

PRACTICE EXAM PAPER

AQA A Level Economics

Question Paper

Paper 1

Individuals, firms, markets and
market failure

AQA A Level Economics

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2 hours

Materials

For this paper you must have:

- ➔ an answer book
- ➔ a calculator

Instructions

- ➔ Use black ink or black ball-point pen. Pencil should only be used for drawing.
- ➔ Write the information provided on the front of your answer book. **The Examining Body** for this paper is AQA.
- ➔ In **Section A** answer **Eight** Questions **OR** Context 2.
- ➔ In **Section B** answer **one** question.

Information

- ➔ There are 80 marks available on this paper.
- ➔ The marks for questions are shown in brackets.

Please write clearly, in capital letters, for character computer recognition.

Centre number

Candidate number

Surname

Forename(s)

Candidate signature _____

Section A

ANSWER EITHER CONTEXT 1 OR CONTEXT 2 IN THIS SECTION

Context 1

Poverty in the UK

Study **Extracts A, B** and **C** and then answer **all** parts of Context 1 which follow

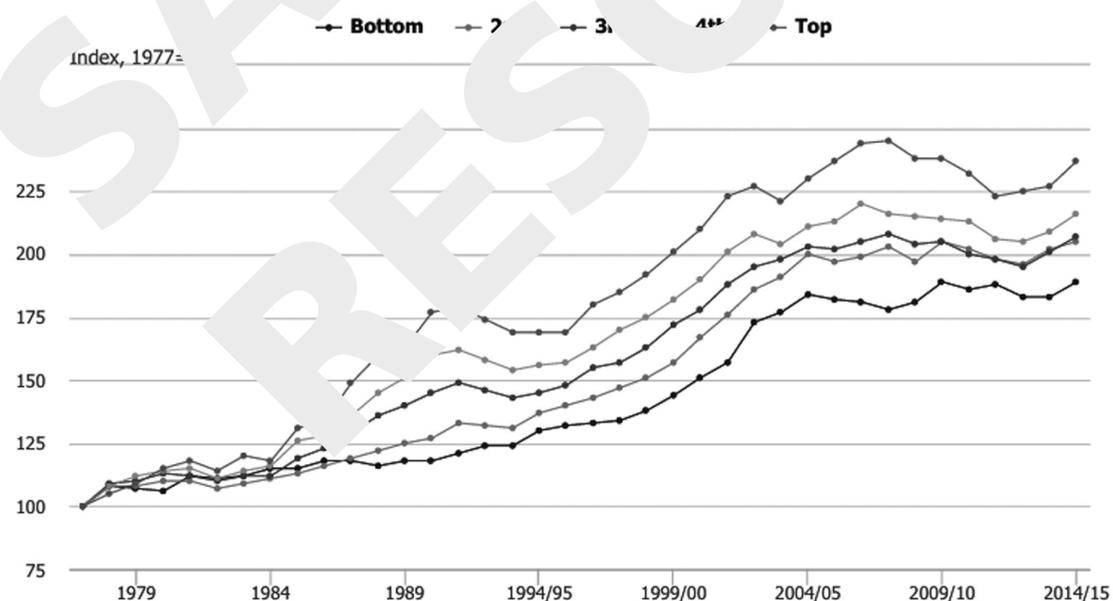
Total for this context: 40 marks

Extract A

Figure 1: Mean and Median Real Household Disposable Income, UK (index, 1977 = 100)

| Year | Median | Mean |
|------|--------|-------|
| 1979 | 110.0 | 109.5 |
| 1989 | 149.7 | 149.7 |
| 1999 | 170.0 | 186.4 |
| 2009 | 207.5 | 222.1 |
| 2015 | 207.5 | 222.1 |

Figure 2: Median Real Household Disposable Income by Quintile 1977 – 2015 (index 1977 = 100)



Source: ONS Statistical Bulletin, Household Disposable Income and Inequality: financial year ending 2015

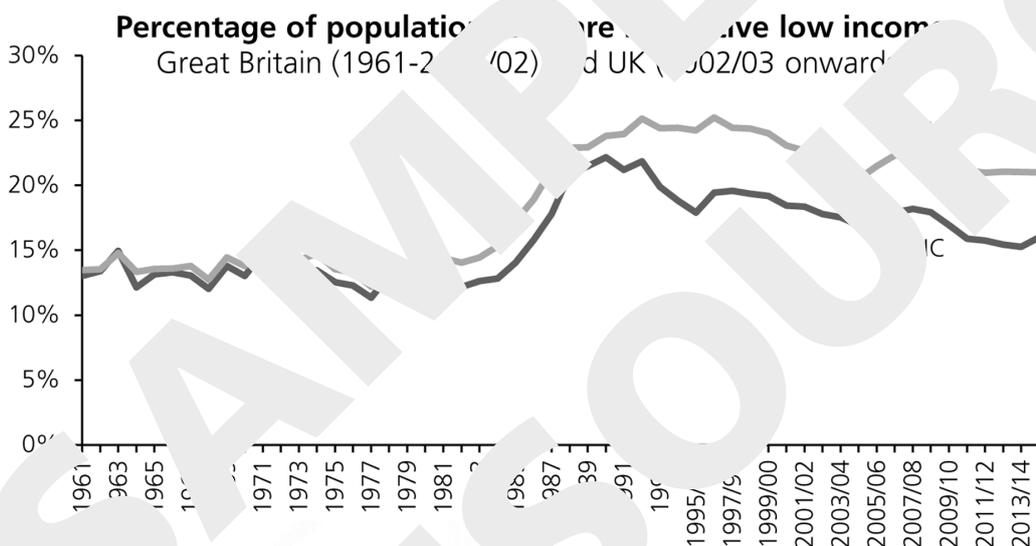
Extract B

Causes of poverty

Poverty within countries, especially in developed economies, is usually measured using an indicator of relative poverty rather than absolute poverty. In the UK, the poor are generally assessed as being so if their annual household disposable income is less than 60% of the UK median. The UK's Department for Work and Pensions (DWP) and the Institute for Fiscal Studies (IFS) also produce statistics on poverty both before and after housing costs such as rents or mortgage payments are taken into account. 5

The demand for rental property in particular continues to rise as a result of an increasing population, the inability of the construction industry to build new houses and the unwillingness of many banks and building societies to provide mortgages to people with no significant deposits. As such, rental prices continue to rise squeezing the incomes of non-home owners and particularly the working and non-working 'poor'.

Figure 3 – Relative Poverty Before Housing Costs (BHC) and After Housing Costs (AHC), 1961 - 2014



Since 1998, the UK government has focused attention and policy on child poverty in particular. In 2015, there were 2.5m children living in relative poverty before housing costs (an increase of 200,000 on the previous year) and 2.4m living in relative poverty after housing costs. The parents of many children living in poverty also live in relative poverty, suggesting that the poverty cycle is difficult to break.

Pensioner poverty has received more scrutiny in recent years with the harsh winters and rising fuel prices during the Coalition period. The 2010-2015 raising public awareness of the issue, although overall since 1998 pensioner poverty has fallen significantly, partly because over three quarters of pensioners own their homes outright and thus incur no mortgage or rental costs. 15

People living in workless families are much more likely to be living in relative poverty than families in which at least one adult is employed. Nevertheless, 20% of all people living in relative poverty in the UK in 2015 were in a working household. A report by the Joseph Rowntree Foundation in 2016 attributes this statistic to slow wage growth, a reduction in benefits for working families, and rising prices of essential items. 20

Sources: House of Commons Briefing Paper No 7096 "Poverty in the UK: statistics", and, "Working families are the new poor", the Telegraph, July 2016

Extract C

Policies to alleviate poverty

Most governments are united in the view that poverty should be tackled as a matter of priority, although there is disagreement over the most appropriate policies. One school of thought suggests that poverty is best addressed by prudent macro-economic policy to deliver an environment in which employment is high, taking the view that if you have a job you are less likely to be poor. This, supported by a sensible 'Welfare to Work' programme using incentives such as a higher National Living Wage and increasing the Personal Allowance, can increase living standards and reduce poverty without overly burdening the taxpayer with additional welfare costs. 5

However, encouraging all unemployed and economically inactive people into work may neither be feasible nor desirable nor effective in reducing poverty. There is still a role for the welfare state system. One such policy is Working Tax Credits (which reduce the marginal rate of tax and tackle the issue of the unemployment trap). These Working Tax Credits, however, are somewhat controversial with some critics claiming that they are expensive, generous and increasingly unaffordable. Former Chancellor George Osborne attempted to abolish Working Tax Credits in 2016 but it was rejected in Parliament amid huge criticism that it punished the working poor and caused a rise in poverty. 10

The UK government also has a Child Poverty Strategy, which attempts to reduce the incidence of poverty between generations. There are three strands to the Strategy: 15

- 1 Support families into work and increase their earnings;
- 2 Improve living standards (for example, reducing energy and water bills, providing Healthy Start Vouchers for young children to access nutritious food, reduce housing costs, and reduce transport costs); 20
- 3 Raise the educational attainment of poor children (for example, making more pre-school education available for free, increasing the Pupil Premium for schools taking in disadvantaged children, and providing more mental health support).

Source: HM Government "Child Poverty Strategy" and various news reports

01 Using **Extract A**, calculate the value of median income in 1979, if median income in 2015 was £25,700. (2 marks)

02 Explain how the data in **Extract A** shows that income inequality increased in the UK between 1977 and 2015. (4 marks)

03 **Extract B** (lines 6-8) states that “the demand for rental property...continues to rise as a result of an increasing population, the inability of the construction industry to build new houses, and the unwillingness of many banks and building societies to provide mortgages to people without significant deposits”.

With the help of a diagram, explain the effect on rental prices of the factors mentioned above and explain how the change in rental prices affects poverty. (4 marks)

04 **Extract C**, (lines 11-12) states that there remains a need for the benefit system to reduce poverty in the UK.

Using the data from all extracts and your economic knowledge, discuss the best way to reduce poverty through the benefit system. (25 marks)

OR

Context 2

The UK Gambling Industry and Competition Policy

Study **Extracts D, E** and **F** and then answer **all** parts of Context 2 which follow.

Total for this context: 40 marks

Extract D

Gambling Industry Statistics

Figure 4: Number of Betting Shops (“Licensed Betting Offices”) in the UK, 2015 – 2016

| Company | March 2015 | March 2016 |
|-----------------|--------------|--------------|
| William Hill | 2,308 | 2,320 |
| Ladbrokes | 2,150 | 2,150 |
| Gala Coral | 1,835 | 1,835 |
| Betfred | 1,360 | 1,360 |
| Other operators | 1,138 | 1,138 |
| Total | 9,751 | 9,751 |

Source: Gambling Commission Industry Statistics March 2016

Figure 5: Online gambling, market share by operator (%) 2015

| | |
|--------------|----|
| William Hill | 15 |
| Betfair | 12 |
| Padawo Power | 10 |
| Sky Bet | 8 |
| Gala Coral | 5 |
| Ladbrokes | 4 |
| Other | 36 |

Source: Gambling Commission, October 2015

Extract E

The changing nature of the UK gambling industry

The changing balance between sectors in the gambling industry

In 2015 the revenue earned across all sectors in the UK's gambling industry totalled £12.6bn, of which £3.2bn came from betting shops. In addition to the 8,809 betting shops, there were also 599 bingo halls (10.1% fewer than in 2014), 147 casinos (0.7% fewer in 2014), and 171,134 gaming machines (a 1.7% increase). The most significant change in the industry between 2014 and 2015 was the significant increase in the amount of revenue generated from online gambling; the share of online gambling as a proportion of the entire market rose from 22.9% in 2014 to 29% by 2015, overtaking the 26% market share of the National Lottery. This increase in market share for online gambling is partly attributed to the rising interest of 18-24 year olds in gambling and betting.

Gambling industry sector concentration

In many of the gambling industry sectors, the market is also becoming more concentrated due to mergers and takeovers. In September 2015 Paddy Power (a betting shop operator) and Betfair (an online gambling provider) merged to form a new company, Paddy Power Betfair. The new firm expects 80% of its revenue to come from online gambling in 2016.

This merger came just a few months after a merger between Ladbrokes and Coral was agreed, resulting in the new merged firm overtaking the market share of William Hill, although the merged firms will have to split at least 40% of their betting shops to tackle concerns from the industry regulator regarding local employment. Again, both brands will remain on the high street. Some critics have argued that the maintenance of the original brand names will confuse gambling customers who may think that they have more choice over where to bet than they actually do. Both mergers were expected to save between £50m and £65m each year by avoiding duplication of some fixed costs in order to increase profits in this surprisingly low-margin industry (in which 50% of the UK adult population places a bet at least once every month, and 73% of adults gamble at least once every year).

Number of Employees in Gambling Industry Sectors

| Employment Sector | March 2014 | September 2016 |
|--|----------------|----------------|
| Betting | 52,527 | 52,566 |
| Casino | 15,611 | 15,814 |
| Bingo | 13,913 | 13,108 |
| Arcades | 12,053 | 10,483 |
| Gaming machine (technical) | 6,901 | 6,092 |
| Remote | 5,835 | 9,082 |
| Lotteries (External Lottery Managers only) | 1,135 | 918 |
| Total | 107,975 | 108,063 |

Sources: "Ladbrokes and Coral Merger to create £3.2bn gambling giant" *The Guardian* 15/7/15; "Paddy Power and Betfair merger agreed" *The Guardian* 8/9/15; Gambling Commission Industry Statistics March 2016; "A look at the trends in the UK betting market" *SBC News* 24/7/15; *SBC News* 24/7/15.

Extract F

Competition Policy and the UK Gambling Industry

The Association of British Bookmakers (ABB) is an industry-representing body. In a 2016 report, the ABB noted that the UK gambling industry makes significant annual contributions to the UK economy. In particular, it contributes £3.2bn directly to GDP, pays over £1bn in tax and a further £58m in business rates to local authorities, and is estimated to have a local multiplier effect of 1.6.

Furthermore, a landmark 2011 study found that, contrary to many news reports, gambling provides huge amounts of pleasure to gamblers, equivalent to other leisure pursuits such as attending concerts. The study also found that the analytical and memory skills of regular gamblers were above those of the 'average' person. According to this report, fewer than 1% of gamblers have gambling addiction; the industry voluntarily spends £6m each year on research into combatting gambling addiction. This research is important; many addicted gamblers end up with high levels of debt and may turn to crime to pay it back. Many addicted gamblers also refuse to spend money on anything other than gambling, so may neglect their health and their well-being, as well as that of their families.

The Gambling Commission is the industry-specific regulator, and is more responsible for ensuring that betting shops, and more recently online betting providers, have a valid licence and comply with the terms and conditions of that licence. Some of these terms and conditions include protection of children and vulnerable people from gambling, and a code of social responsibility to help gamblers who may be addicted. The Gambling Commission also works closely with the UK's Competition and Markets Authority (CMA) in terms of handling charges and investigating complaints of unfair competition. For example, in October 2016, the CMA announced an investigation into whether online betting providers were using unfair tactics such as misleading promotions to lure in new customers. The CMA found that some providers could not access their winnings unless they continued to gamble for longer than they had planned.

Sources: The Gambling Commission website; "CMA launches investigation into online gambling" CMA press release 20/10/16; "The truth about betting shops and gaming machines" ABB April 2013.

05 Using the data in **Extract D** calculate the 3 firm concentration ratio for UK betting shops in 2016. (2 marks)

06 Explain how the data in **Extract D** suggests that the UK gambling industry is oligopolistic. (4 marks)

07 **Extract E** (lines 20-22) states that “both mergers were expected to save between £50m and £65m each year by avoiding duplication of some fixed costs in an attempt to increase profits in this surprisingly low-margin industry”

With the help of a diagram, explain how a reduction in total fixed costs could lead to an increase in profit for a price-making firm such as a betting shop. (6 marks)

08 **Extracts E** and **F** describe the changing structure and nature of the UK gambling industry, as well as providing background information that may be helpful in assessing the need for regulation in this industry.

Using the data in the extracts and your economic knowledge, argue the case that as more gambling takes place online rather than in traditional betting shops there is a need for regulation in the gambling industry. (25 marks)

Section B

ANSWER ONE ESSAY FROM THIS SECTION

Each essay carries 40 marks

Either

Essay 1

In many, if not all cases, the market delivers an efficient allocation of resources and as such governments often seek to intervene but not always successfully.

09 Using appropriate diagrams, explain how positive and negative externalities may result in market failure. (15 marks)

10 Evaluate the view that government intervention to correct market failure is justified in government failure. (25 marks)

Or

Essay 2

Oligopoly often receives 'bad press' and is often seen as harmful. However, there are many different types of oligopoly.

11 Explain how the existence of uncertainty and interdependence affect the behaviour of firms in oligopolistic markets. (15 marks)

12 Evaluate the view that collusion between oligopolistic firms is always harmful to both consumers and firms. (25 marks)

Or

Essay 3

There are many factors which determine wage rates and employment levels in labour markets. Trade union involvement is one such factor.

- 13** Explain how the marginal revenue product of labour **and** factors which influence supply of labour can determine the equilibrium wage rate in labour markets. **(15 marks)**
- 14** Evaluate the view that trade union influence in a labour market inevitably causes wages to rise and employment to fall. **(15 marks)**