EZY ECONOMICS

# Sample Papers – Set 1

# OCR A Level – Paper 1 (Microeconomics)

# Question Paper

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## Time Permitted: 2 hours

## Paper Instructions:

- In **Section A**, answer **all questions**.
- In **Sections B and C**, answer **one** essay question in each section.
- There are 80 marks available in this paper
- The mark allocation for each question are shown in the accompanying brackets.
- You may use a calculator.

**SECTION A**

Read the following stimulus material and answer **ALL** parts of question 1 which follows.

## Developments in the UK Rail Industry

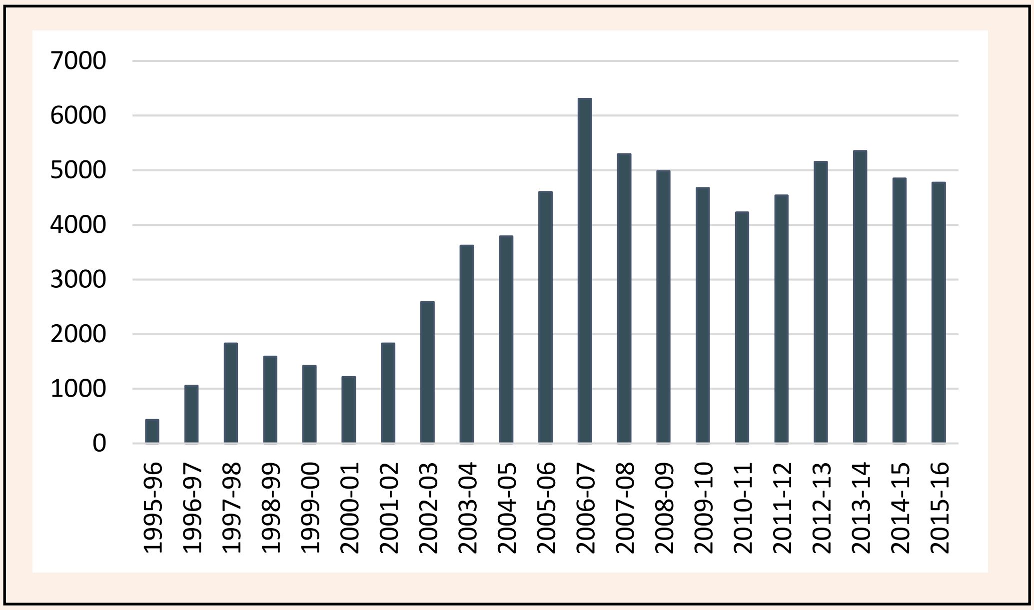
Until the mid-1990s the UK rail industry was publicly owned and operated by British Rail. This state-owned enterprise oversaw a period of significant change across the UK rail network, most notably the transformation from steam powered traction to electric traction.

In 1997 the structure of the industry was radically reshaped to help lower fares, improve customer service, and increase infrastructure investment. To achieve this the ownership and control of the UK railway infrastructure was passed down to Network Rail, an arms-length public body of the Department for Transport, which maintains and operates the tracks, signalling and stations in the industry. Whilst rail infrastructure bears many of the hallmarks of a natural monopoly, the provision of train services themselves arguably does not.

Network Rail supplies the rail infrastructure to a collection of privately-owned train operating companies (TOCs). These TOCs apply for franchises through the market and if successful provide train services to rail passengers on those selected routes. Despite TOCs facing a competitive bidding process to secure franchise contracts, once they secure a contract they usually have a monopoly on providing services on their routes.

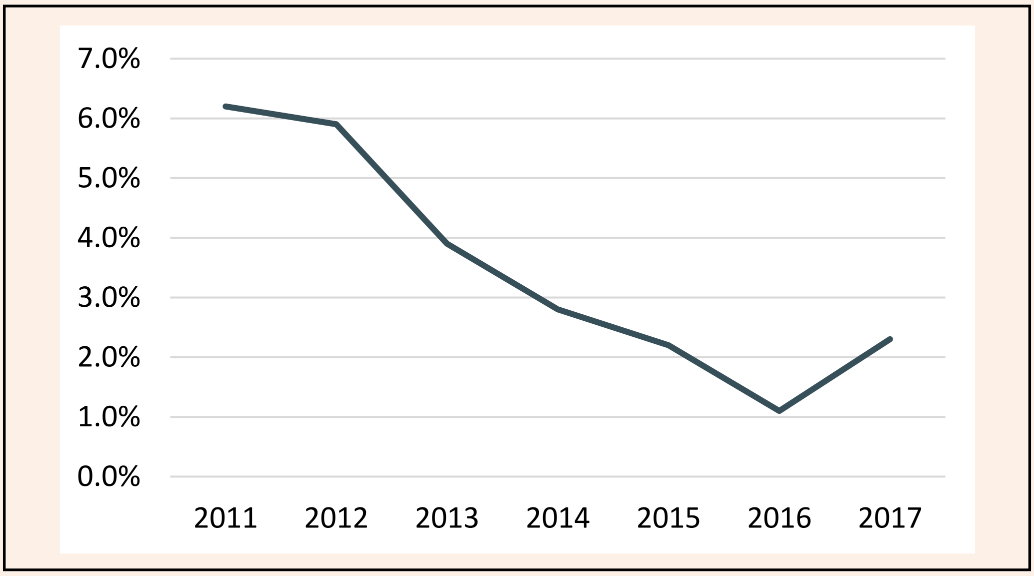
The overall cost of running the UK's railways totalled £13.6bn in 2014-15, 54% of the costs relate to the running of the trains and 46% of the costs relate to the continued maintenance of the rail infrastructure. Over that period, UK government rail subsidies of £4.9bn represented 36% of total industry costs. In 2015-16, the total value of the subsidy paid to the rail network fell to £4.7bn whilst total industry costs rose to £14.5bn. Meanwhile, franchised train operators received an average subsidy of 6.8p per passenger mile over the same period. The subsidies have helped exert downward pressure on unregulated UK rail fares.

**Figure 1 – Government support to the UK rail industry since privatisation (£millions)**




**Source: Department for Transport**

**Figure 2 – Annual average increase in UK rail fares (regulated and unregulated)**




**Source: Rail Delivery Group**

Despite this, the Competition and Markets Authority (CMA) has raised concerns about the current structure of the rail network, outlining the impact that a lack of 'on-rail' competition is having on rail passengers. They argue that rail passengers are suffering from more delays and cancellations on routes despite paying higher fares.

In the last decade, the cost of travelling by train in the UK for commuters has increased significantly. The average price of a standard ticket from London to Manchester has increased from £50 in 1995 to £154 in 2013. Since 2010, average rail fares in the UK have risen by 24%, outstripping the average weekly wage growth of 12% across the same period. This is partly down to structure of the industry and market forces. In the UK, an increasing number of commuters are using the rail network as their preferred mode of transport. Because of this, one million more trains run every year compared to five years ago, and since 2006, passenger journey numbers have increased by 60% to exceed 1.6 billion journeys made annually, the largest increase of any European country.

The CMA has made the case to increase 'on-rail' competition on selected routes to put downward pressure on rail fares: "A more competitive environment will force companies to be more efficient which may mean lower fares, new routes and destinations, more innovations and flexible ticket pricing."

The East Coast Line is an example of a route that has benefitted from increased 'on-rail' competition. Since 2014, First Hull Trains have competed on the East Coast main line with Virgin East Coast Trains, creating pressure for rail fares to fall and the quality of service delivered to improve. The average price of a ticket from Hull to London has fallen from £96.80 to £79.00. In 2016, First Hull Trains recorded a 97% satisfaction rating with rail passengers in the annual Trains Satisfaction Survey, the highest of any TOC.

However, the East Coast Main Line only makes up 1% of all passenger miles covered in the UK rail network. Some industry experts, however, are worried that in the long-term introducing greater competition between lines may reduce the incentives for firms to compete for TOC contracts. They point out that the typical profit margin for a TOC is around 3%.

**Figure 3 - Average Price of Rail Tickets on Selected Routes**

| Route | Peak | Off-Peak | Advance |
|---|---|---|---|
| Doncaster to London | £84.00 | £64.90 | £26.50 |
| London to Hull | £106.00 | £98.70 | £62.50 |

**Source: adapted from 'CMA, Passenger Rail Services: Competition Policy Project', November 2016**

The increase in competition has also created wider economic benefits for businesses as it has provided many cities direct connections to London during peak times of the day, providing an increasing amount of rail commuters with the opportunity to commute to work from home.

Despite the economic benefits of increased competition, the East Coast Main Line only makes up 1% of all passenger miles covered in the UK rail network. Some industry experts are worried that if greater competition within franchised lines is covered on a larger scale this may reduce the incentives for firms to compete for TOC contracts. This is because currently 97p of every £1 raised from fares is reinvested back into the rail network.

## Question 1

**a)** Identify one piece of evidence in the stimulus material of price discrimination in the UK rail industry and explain why it is an example of price discrimination.

**[2 marks]**

**b)** Explain, using relevant calculations, whether the UK rail industry was more or less reliant on government subsidies as a percentage of its total costs in the period 2015-16 compared to 2014-15.

**[4 marks]**

**c)** The Competition and Markets Authority has raised concerns about the current structure of the UK rail network and the impact on rail passengers.

Using figure 2 and data in the stimulus material, explain how train operating companies have taken advantage of the lack of 'on-rail' competition in the UK rail industry.

**[4 marks]**

**d)** In the last decade, an increasing number of UK commuters are using rail as their preferred mode of transport.

Evaluate the impact of increased passenger demand upon rail fares.

**[8 marks]**

**e)** Using evidence from the stimulus material, evaluate the impact of introducing more competition on rail lines in the UK rail industry.

**[12 marks]**

**SECTION B**

Answer **EITHER** Question 2 **OR** Question 3.

**EITHER**

**Q2**

'Premier League footballers earn significantly more than nurses and yet contribute far less to society.'

Evaluate, using an appropriate diagram(s), the case for government intervention in labour markets to improve pay differentials and achieve a fairer distribution of income.

**[25 marks]**

**OR**

**Q3**

In October 2016, despite the environmental concerns from local campaign groups, the UK government approved plans for the development of fracking sites in Lancashire to provide the UK shale gas an oil industry with a boost.

Evaluate, using an appropriate diagram(s), the view that taxation is the most effective form of government intervention in markets that are affected by negative production externalities.

**[25 marks]**

## SECTION C

Answer **EITHER** Question 4 **OR** Question 5.

**EITHER**

**Q4**

At the end of 2016, in the face of excess supply, weakening world demand, a falling oil price and increased competition from US shale oil producers, OPEC, a group of major oil producing countries often described as a cartel, announced a cut in their production levels.

Evaluate how effective OPEC's production cut is likely to be at raising the worldwide market price of oil.

**[25 marks]**

**OR**

**Q5**

Prices for the world's top-selling medicines are typically higher in developed countries compared to developing countries.

Assess the view that price discrimination always leads to undesirable results for society.

**[25 marks]**