AQA

A-level
ECONOMICS

Paper 1 Markets and market failure

Tuesday 5 June 2018 Afternoon Time allowed: 2 hours

Materials
For this paper you must have:
- an AQA 12-page answer book
- a calculator.

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front cover of your answer book. The **Paper Reference** is 7136/1.
- In **Section A** answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **ONE** essay.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- You will be marked on your ability to:
  - use good English
  - organise information clearly
  - use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

Section A

Answer **EITHER** Context 1 **OR** Context 2.

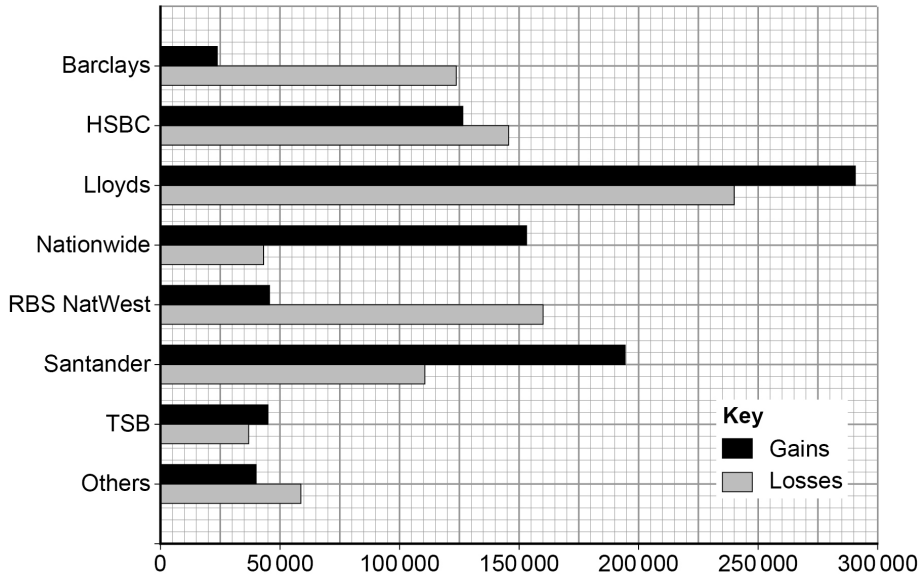
EITHER

Context 1 **Total for this context: 40 marks**

Competition in UK Banking

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

Extract A: Customers switching personal bank accounts in 2016



Source: BACS

Extract B: Gradual change in the UK banking market

There have been 11 separate inquiries into the banking sector in the past 17 years but not much has changed. As in 1999, the Big Four of HSBC, Barclays, RBS NatWest and Lloyds dominate the market with a combined market share of 75%. A 2017 inquiry by the Competition and Markets Authority (CMA) concluded that banks do not feel enough pressure to compete on price or quality, leading some to call for the Big Four to be split into a number of smaller banks. Nevertheless, the personal account market has changed, with an increase in product innovation, suggesting that competition is working. Whilst 'free if in credit' accounts remain dominant, a third of newly opened accounts charge fees in exchange for a premium rate of interest or cashback on purchases.

Last year fewer than 1 million customers (from a total 70 million) switched accounts, though switching rates may not be the best indicator of competition. The market lacks the same prompts to switch as other markets, such as the annual cost of renewing car and house insurance. The personal account market is therefore more static than energy, telecommunications and insurance. Ultimately, consumers do not operate like economists, rationally examining each product in detail and securing the best deal. Some of the stickiness in the market also derives from higher satisfaction rates (91%) than other sectors.

The CMA inquiry is unlikely to worry the Big Four as the most significant proposed reform amounts to little more than a new app to help customers switch accounts. The idea is that people will be more inclined to switch if they have transparency about charges and interest

rates. Greater contestability, with more customers switching and the entry of new players, has improved value for money for all customers, not only switchers. Revenue per active account has fallen by 17% in real terms since 2006, as banks offer higher rewards to keep or win customers. While the new entrants have yet to grow to a significant size, mid-sized providers like Santander have grown their market share. From this perspective, breaking up the Big Four may seem to be too extreme a measure.

Source: News reports, August 2017

Extract C: The rise of challenger banks

As the first new high street bank in 150 years, Metro Bank promises to operate distinctively: longer opening times than its rivals, instant debit cards for new account holders and eye-catching initiatives such as in-store dog water bowls. There are plans to grow its branch network from 48 to 110 by 2020. This bucks the UK trend for closing bank branches, more than 8000 of which have disappeared from high streets in the past 25 years. Metro Bank's Chief Executive Officer said of the big banks: "They act like oligopolies are supposed to: they under-invest; under-serve and they take you for granted."

Many of the major banks suffer from inefficient, outdated IT infrastructure which limits their ability to reduce prices. They may also suffer from diseconomies of scale, given the size of their workforce and the breadth of their operations. There is ample opportunity for new players to enter the sector.

Metro Bank may take years to grab meaningful market share in the UK. Its straightforward business model involves opening new branches, collecting deposits and lending these funds to borrowers. This is safer than the riskier funding methods deployed by the some of the banks that failed during the financial crisis, but is unlikely to generate rapid growth. Even so, its customer focus puts pressure on dominant banks to improve their service.

Source: News reports, August 2017

0 1 Using **Extract A**, calculate the ratio of customers gained to customers lost by Nationwide. Give your answer correct to **one** decimal place.

[2 marks]

0 2 Explain how the data in **Extract A** show that the market power of the Big Four banks is weakening against competition from smaller rivals.

[4 marks]

0 3 **Extract C** (lines 10–11) states that 'There is ample opportunity for new players to enter the sector.'

With the help of a diagram, explain how the lowering of barriers to entry in the banking market might lead to lower prices and a situation in which banks make normal profit.

[9 marks]

0 4 **Extract B** (lines 4–6) states that 'banks do not feel enough pressure to compete on price or quality, leading some to call for the Big Four to be split into a number of smaller banks.'

Use the extracts and your knowledge of economics to assess the view that the government should intervene further in the banking sector to promote greater competition.

[25 marks]

Turn over ►

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

OR

Context 2 **Total for this context: 40 marks**

Automation and the Labour Market

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

Extract D: The threat of automation to selected UK industries

Table of figures showing automation in UK industries cannot be reproduced here due to third-party copyright restrictions.

Extract E: The rise of the robots

Workers have always been concerned about their livelihoods being replaced by new technology, but many economists maintain that technology has always ended up creating more jobs than it destroys. Automating tasks increases the demand for workers elsewhere. When weaving was automated in the 18th century workers shifted into operating and maintaining the new machines. Gradually, wages rose in line with productivity. The same pattern can be seen with computerisation.

But could this time be different? This time around automation is broader-based as every industry uses computers. During previous waves of automation, workers could switch from one kind of routine work to another; but this time many workers must switch from routine, unskilled jobs to non-routine, skilled jobs to stay ahead of automation. A recent report found that in the US between 1990 and 2007, the addition of each robot into manufacturing industries resulted in the loss, on average, of 6.2 jobs and depressed wages. The report argues that even if overall employment and wages recover, there will be losers in the process, and it will take a very long time for these communities to recover. The market economy is not going to create the jobs by itself for those workers who are most affected by the change.

Others argue that producers need a profitable market to sell to, and such markets only exist if consumers earn enough to purchase their goods and services. If robots replaced all workers, thereby creating mass unemployment, where would demand come from?

Source: News reports, 2017

Extract F: Policy responses

Robots are no different from earlier technologies in that they are capital goods which can enrich those who own them. Bill Gates, the founder of Microsoft, has suggested a robot tax, which has since become widely debated. Larry Summers, former US Treasury Secretary, thinks taxing productivity-enhancing tools like robots or machines makes no economic sense: “Staving off progress is a poor strategy for helping less fortunate workers.”

The prospect of large rises in unemployment and inequality has led to the suggestion of a Universal Basic Income (UBI). A UBI is a fixed payment to all members of society, regardless of income, which could replace costly welfare and unemployment benefits. It can

also create incentives for individuals to take risks, start businesses, change jobs, return to education or try a new career. Critics point out that getting a cheque from the government may help, but it doesn't provide the fulfilment that comes from employment.

A recent report suggested that the government should provide lower-skilled workers with more training to help them manage the changing demand for labour. Another way to deal with sudden unexpected layoffs is for the government to create jobs, primarily in sectors not adequately served by the private sector such as care for the elderly and children, health, education and the arts.

Source: News reports, 2017

0 5 Using **Extract D**, calculate the number of transportation and storage jobs at high risk of automation, as a percentage of those who are at high risk across all industries. Give your answer to **two** decimal places.

[2 marks]

0 6 Explain how the data in **Extract D** show that workers employed in routine, repetitive work are at greater risk from automation.

[4 marks]

0 7 **Extract E** (lines 4–5) claims that workers in the 18th century saw wages rise in line with productivity.

With the help of a diagram, explain how advances in modern technology are likely to lead to rising wages in some industries.

[9 marks]

0 8 **Extract E** (lines 14–16) states that 'The market economy is not going to create the jobs by itself for those workers who are most affected by the change.'

Extract F (lines 4–5) states that 'taxing productivity-enhancing tools like robots or machines makes no economic sense.'

Use the extracts and your own knowledge of economics to evaluate whether governments should allow markets to respond freely to the opportunities and challenges presented by technological progress, without any state intervention.

[25 marks]

Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

According to Public Health England, poor air quality is the largest environmental risk to public health in the UK. In particular, diesel cars are estimated to be responsible for 40 000 premature deaths each year. In response, the Government announced in 2017 that it would ban the sale of new petrol and diesel cars by 2040.

0 9 Explain why the use of petrol and diesel cars may be a source of market failure.

[15 marks]

1 0 Assess the view that regulation is a better policy for dealing with the problem of air pollution than the allocation of property rights or taxation.

[25 marks]

OR

Essay 2

The Resolution Foundation estimates that 1% of adults, about 488 000 people, own 14% of the UK's assets – worth about £11 trillion. At the other end of the scale, 15% of adults, about 7.3 million people, either own no assets at all, or are in debt. Meanwhile, income is also unequally distributed, but not to the same extent as wealth.

1 1 Explain how the Lorenz curve and Gini coefficient may be used to illustrate increasing income inequality in a country.

[15 marks]

1 2 Assess the view that, in the UK, the consequences of wealth inequality are more damaging than the consequences of income inequality.

[25 marks]

OR

Essay 3

In the United States, corporate profits since 2010 have averaged 9% of GDP, compared to 5% in the 1990s. This is causing concern that the US economy is increasingly dominated by companies with monopoly power.

1 3 Explain the role of profit in a market economy.

[15 marks]

1 4 Evaluate the view that a firm making low profits must be inefficiently managed.

[25 marks]

END OF QUESTIONS

There are no questions printed on this page

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