



General Certificate of Education  
Advanced Level Examination  
June 2015

## Economics

## ECON3

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

Thursday 11 June 2015 1.30 pm to 3.30 pm

**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**.

**Section A**

Answer **either** Context 1 **or** Context 2.

**Total for this Context: 40 marks**

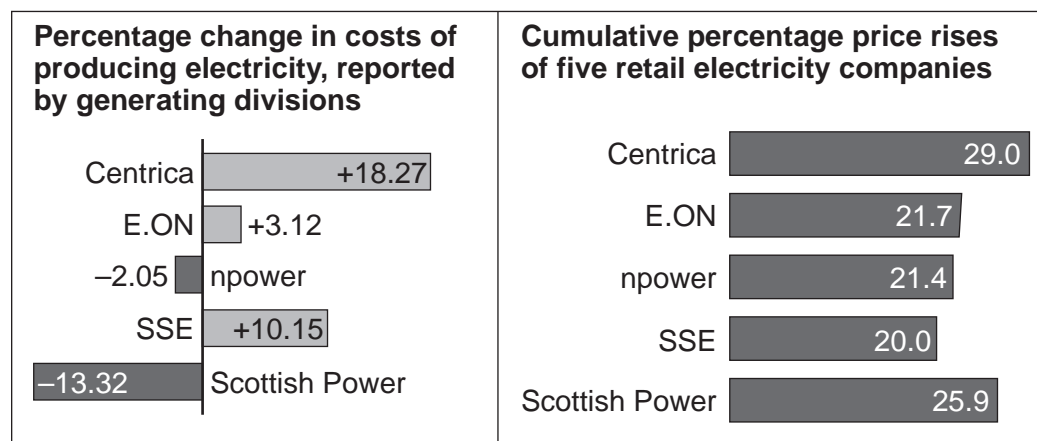
**Either**

**Context 1**

**THE GLOBAL CONTEXT**

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

**Extract A: Percentage changes in electricity costs and prices, UK, 2010–12**



Source: Greenpeace, 2013

**Extract B: The Big Six**

The UK electricity industry used to be a nationalised state monopoly. In the 1980s, a process of privatisation of utilities began with the stated aims of increasing competition, efficiency and investment. Now, in theory, competing generating companies produce electricity and sell it wholesale to competing supply companies to sell retail to final customers. In practice, the markets have become dominated by six large-scale multinationals (the Big Six). There are about ten smaller firms which are mainly involved on the retail side but some have generating capacity, such as wind farms.	1 5
There is evidence that, while the wholesale costs of generating electricity differ quite considerably, retail prices charged to customers all end up being very similar. Critics say that the market is not working efficiently for various reasons, including insufficient separation between generating and selling electricity. The main concern of the regulator, Ofgem, has been to promote consumer choice. It has therefore encouraged consumers to consider switching suppliers. Prime Minister, David Cameron, has suggested that customers should shop around as they would when buying groceries from supermarkets. The generators are now charging prices which have given profit margins of between 8 and 32 per cent, while the retailing divisions have profit margins of 5 or 6 per cent.	10 15

For comparison, supermarkets can operate on profit margins as low as 2 or 3 per cent. The electricity companies claim that they have to make high profits in order to invest. Critics argue that supermarkets also have to invest, and are more genuinely competitive.

In 1997, the Labour Government announced a one-off windfall tax on the privatised utilities, which took a percentage of their supernormal profits (also referred to as 'abnormal' or 'excess' profits). This was done to put right the bad deal customers and taxpayers were alleged to have got from privatisation. In 2013, when Leader of the Opposition, Ed Miliband, announced a possible future government policy of freezing energy prices for 20 months, the companies claimed this would hit investment in much needed new generating capacity.

Source News reports, 2013

### Extract C: Some international trends

Some of the costs facing firms in the electricity market are domestic, such as, the charges levied by the companies who own the transmission cables. However, many input costs are determined internationally, including coal, gas and even labour costs. For example, npower, which is owned by a German company, recently announced plans to cut 1400 office and call centre jobs (about 15% of its UK workforce) as part of a major re-structuring, outsourcing them to India. While reducing labour costs this way, it increased prices by 10.4 per cent.

The costs of producing electricity could go down if the UK adopts fracking, a process widely used in the USA. Fracking involves the use of chemicals to extract oil and gas from rocks deep underground. In the USA, electricity prices have fallen as a result of the production of shale gas using this controversial process. Would there be a similar reduction in electricity prices in the UK? Some economists predict that this will not be the case. American shale gas is sold within the USA, whereas, without government intervention, UK gas is more likely to be exported via pipelines to generators on the Continent, to take advantage of high prices there.

Critics of the Big Six might argue that electricity companies should not have been privatised as they can never behave or perform like supermarkets. They claim that this is due to differences between the two industries, such as the type of product sold, entry barriers, minimum efficient scale, company objectives, effects of technological change and international factors.

Source: News reports, 2013

0 1

Using **Extract A**, identify **two** significant points of comparison between the changes in electricity costs and prices between 2010 and 2012.

[5 marks]

0 2

Explain what is meant by 'supernormal profits' (**Extract B**, line 21) and analyse the likely effects on an electricity company of a one-off windfall tax that would take a percentage of its supernormal profits.

[10 marks]

0 3

'Critics of the Big Six might argue that electricity companies should not have been privatised as they can never behave or perform like supermarkets.'  
(**Extract C**, lines 15–16).

Using the data and your knowledge of economics, assess the arguments for and against the UK electricity industry being brought back into public ownership.

[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: Housing tenure in England, as a percentage of households, for selected years**

Housing tenure	2000	2010	2020*
Owner occupied, with a mortgage being repaid	43	35	29
Owner occupied, owned outright (no mortgage)	27	33	34
Social rented (from a council or housing association)	20	18	17
Private rented	10	14	20

**Source:** Official statistics, 2014

\* The figures for 2020 are projected from current trends

**Extract E: Housing tenure and externalities**

Most Spaniards and Estonians live in flats, while most people in the UK and Ireland live in semi-detached houses. Housing markets are made up of different sectors or ‘tenures’ which describe the legal basis under which houses are occupied. Most of the population of the EU live in owner-occupied houses. Social housing is built or funded by the public sector and, in the past, the UK has been almost unique in Europe in providing such houses mainly through local councils. In France, this is done by not-for-profit organisations, similar to UK housing associations. About two-thirds of tenants across the EU pay a market price rent, while the rest receive some form of subsidy. In the UK, the concept of social housing has become complicated by the large number of private landlords whose tenants are receiving welfare benefits. While the UK government has moved away from rent controls, it has attempted to influence rents indirectly by capping housing benefits for low income tenants.	1 5 10
While housing has many of the characteristics of a merit good, externalities from housing can be positive or negative. Bad housing is often associated with crime, ill-health and other problems, and the opposite is true of good housing. Tenure can also be linked to externalities, for example, if poorly designed social housing, such as an inner-city block of flats, is compared with high-quality private housing in a prosperous area. Much depends on the quality of the build, the surrounding social conditions and the economic infrastructure.	15

Source: News reports, 2014

**Extract F: Housing and inequality**

The EU Commission has said: ‘Decent housing at an affordable price in a safe environment is a fundamental need and right. Ensuring this need is met, which is likely to alleviate poverty and social exclusion, is still a significant challenge in a number of European countries.’ Housing inequality can result in part from income inequality and can, in turn, help cause wealth inequality. Most houses are bought using mortgages which are issued by banks and building societies on the basis of income. The UK’s ‘Right to Buy’ policy, dating from the 1980s, makes a one-off redistribution of wealth from the state to low income families when tenants buy their council houses at a subsidised price. Regional and international differences enable some house owners to convert their housing assets into other forms of wealth. For example, someone who sells a former council house they have owned for 30 years in south-east England might release enough profit to be able to purchase a similar house in north-west England, or even two houses in Bulgaria, while still having cash left over.	1 5 10
In most EU countries, ‘austerity’ pressures on public finances can be expected to cause a further withdrawal by government from a direct role in housing. The financial crash of 2007 was made worse in Europe by excessive property speculation, particularly in the UK, Ireland and Spain. In future, many young British people will have to adopt the German tradition of renting rather than buying, unless they eventually inherit a house from their parents. This has major implications for many aspects of the economy, including the mobility of labour and the distribution of wealth. Moreover, in 2013, a government ‘Help to Buy’ scheme, intended to assist first-time buyers with their deposits, has also subsidised would-be landlords buying property to rent out. Yet the UK remains short of social housing and affordable private housing.	15 20

Source: News reports, 2014

**0 4**

In 2010, there were 6.91 million households in England who lived in rented accommodation.

Using **Extract D**, calculate to the nearest half million, the total number of households in England in 2010, **and** identify **one** significant point of comparison between the different housing tenures over the period shown.

**[5 marks]****0 5**

Explain what is meant by the term ‘externalities’ (**Extract E**, line 12) **and** analyse how housing can create **both** positive **and** negative externalities.

**[10 marks]****0 6**

‘In future, many young British people will have to adopt the German tradition of renting rather than buying, unless they eventually inherit a house from their parents. This has major implications for many aspects of the economy, including the mobility of labour and the distribution of wealth.’ (**Extract F**, lines 17–20)

Should government intervene in the UK housing market, for example using subsidies, or leave the provision of housing to market forces? Using the data and your knowledge of economics, justify your answer.

**[25 marks]****Turn over for Section B****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**

**0 | 7**

'The internet has benefited small firms and has helped to make some markets more competitive.'

Explain why this might be the case.

**[15 marks]**

**0 | 8**

Critically assess the proposition that perfect competition will always result in an efficient allocation of resources, no matter what good or service is being produced and consumed.

**[25 marks]**

**or**

**Essay 2**

**0 | 9**

Explain how the determination of prices and output by oligopolists is affected not only by the reactions of their customers, but also by their interdependence with other producers.

**[15 marks]**

**1 | 0**

The European Commission prevents mobile phone networks from colluding on 'roaming charges' when consumers travel around Europe. Meanwhile, the EU has forced mobile phone manufacturers to cooperate in making a single design of phone charger.

Evaluate the view that governments should never intervene to influence how oligopolists collude or cooperate on such issues as fixing prices, varying output, conducting research, developing products, or carrying out any other aspect of their business.

**[25 marks]**

**or**

**Essay 3**

**1 | 1**

'Nurses, who benefit society, earn comparatively little, while some bankers, whose work may cause harm, can earn millions. This is not fair.'

How does economic theory explain such differentials in pay?

**[15 marks]**

**1 | 2**

'Government should be concerned about incentives and disincentives to work. They should not be concerned with fairness in the treatment of various income groups.'

Assess the case for and against governments intervening in labour markets to achieve a fairer distribution of income.

**[25 marks]**

**END OF QUESTIONS**

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