.3 Price determination in a competitive market: Test Pack

Total Marks

AQA 7136 · Calculator allowed · about 30 minutes

Name: _____ Date: ____ / ____ / _____

Answer ALL questions. Show all your working.

1 Movements along, and shifts of, the demand curve.

(a) State what is meant by the term 'ceteris paribus' in economic analysis. **(1)**

(b) Distinguish between a movement along the demand curve and a shift of the demand curve, giving one cause of each. **(4)**

(Total for Question 1 is 5 marks)

2 Consumer and producer surplus.

(a) Define consumer surplus. **(2)**

(b) Define producer surplus. **(2)**

(c) Explain what happens to total consumer surplus following an increase in supply (a rightward shift of the supply curve), other things remaining constant. **(2)**

(Total for Question 2 is 6 marks)

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3 A government imposes a specific (per-unit) tax of £2 on a good. Before the tax, the equilibrium price was £10 and quantity was 500 units. After the tax, the price paid by consumers rises to £11.50 and the quantity falls to 420 units.

(a) Calculate the amount of the £2 tax paid by consumers per unit, and the amount paid by producers per unit. **(3)**

(b) Calculate the government's total tax revenue from this tax. **(2)**

(c) Explain why consumers bear a larger share of the tax burden than producers in this case. **(3)**

(Total for Question 3 is 8 marks)

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Mark scheme · 1.3 Price determination in a competitive market: Test Pack

Question 1

(a) holding all other (relevant) factors/variables constant, so the effect of changing only one factor at a time can be isolated oe **B1**

(a) Answer: All other relevant factors are held constant.

(b) a movement along the demand curve is caused only by a change in the price of the good itself **B1**

(b) this causes an extension (more demanded) if price falls or a contraction (less demanded) if price rises **B1**

(b) a shift of the demand curve is caused by a change in a non-price determinant of demand (a factor other than the good's own price) **B1**

(b) example: a rise in consumer income increases demand at every price, shifting the curve to the right (allow any other valid determinant: tastes, price of a substitute/complement, population, advertising, expectations) **B1**

(b) Answer: Movement = change in the good's own price (extension/contraction along D); shift = change in a non-price determinant (e.g. income), moving the whole curve.

Question 2

(a) the difference between the maximum price a consumer is willing and able to pay for a good and the price they actually pay **B1**

(a) shown on a diagram as the area below the demand curve and above the market price **B1**

(a) Answer: The gap between what consumers are willing to pay and what they actually pay.

(b) the difference between the price a producer receives for a good and the minimum price they would have been willing to accept (their cost) **B1**

(b) shown on a diagram as the area above the supply curve and below the market price **B1**

(b) Answer: The gap between the price producers receive and the minimum price they would accept.

(c) consumer surplus increases **B1**

(c) because the equilibrium price falls and the equilibrium quantity rises, so consumers pay less for a good they were willing to pay more for, and more consumers now buy the good **B1**

(c) Answer: Consumer surplus rises, since price falls and quantity rises.

Question 3

(a) consumer share of tax = new price paid by consumers - original price = 11.50 - 10.00 = £1.50 **M1**

(a) producer share = total tax - consumer share = 2.00 - 1.50 = £0.50 **A1**

(a) consumers pay £1.50 per unit and producers bear the remaining £0.50 per unit **B1**

(a) Answer: Consumers pay £1.50 per unit; producers pay £0.50 per unit.

(b) tax revenue = tax per unit x new equilibrium quantity = 2 x 420 **M1**

(b) = £840 **A1**

(b) Answer: £840.

(c) the incidence (burden) of a tax falls more heavily on the side of the market that is relatively less elastic (less price responsive) **M1**

(c) since consumers bear £1.50 of the £2.00 tax (75%) compared with producers' £0.50 (25%), demand must be relatively more inelastic than supply for this good **M1**

(c) inelastic demand means consumers cannot easily reduce the quantity they buy or switch to a substitute in response to the higher price, so firms can pass most of the tax on to them without losing many sales **A1**

(c) Answer: Demand is relatively more inelastic than supply, so firms can pass most of the tax on to consumers.

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