General Certificate of Education
January 2004
Advanced Level Examination

ECONOMICS ECN5
Unit 5 Business Economics and the Distribution of Income

Thursday 29 January 2004 Afternoon Session

In addition to this paper you will require: an 8-page answer book. You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- Mark allocations are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between different aspects of Economics.
- You will be assessed on your ability to use an appropriate form and style of writing, to organise relevant information clearly and coherently, and to use specialist vocabulary where appropriate. The degree of legibility of your handwriting and the level of accuracy of your spelling, punctuation and grammar will also be taken into account.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

SECTION A

Answer **all** parts of this question.

1 **Total for this question:** ***50 marks***

Study **Extracts A, B, C and D**, and then answer **all** parts of Question 1 which follows.

The following extracts relate to the US Justice Department's prosecution of Microsoft for alleged abuse of its monopoly power in the American personal computer software market. This includes the market for personal computer operating systems, in which Microsoft's Windows operating system is the market leader.

Extract A: Nominal and real prices of Microsoft's Windows operating system, 1990–1999, United States dollars

Extract A was a table entitled "Nominal and real prices of Microsoft's Windows operating system, 1990–1999, US dollars", adapted from *Trust on Trial* by RICHARD B MCKENZIE (Perseus Publishing) 2001.

Extract B: Microsoft is a monopoly

Extract B was an extract of text entitled "Microsoft is a monopoly", adapted from *Trust on Trial* by RICHARD B MCKENZIE (Perseus Publishing) 2001.

Extract C: Microsoft is not a monopoly

Professor Richard Schmalensee, a leading authority on competition and monopoly, argues that in the market for personal computer (PC) operating systems, where Microsoft supplies nearly the entire market, the company has no monopoly power. Neither its share of the market nor its enormous profit margins, he says, are sufficient to show that the firm is doing what economics textbooks say monopolies do: namely, maximise profits by charging a price that is higher than would exist in a perfectly competitive market. Professor Schmalensee has calculated that Microsoft's profit-maximising price for the Windows operating system would be between $900 and $2 000 if it were a true monopoly. But since Microsoft charges a much lower price for its operating system, Professor Schmalensee concludes that Microsoft cannot be exercising monopoly power.

Source: adapted from *The Economist*, 28 January 1999

Extract D: Microsoft's pricing policy, allocative efficiency and resource allocation

Question 1

(a) For the period 1990 to 1999, compare the changes in the nominal price and the real price of Microsoft's Windows operating system for personal computers that are shown in **Extract A**. *(4 marks)*

(b) **Extract C** (lines 5-6) states that monopolies "maximise profits by charging a price that is higher than would exist in a perfectly competitive market". With the use of a diagram, explain the price charged **and** the level of output produced by a profit-maximising monopolist. *(6 marks)*

(c) **Extract D** (lines 3-4) states that "when prices exceed marginal costs, economic inefficiency and resource misallocation occur". Analyse how the price set by a monopolist may affect economic efficiency **and** resource allocation. *(10 marks)*

(d) Using the data and your economic knowledge, evaluate the view that, in all cases, a government should break up monopolies and replace them with a number of smaller competitive firms. *(30 marks)*

SECTION B

Answer **one** question from this Section.

Each question carries 50 marks.

2 (a) Explain the economic reasons for privatisation. *(20 marks)*

(b) Do you agree that certain economic activities, such as producing electricity from nuclear energy, and running railways and air traffic control, should be undertaken by the state rather than by private sector companies? Justify your answer. *(30 marks)*

3 (a) Explain why markets may fail to provide public goods **and** under-provide merit goods. *(20 marks)*

(b) Critically evaluate the view that government provision of public goods and merit goods will always eliminate market failure. *(30 marks)*

4 (a) Explain why the distribution of income in the United Kingdom is unequal. *(20 marks)*

(b) Assess the economic benefits **and** costs of government intervention which aims to make the distribution of income considerably more equal. *(30 marks)*

END OF QUESTIONS

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