



General Certificate of Education  
Advanced Level Examination  
June 2014

## Economics

## ECON3

### Unit 3 Business Economics and the Distribution of Income

Tuesday 3 June 2014 9.00 am to 11.00 am

**For this paper you must have:**

- an AQA 12-page answer book
- a calculator.

#### Time allowed

- 2 hours

#### Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Paper Reference** is ECON3.
- 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**.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- 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**.

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**Section A**

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

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**Total for this Context: 40 marks**

**Either**

**Context 1**

**THE GLOBAL CONTEXT**

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

**Extract A: Pension data from selected countries**

	<b>Australia</b>	<b>UK</b>	<b>USA</b>	<b>India</b>
Percentage of total population over 60 in 2010	20	23	18	8
Projected percentage of population over 60 in 2050	35	34	33	22
Average monthly basic state pension (\$ US) in 2010	1558	960	674	4
Purchasing power of the average monthly basic state pension as a percentage of the United Nations 'poverty line'*, 2010	2521%	2347%	1773%	27%

\* The UN 'poverty line' measures the ability of the population of a country to purchase a basic basket of goods. It used to be referred to as 'a dollar a day' and is an indicator of absolute poverty.

Source: Pensionwatch, 2012

**Extract B: Poverty and age**

The UN estimates that half the children in the world live in poverty. The 40 poorest countries in the world contain 500 million people who share a total annual income which is less than the total personal wealth of the 40 richest people in the world.	1
When measuring poverty within countries, economists generally use an indicator of relative poverty. In the UK, government statisticians generally view people as being 'at risk of poverty' if their household disposable income after housing costs is less than 60% of the average. Politicians in the UK often focus on child poverty, because children from poor families are likely to grow into poor adults, and remain poor into old age. In 1999, the then Prime Minister, Tony Blair, promised to eliminate child poverty by 2020. In 2012, the Office for National Statistics (ONS) reported that relative poverty, as measured by the gap between a family's income and the national average, had fallen since 2008. However, this was likely to be because people in the middle had become worse off, rather than the poorest becoming better off. People aged 18 to 24 saw their risk of poverty rise, due to rising unemployment among that age group. However, it is not necessary to be unemployed to be poor. It has been said that some UK government benefits, such as tax credits, subsidise low wages paid by employers to many workers whose jobs are essential but may require few specialist skills. Training schemes and minimum wage legislation are among government policies aimed at reducing the number of 'working poor' in the labour market.	5 10 15

Sources: news reports, government statistics, 2013

**Extract C: Pensions and poverty**

A major factor in tackling global poverty is the provision of adequate pensions. According to the think tank, Pensionwatch, four out of five older people around the world have no access to a pension, with many millions living in poverty or working well into their old age. Around 80 countries have some form of state pension which gives a basic income in old age. 1

An important question is whether individuals should take responsibility for their old age by choosing to contribute to a scheme provided by the state, or an employer, or via the insurance industry. Only a few wealthier countries also have a basic 'universal' state pension, financed from general taxation rather than contributions. These have a cost to the taxpayer but they reduce the social costs of old age poverty. 5

Statisticians can make long-term predictions of population changes and yet many private and public sector pension schemes are in crisis as countries are faced with ageing populations and rising levels of national debt. This can be seen as government failure, caused by poor forward planning. There has also been some market failure. For instance, due to the selling of inappropriate insurance-based private pension schemes, and a significant fall in the value of pensions being provided by even the better schemes, many consumers have lost trust in the private sector pensions industry. 10 15

It could be that many people are simply too poor to be able to afford to save, or it might be that people often prefer current consumption over future consumption. This form of market failure could be tackled by the government imposing a high rate of compulsory pension saving, as in Chile and Singapore. There was a small step in this direction in the UK in 2012 when the government launched 'auto-enrolment', an occupational pension scheme pioneered in Australia and New Zealand where employees are automatically included unless they opt out. While rich countries argue over who should pay for pensions, and by what methods, in poor countries, where pensions are needed the most, they are likely not to exist at all. 20

Sources: news reports, government statistics, 2013

- 0 1** Using **Extract A**, calculate to **two** decimal places the average monthly basic state pension in India as a percentage of the monthly pension in the UK, **and** identify **one** other significant feature of the data shown. [5 marks]
- 0 2** Explain what is meant by 'market failure' (**Extract C**, line 13) **and** analyse **two** reasons why markets might fail to provide adequate pensions. [10 marks]
- 0 3** '...children from poor families are likely to grow into poor adults, and remain poor into old age' (**Extract B**, lines 7–8).  
Using the data and your economic knowledge, evaluate whether it is better for the UK government to reduce poverty by using policies to improve people's ability to earn higher wages during their working lives, rather than through the provision of state benefits to those who are poor for various reasons. [25 marks]

Turn over ►

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

**Total for this Context: 40 marks**

or

## Context 2

### THE EUROPEAN UNION CONTEXT

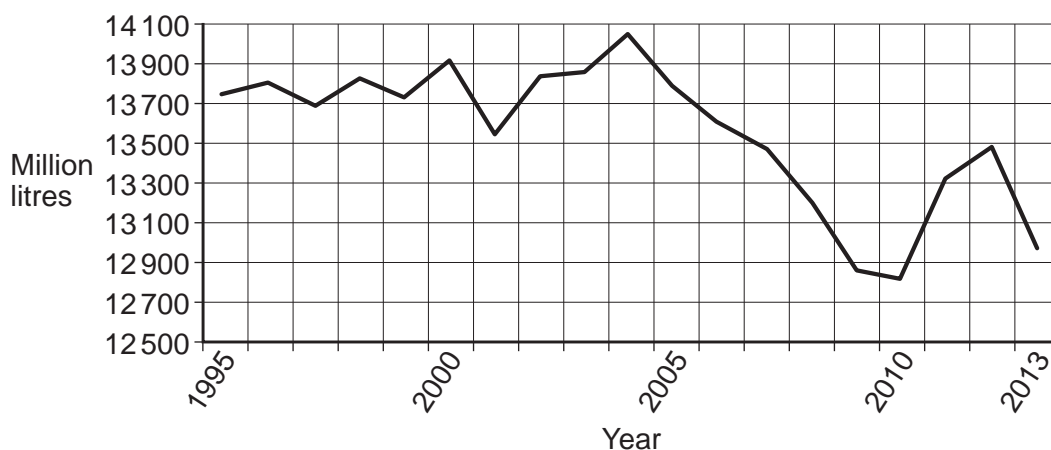
Study **Extracts D, E and F**, and then answer **all** parts of **Context 2** which follow.

#### Extract D: EU milk production, 2007 and 2013

	2007	2013
<b>Output (million tonnes)</b>	148	151
<b>Dairy cows (millions)</b>	24	22

Source: Euromilk.org 2013

#### UK milk production, 1995–2013 (millions of litres)



Source: [www.dairyco.org.uk](http://www.dairyco.org.uk) 2013

#### Extract E: British milk from British cows

Milk is the single largest part of the UK agricultural sector by value of output. Almost all the milk in the UK is purchased by just six major processors who then sell on to a market dominated by five or six large supermarket chains. UK dairy farmers complain that while they have to act competitively as price takers, there is a combination of some degree of monopsony power and oligopoly standing between the farms and the public. They claim that dairy processors have too much power when they buy milk from the farms and, in turn, the market for the processors' output is dominated by the buyers working for large, powerful supermarkets, which then sell to the public as oligopolists.

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The supermarkets argue that British producers are in a weak position because alternative sources of cheap milk are available for import. The farmers claim that this argument is unsustainable because, if they were forced into bankruptcy, consumers would have no alternative but to buy imported milk which would no longer be offered at low prices.

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In 2013, there were concerns about complicated supply chains across Europe resulting in a lack of traceability in meat products, leading to problems such as supermarket beef burgers containing horse meat. If more dairy farms go out of business, similar problems might occur with milk. 15

Sources: news reports and government information, 2013

### Extract F: The EU milk market

Over recent decades, the governments of most industrialised countries have intervened in their agricultural markets to offer support through subsidies and other measures. In Europe, agriculture employs less than 5% of the workforce, while agricultural intervention has traditionally taken about 50% of the EU budget. 1

Aimed at limiting state spending on the dairy sector, controlling milk production, and stabilising both milk prices and producer incomes, the EU introduced a milk quota system in 1984 as part of the Common Agricultural Policy (CAP). Milk quotas place a limit on the amount of milk that a farmer can sell every year without paying a 'levy' or penalty to the EU. The CAP has forced dairy farmers to work below capacity and even to dump milk, damaging the EU's reputation for economic efficiency. 5 10

The EU plans to end milk quotas in 2015 and wants agriculture to be less influenced by government intervention and more responsive to market forces. As quotas are removed, farms might be expected to become fewer, larger and more intensive. In Spain, for example, the industry has been allowed three times as much milk output since 1993, while the number of dairy farms has fallen drastically and productivity has risen. Meanwhile, like the UK government, the Spanish government has intervened to try to negotiate new pricing contracts between farmers, food processors and retailers. There is always a risk that government intervention in such negotiations in any market can adversely affect efficiency. 15

Sources: news reports and government information, 2012

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Using the table in **Extract D**, calculate to **two** decimal places the increase in annual productivity (tonnes of output per dairy cow) when 2013 is compared with 2007, **and** identify **one** significant feature of the data shown in the graph.

[5 marks]

0 5

Explain the distinction between 'monopsony power' and 'oligopoly' (**Extract E**, line 5) **and** analyse how the market power of supermarkets can affect the profitability of dairy farms.

[10 marks]

0 6

In recent years, the EU has decided that the agricultural sector must become 'more responsive to market forces' (**Extract F**, line 12).

Using the data and your economic knowledge, discuss whether UK farming would benefit from greater responsiveness to market forces and less intervention by the UK government and the EU.

[25 marks]

Turn over ►

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**Section B**

Answer **one** essay from this section.

Each essay carries 40 marks.

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**Either****Essay 1**

Small, independent coffee shops face competition from large multinational companies with well-promoted brands. In the High Street of a major British city, one such independent business advertises in the following way:

‘Cappuccino or Pot of Tea: £1.19 before 12 noon; £1.39 during lunch time (12–2.30 pm); and only 99p after 2.30 pm.’

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 Explain how such a pricing strategy is influenced by price elasticities of demand, revenues and costs.

**[15 marks]**

0	8
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 Economists sometimes analyse small and large businesses through a ‘structure, conduct, performance model’ and consider such issues as a ‘divorce’ of ownership from control.

Discuss ways in which the size of firms and the structure of the coffee-shop market might affect the conduct **and** performance of the firms within it.

**[25 marks]**

**or**

**Essay 2**

Thirty years ago the computer market was dominated by one huge monopoly called IBM (International Business Machines). Today, most people have never even heard of IBM. Newer companies such as Microsoft, Apple and Google have grown rapidly to become very competitive giants.

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 Explain the main sources of monopoly power.

**[15 marks]**

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 Evaluate the view that competition policy is never necessary because, in the long run, market forces will ensure that monopolies cannot abuse their power and will not last.

**[25 marks]**

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or

### Essay 3

The UK government is considering building a high-speed train line (known as HS2) linking London with cities in the north. It is claimed that HS2 will enable significant reductions in journey times for passengers and goods.

- |   |   |
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 Explain the likely short-run and long-run effects of investment in infrastructure projects such as HS2 on both labour **and** product markets in the UK. **[15 marks]**
- |   |   |
|---|---|
| 1 | 2 |
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 Assess how useful a cost-benefit analysis (CBA) would be in helping to decide whether a project, such as a high-speed train line, should go ahead. **[25 marks]**

**END OF QUESTIONS**

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