

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?

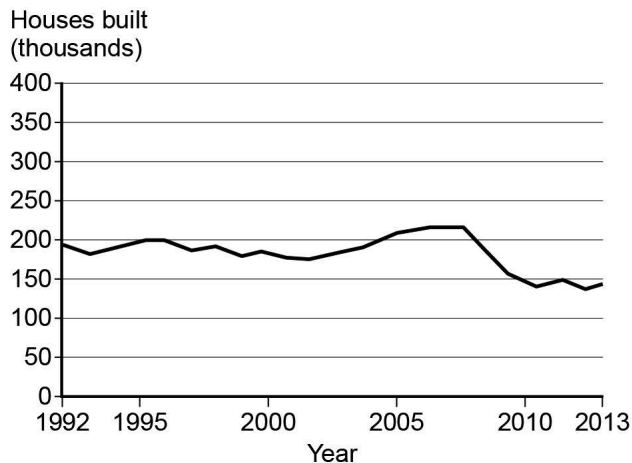
Context 1

Total for this Context: 50 marks

THE UK HOUSING MARKET

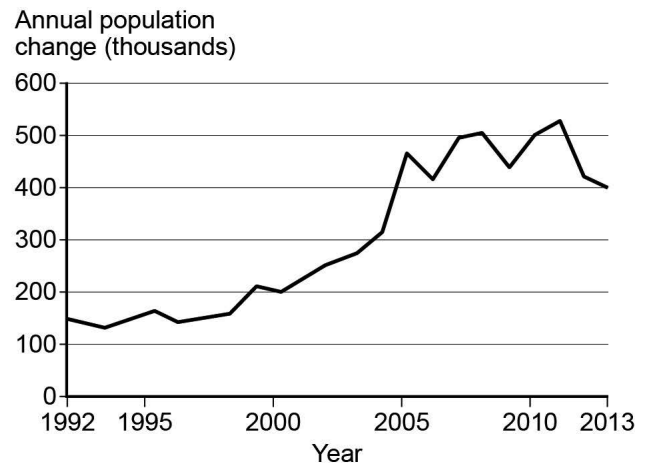
Extract A:

New houses built per year, UK, 1992 to 2013



Source: ONS, DCLG Live table 209, September 2014

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



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 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 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 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 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 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.

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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 industrial sites, but this takes time.

10

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 failure and advocate a lesser role for governments.

20

Source: news reports, 2014

Turn over for Context 1 questions

Context 1 – Questions 21 to 26

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

[3 marks]

2	2
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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
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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
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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
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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
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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

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 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 to the age of 12 months. 1 5

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 £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. 10

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 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. 1
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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 taxes have encouraged illegal importation of tobacco products into the UK. 10

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 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. 15

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 products. 20

Source: news reports, March 2015

Turn over for Context 2 questions

Context 2 – Questions 27 to 32

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

[3 marks]

2	8
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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
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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
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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
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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
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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]

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