AQA

AS
ECONOMICS

Paper 1 The operation of markets and market failure

Monday 16 May 2016   Morning   Time allowed: 1 hour 30 minutes

Materials
For this paper you must have:
* the source booklet
* a calculator.

Instructions
* Use black ink or black ball-point pen. Pencil should only be used for drawing.
* Fill in the boxes at the top of this page.
* Answer **all** questions in **Section A**.
* Answer **either** Context 1 **or** Context 2 in **Section B**.
* You will need to refer to the source booklet provided to answer **Section B**.
* You must answer the questions in the spaces provided. Do not write outside the box around each page or on blank pages.
* Do all rough work in this book. Cross through any work you do not want to be marked.

Information
* There are 70 marks available on this paper.
* The marks for questions are shown in brackets.
* No deductions will be made for wrong answers.

Section A

Answer **all** questions in this section.

Only **one** answer per question is allowed.

For each answer completely fill in the circle alongside the appropriate answer.

CORRECT METHOD ● WRONG METHODS ⊗ ⊙ ▭ ⊘

If you want to change your answer you must cross out your original answer as shown. ⊠

If you wish to return to an answer previously crossed out, ring the answer you now wish to select as shown. ⊗

| 0 | 1 |

In a free market economy, the economic problem of what goods should be produced is usually solved by

A consumers expressing their tastes and preferences in their pattern of spending. ⬭

B households completing business surveys to reveal their preferred products. ⬭

C firms planning their activities to meet production targets set by government. ⬭

D entrepreneurs producing their own goods to satisfy their own needs and wants. ⬭

[1 mark]

0 2 The diagram below shows a production possibility boundary for an economy that produces goods and services.
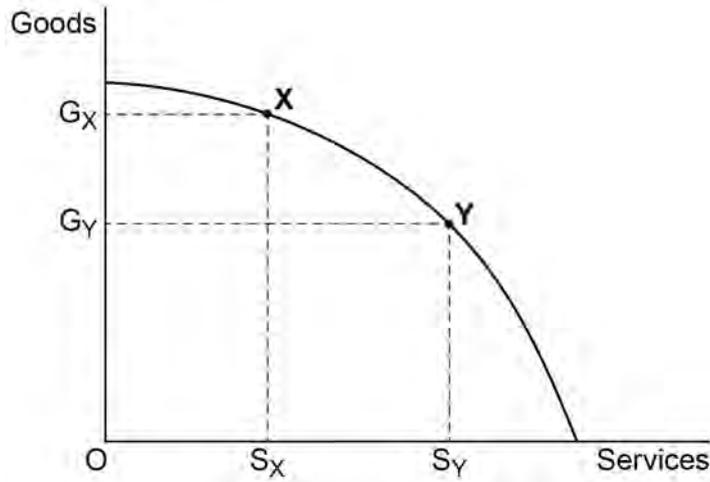
From the diagram it can be concluded that

A point X is productively efficient and point Y is allocatively efficient.

B point Y is productively efficient and point X is allocatively efficient.

C points X and Y are allocatively efficient.

D points X and Y are productively efficient.

[1 mark]

0 3 A demand curve is drawn on the assumption that

A quantity demanded always increases as price falls.

B changes in price do not influence supply.

C price elasticity of demand does not vary along the demand curve.

D factors affecting demand, other than price, remain constant.

[1 mark]

Turn over ▶

0 4 Monopoly can provide an example of market failure because firms with monopoly power

A may produce a larger output than would be supplied in a competitive market so that they achieve economies of scale. ◯

B may produce a lower output, less efficiently, than would be supplied by a competitive market. ◯

C always charge high prices and earn high profits. ◯

D have no incentive to meet consumer demands. ◯

[1 mark]

0 5 The cross elasticity of demand between goods X and Y is positive. This implies that they are

A normal goods. ◯

B substitute goods. ◯

C goods in composite demand. ◯

D complementary goods. ◯

[1 mark]

0 6 Many agricultural products are subject to large fluctuations in price. One reason why these large fluctuations occur is because the

A demand for agricultural products is income inelastic in the long run. ◯

B supply of agricultural products is price elastic in the long run. ◯

C supply of agricultural products is price inelastic in the short run. ◯

D demand for agricultural products is price elastic in the short run. ◯

[1 mark]

0 7 A good has a price elasticity of supply of +0.8. At present, the quantity supplied of the good is 200 units per week at a market price of £800 per unit. If the price rises to £1000 per unit then the quantity supplied per week would

A increase to 250 units. ○

B increase to 240 units. ○

C increase to 360 units. ○

D decrease to 160 units. ○

[1 mark]

0 8 A reduction in the market price of a firm's product will always result in an increase in its profits or a reduction in its losses if it

A increases its share of the market. ○

B increases its total revenue by more than its total costs. ○

C enables it to reduce its average costs. ○

D leads to a reduction in the price of its inputs. ○

[1 mark]

0 9 The diagram below shows a firm's average total cost curve (ATC), with the firm producing an output of OX.
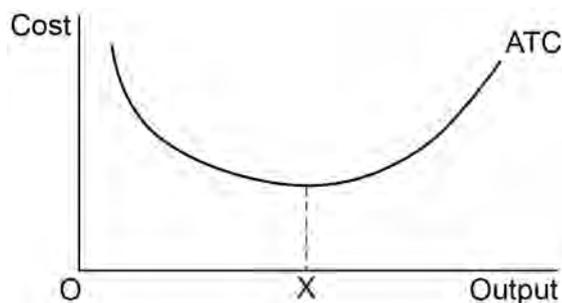
The firm's productive efficiency will improve if the

A ATC curve shifts upwards for any given level of output. ○

B ATC curve shifts downwards for any given level of output. ○

C firm increases its level of output. ○

D firm reduces its level of output. ○

[1 mark]

1 0 All other things being equal, which one of the following situations always results in a rise in labour productivity?

A Output falls at a slower rate than the fall in the number of workers employed ⬭

B Output falls at a faster rate than the fall in the number of workers employed ⬭

C Output rises at a slower rate than the rise in the number of workers employed ⬭

D Output always rises as the number of workers employed increases ⬭

[1 mark]

1 1 Which one of the following is the best indicator of the degree of competition in an industry?

A The industry's concentration ratio ⬭

B The elasticity of supply of the industry's output ⬭

C The number of workers employed in the industry ⬭

D The total value of the industry's sales ⬭

[1 mark]

1 2 The table below shows the characteristics of four private sector firms. Which one of the firms, **A, B, C or D**, is most likely to be in a competitive market?

	Firm	Profit	Barriers to entry	
A	**A**	Low	High	⬭
B	**B**	Low	Low	⬭
C	**C**	High	High	⬭
D	**D**	High	Low	⬭

[1 mark]

| 1 | 3 |

The diagrams below show four possible long run average cost curves (LRAC) for a firm operating in a market where the annual sales are 400 000 units per year.

All other things being equal, which one of the cost curves, **A, B, C or D**, is most likely to enable the firm to achieve monopoly power in the market for its product?

A
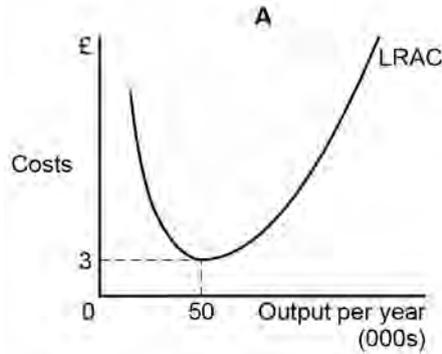
B
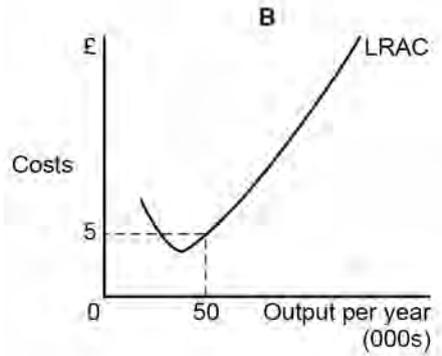
C
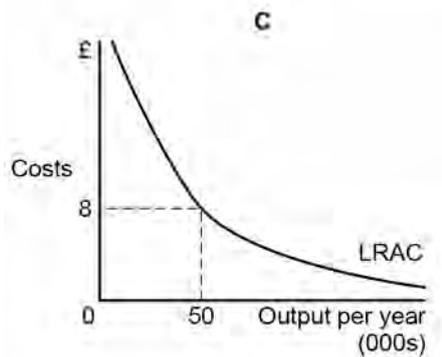
D
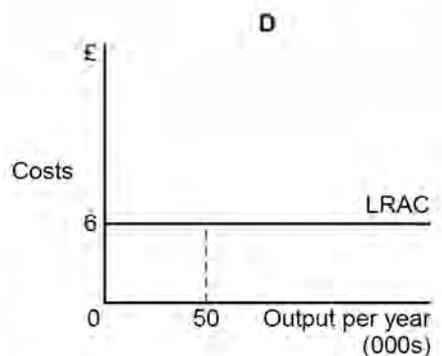
[1 mark]

1 4 An essential characteristic of a public good is that it is non-excludable. This means that

A public goods are of equal benefit to all consumers. ⬭

B there is no opportunity cost in the provision of public goods. ⬭

C people could consume the good without paying for it. ⬭

D the government should not levy a tax for providing public goods. ⬭

[1 mark]

1 5 The elasticity of supply of a particular good is more likely to be low

A the shorter the time period under consideration. ⬭

B if the good in question has many close substitutes. ⬭

C if the good in question is a necessity. ⬭

D if complementary goods are required for its consumption. ⬭

[1 mark]

1 6 The diagram below illustrates a market in which a monopolist takes control and sets a price above the competitive level.
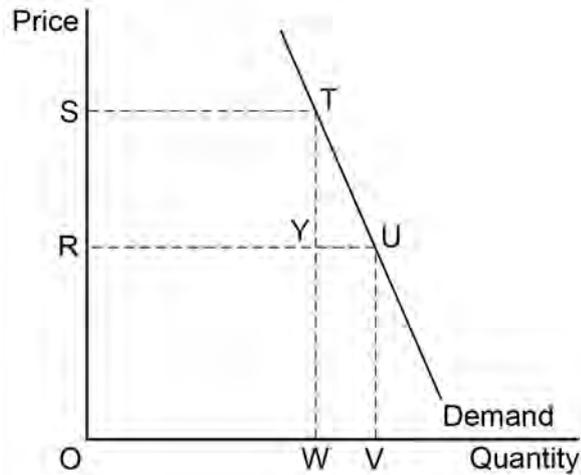
The price charged by the monopolist is OS. If the market had been competitive, the price would have been OR. Under monopoly, the amount buyers spend on the product has increased by

A RSTY. ○

B OS multiplied by OW. ○

C RSTU. ○

D RSTY minus WYUV. ○

[1 mark]

1 7 An increase in the world market price of wheat, following a series of poor harvests, leading to falling sales is an example of

A market failure due to an externality in production. ○

B government failure to support agricultural markets. ○

C scarcity caused by high prices. ○

D the rationing function of price. ○

[1 mark]

Turn over ▶

1 8   The diagram below shows the market demand curve (D) and two market supply (S_1 and S_2) curves for a good. The initial equilibrium point is at E_1. The introduction by the government of an indirect tax per unit of the good results in a new equilibrium at E_2.
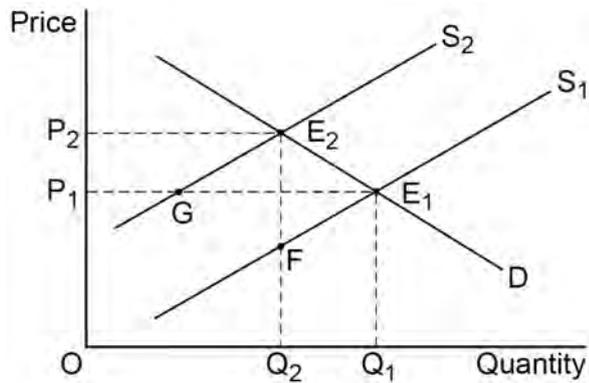
The amount of the indirect tax per unit is measured by the

**A**   vertical distance FE_2.

B   increase in price P_1P_2.

C   the diagonal distance E_1E_2.

D   the horizontal distance GE_1.

[1 mark]

1 9 The diagram below shows the demand and supply curves for a good provided solely by a free market.
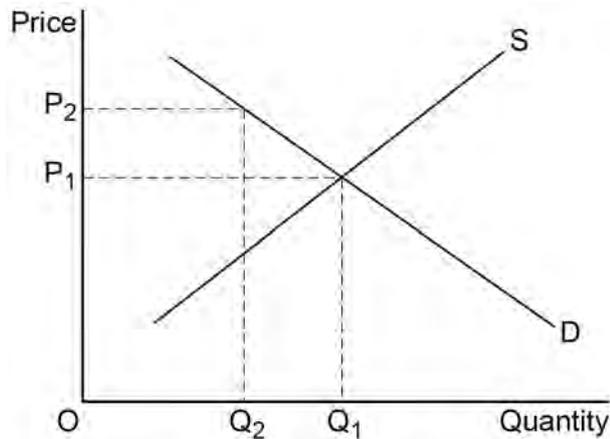
Currently, output is at OQ_1. However, there is a misallocation of resources resulting in market failure. The socially optimal level of production is OQ_2. Which one of the following statements is correct? The diagram shows the market for

A a merit good.

B a public good.

C a good with negative externalities in production.

D a good with positive externalities in production.

[1 mark]

2 0 Which one of the following statements about the distribution of income must be correct?

A The distribution of income is equitable when everyone has the same income

B 'The distribution of income is equitable' is a positive statement

C An unequal distribution of income is, by definition, inequitable

D Whether the distribution of income is equitable depends on a value judgement

[1 mark]

QUESTION 20 IS THE LAST
QUESTION IN SECTION A

Section B

Look at the source booklet and choose to answer **EITHER** Context 1 **OR** Context 2.

Answer **EITHER** Questions 21 to 26 in the spaces below

OR

Questions 27 to 32 on pages 22 to 32 of this answer booklet.

There is a total of 50 marks for either context.

Shade the circle below to indicate which context you have answered.

Context **0** **1** ⬭   Context **0** **2** ⬭

WRONG METHODS ⊗ ⊙ ≋ ⬭   CORRECT METHOD ●

EITHER

Context 1   **Total for this Context: 50 marks**

THE UK HOUSING MARKET

Use the source booklet provided to study **questions 21** to **26** and **Extracts A, B** and **C**, and then answer the questions in the spaces which follow.

| **2** | **1** | Define the term 'government failure' **Extract C** (lines 20 and 21).

[3 marks]

Extra space

2 2 Use **Extract C** to calculate, to the nearest whole number, the estimated number of people sleeping on the streets in England on any one night in 2010.

[4 marks]

_____

_____

_____

_____

_____

_____

_____

_____

2 3 Use **Extract A** to identify **two** significant points of comparison between the number of new houses built per year in the UK and the changes in UK population over the period shown.

[4 marks]

Comparison 1 _____

_____

_____

_____

Extra space _____

Comparison 2 _____

_____

_____

_____

Extra space _____

_____

Turn over ▶

2 4   **Extract C** (lines 17 to 19) states 'Some economists have suggested the implementation of maximum price controls on rented accommodation that prevent landlords from charging the market rent.'

Draw a diagram to show the effects of implementing this suggestion on the market for rented accommodation.

[4 marks]

2 5   **Extract B** (lines 10 and 11) states 'However, the housing market is not a perfectly competitive market.'

Explain why the housing market is not a perfectly competitive market.

[10 marks]

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

Turn over ▶

Extra space

2 6 | **Extract C** (lines 20 and 21) states 'Some are mindful of government failure and advocate a lesser role for governments.'

Use the extracts and your knowledge of economics to assess the view that housing markets should be left to market forces with only the minimum of intervention from governments.

[25 marks]

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

Turn over ▶

Extra space

Do **not** answer Context 2 if you have answered Context 1.

OR

Context 2   **Total for this Context: 50 marks**

THE COSTS OF SMOKING

Use the source booklet provided to study **questions 27** to **32** and **Extracts D, E** and **F,** and then answer the questions in the spaces which follow.

2 7 Define the term 'demerit good' **Extract F** (line 1).

[3 marks]

_____

_____

_____

_____

_____

_____

Extra space _____

_____

_____

2 8 Use **Extract D** to calculate, to the nearest penny, the mean price of a pack of 20 cigarettes between 2007 and 2013.

[4 marks]

_____

_____

_____

_____

_____

_____

_____

_____

| 2 | 9 |

Use **Extract D** to identify **two** significant points of comparison between the price and the quantity of cigarettes consumed in the UK from 2007 to 2013.

[4 marks]

Comparison 1

_____

_____

_____

_____

_____

Extra space _____

_____

Comparison 2 _____

_____

_____

_____

_____

Extra space _____

_____

Turn over for the next question

Turn over ▶

3 0 **Extract E** (lines 10–11) states 'Researchers at the Universities of Glasgow and Stirling offered pregnant smokers up to £400 worth of shopping vouchers to give up smoking …'

Draw a diagram to show the effect on the market for cigarettes of giving shopping vouchers to pregnant women as an incentive to stop smoking.

[4 marks]

3 1 **Extract F** (line 10) states 'Taxation is one way governments attempt to control cigarette consumption.'

Explain the effect of indirect taxation on the consumption of cigarettes.

[10 marks]

Extra space

3 **2**   **Extract F** (line 12) states 'Regulation to reduce consumption of cigarettes is extensive in the UK.'

Use the extracts and your economic knowledge to assess the view that regulation is the best way of dealing with the market failure that results from the consumption of cigarettes.

[25 marks]

Extra space

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

_____

Turn over ▶

END OF QUESTIONS

AQA

AS
ECONOMICS
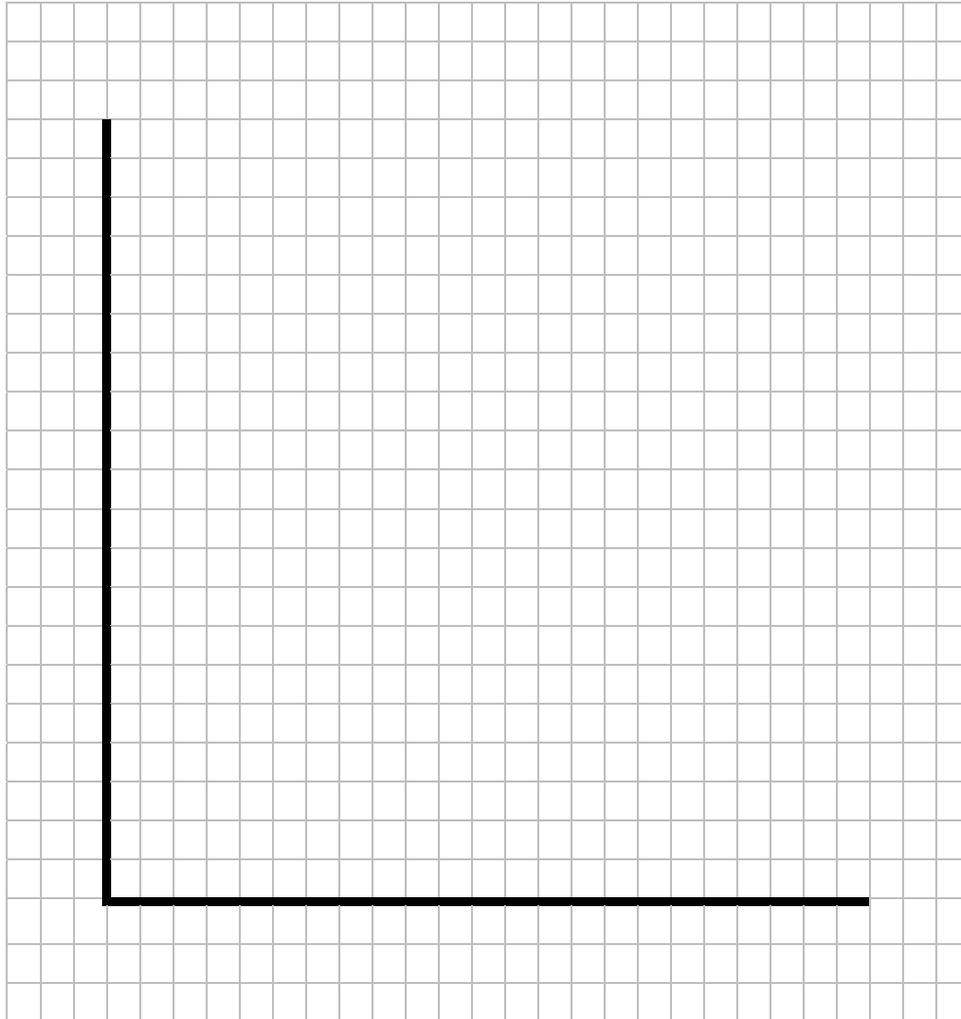
Paper 1 The operation of markets and market failure

Source booklet

DO NOT WRITE ANY ANSWERS IN THIS SOURCE BOOKLET. YOU MUST ANSWER THE QUESTIONS IN THE ANSWER BOOKLET PROVIDED.

CONTEXT 1: THE UK HOUSING MARKET

Questions 21 to 26

- **Extract A:**   **New houses built per year, UK, 1992 to 2013**
  Estimates of annual changes in the UK population, 1992 to 2013

- **Extract B:**   **A market working well?**

- **Extract C:**   **Or a market failing?**

CONTEXT 2: THE COSTS OF SMOKING

Questions 27 to 32

- **Extract D:**   **Price and quantity of cigarettes consumed in the UK, 2007 to 2013**

- **Extract E:**   **Smoking and pregnancy**

- **Extract F:**   **How should governments deal with smokers?**

7135/1

Context 1

Total for this Context: 50 marks

THE UK HOUSING MARKET

Extract A:

New houses built per year, UK, 1992 to 2013

Houses built
(thousands)
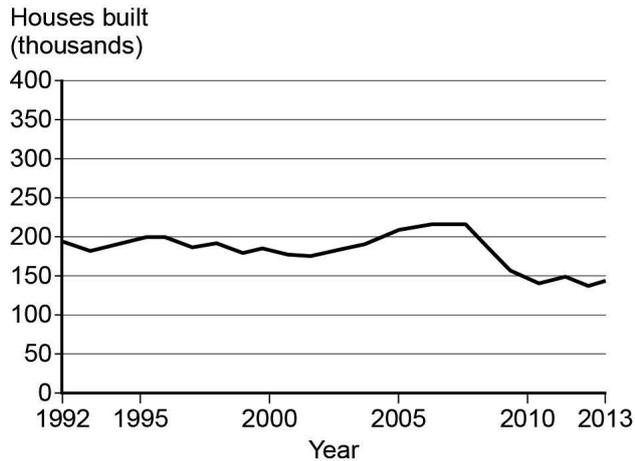
Source: ONS, DCLG Live table 209, September 2014

Estimates of annual changes in the UK population, 1992 to 2013

Annual population
change (thousands)
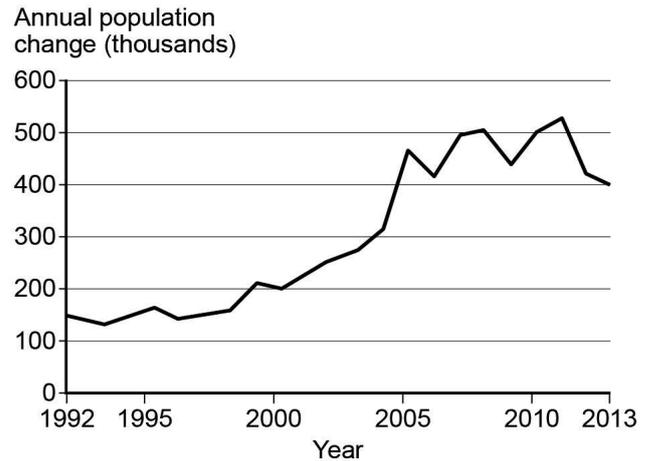
Source: ONS, NRS, NISRA, June 2014

Extract B: A market working well?

House prices are increasing again in the UK. Demand is increasing due to a growing   1
number of one-person households, rising immigration and various government initiatives
such as the 'Help to Buy' scheme for first time buyers. When this is combined with a price
inelastic supply of houses it means prices rise, sometimes significantly, to eliminate the
excess demand. In the long run, with the incentive of higher profits, supply should increase   5
as new building firms are encouraged to enter the market, although recent evidence
suggests that larger firms account for a greater percentage of new house building. Recent
reductions in planning regulations should also help the market respond to excess demand.
Additionally, with ever-growing use of the internet, there is greater price transparency,
leading to more information for buyers and sellers, even between regions. However, the   10
housing market is not a perfectly competitive market.

Source: news reports, 2014

Extract C: Or a market failing?

So, is the housing market working well then? Not everyone would agree: the charitable   1
organisation, the Joseph Rowntree Foundation, suggests that rising homelessness is a
'clear sign that the housing market is failing'. In 2014, the estimated number of people
sleeping on the streets in England on any one night was 2714, a 55% rise since 2010; and
this doesn't include the 'hidden' homeless, those who stay in hostels, in overcrowded   5
accommodation, or even on floors and sofas in friends' houses. The annual cost to the
government of homelessness is estimated to be in the region of £1 billion.

Clearly, part of the solution is that the supply of houses should be increased. But where?
Individuals and communities tirelessly campaign for the protection of the countryside and
object to new developments. Alternatively, much has been done to encourage the re-use of   10
industrial sites, but this takes time.

For most homeowners, a house is the most valuable asset that they will ever own, it adds
considerably to their stock of wealth, and as house prices rise, so does the value of their
wealth. However, for the homeless and those forced to rent, the inequality that exists in the
distribution of wealth grows bigger.   15

Even the price of renting has increased, making it increasingly difficult for tenants to save
for the large deposit needed to buy their own home. Some economists have suggested the
implementation of maximum price controls on rented accommodation that prevent landlords
from charging the market rent. Others have suggested a more radical approach, with
increased government provision of affordable housing. Some are mindful of government   20
failure and advocate a lesser role for governments.

Source: news reports, 2014

Turn over for Context 1 questions

Turn over ►

Context 1 – Questions 21 to 26

2 1 Define the term 'government failure' **Extract C** (lines 20 and 21).

[3 marks]

2 2 Use **Extract C** to calculate, to the nearest whole number, the estimated number of people sleeping on the streets in England on any one night in 2010.

[4 marks]

2 3 Use **Extract A** to identify **two** significant points of comparison between the number of new houses built per year in the UK and the changes in UK population over the period shown.

[4 marks]

2 4 **Extract C** (lines 17 to 19) states 'Some economists have suggested the implementation of maximum price controls on rented accommodation that prevent landlords from charging the market rent.'

Draw a diagram to show the effect of implementing this suggestion on the market for rented accommodation.

[4 marks]

2 5 **Extract B** (lines 10 and 11) states 'However, the housing market is not a perfectly competitive market.'

Explain why the housing market is not a perfectly competitive market.

[10 marks]

2 6 **Extract C** (lines 20 and 21) states that: 'Some are mindful of government failure and advocate a lesser role for governments.'

Use the extracts and your knowledge of economics to assess the view that housing markets should be left to market forces with only the minimum of intervention from governments.

[25 marks]

There are no questions printed on this page

Turn over for Context 2

Turn over ▶

Context 2   **Total for this Context: 50 marks**

THE COSTS OF SMOKING

Extract D: Price and quantity of cigarettes consumed in the UK, 2007 to 2013

Year	Price of a pack of 20 cigarettes (£)	Cigarettes consumed (billions)
2007	5.33	47.0
2008	5.44	46.5
2009	5.67	46.5
2010	6.13	44.5
2011	6.63	42.0
2012	7.09	40.5
2013	7.72	37.9

Source: Tobacco Manufacturers' Association, 2015

Extract E: Smoking and pregnancy

Smoking during pregnancy increases the risk of miscarriage, premature birth and even   1
stillbirth. Babies may suffer lower birth weight, a higher chance of cot death and are more
likely to have health problems throughout their lives. Smoking results in the deaths of an
estimated 5000 babies each year in the UK. The estimated annual cost to the health service
is £64m for treating smoking-related problems in mothers, and £23.5m for treating babies up 5
to the age of 12 months.

Statistics show that 12% of pregnant women in England are smokers. The rates are even
higher in other parts of the UK; for example, 20% of women in Scotland smoke during
pregnancy.

Researchers at the Universities of Glasgow and Stirling offered pregnant smokers up to   10
£400 worth of shopping vouchers to give up smoking; the results indicate vouchers could be
cost-effective. After a year, 15% of those who received the vouchers remained non-
smokers, compared with only 4% who received standard anti-smoking advice. However,
some critics argue using financial incentives to promote healthy behaviour is just bribery.

Source: news reports, March 2015

Extract F: How should governments deal with smokers?

Smoking is a major health issue and cigarettes are regarded as a demerit good. Research   1
by the American Cancer Society suggests that two in three smokers will die early from
cancer, heart disease or other smoking-related diseases. Smoking caused a fifth of all
deaths in the UK in 2010. The cost in terms of lost output, fires, litter and health care was
estimated to be £13.8bn.   5

In 1974, 51% of men and 41% of women in the UK smoked. By 2013, rates had more than
halved, to 22% of men and 19% of women. However, ten million adults still smoke and
200 000 children aged between 11 and 15 start smoking each year.

Indirect taxes added approximately £5.91 to the price of a pack of 20 cigarettes in 2013.
Taxation is one way governments attempt to control cigarette consumption. However, high   10
taxes have encouraged illegal importation of tobacco products into the UK.

Regulation to reduce the consumption of cigarettes is extensive in the UK. From October
2015, drivers will be fined £50 if they smoke when children are in the car. Pictures warning
of the dangers of smoking were introduced on cigarette packs in October 2008. All forms of
tobacco advertising and promotion are now banned, including the display of tobacco   15
products in shops. Since 2007, it has been illegal to sell tobacco products to anyone under
the age of 18. Smoking is now illegal in virtually all enclosed public places and workplaces.

Some argue that government intervention in the UK has gone too far; regulations interfere
with consumer choice and the operation of the free market. Currently, there are 66 000
people in tobacco-related jobs and around £12bn is collected from taxes on tobacco   20
products.

Source: news reports, March 2015

Turn over for Context 2 questions

Turn over ▶

Context 2 – Questions 27 to 32

2 7   Define the term 'demerit good' **Extract F** (line 1).

[3 marks]

2 8   Use **Extract D** to calculate, to the nearest penny, the mean price of a pack of 20 cigarettes between 2007 and 2013.

[4 marks]

2 9   Use **Extract D** to identify **two** significant points of comparison between the price and the quantity of cigarettes consumed in the UK from 2007 to 2013.

[4 marks]

3 0   **Extract E** (lines 10–11) states 'Researchers at the Universities of Glasgow and Stirling offered pregnant smokers up to £400 worth of shopping vouchers to give up smoking …'

Draw a diagram to show the effect on the market for cigarettes of giving shopping vouchers to pregnant women as an incentive to stop smoking.

[4 marks]

3 1   **Extract F** (line 10) states 'Taxation is one way governments attempt to control cigarette consumption.'

Explain the effect of indirect taxation on the consumption of cigarettes.

[10 marks]

3 2   **Extract F** (line 12) states 'Regulation to reduce the consumption of cigarettes is extensive in the UK.'

Use the extracts and your economic knowledge to assess the view that regulation is the best way of dealing with the market failure that results from the consumption of cigarettes.

[25 marks]