General Certificate of Education January 2008 Advanced Level Examination



ECONOMICS ECN5 Unit 5 Business Economics and the Distribution of Income

Tuesday 29 January 2008 9.00 am to 10.30 am

For this paper you must have:

• 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.
- The marks for questions are shown in brackets.
- 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, to organise information clearly and to use specialist vocabulary where appropriate.

Advice

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

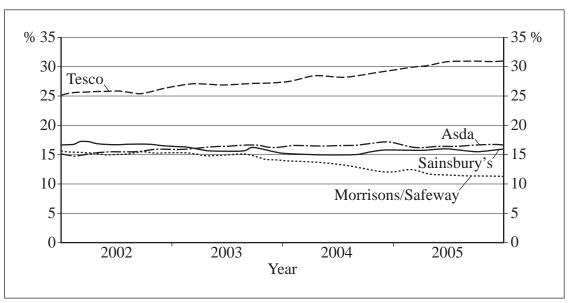
SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

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

Extract A: The UK grocery market: market shares of the four largest UK supermarkets



Source: The Grocery Market: The OFT's reasons for making a reference to the Competition Commission,
Office of Fair Trading, May 2006

Extract B: How supermarkets are harming communities

Food retailing has undergone a massive shift in the past forty years. The loss of independent butchers, bakers, grocers and pharmacies from the high street has punctured the heart of many local communities, and food retailing is now dominated by the 'big four' supermarket chains. The influential *All Party Parliamentary Shops Report* (2006) says that by 2015 there will be no independent convenience stores, grocers or newsagents left.

Shopping in the high street is much more than a consumer experience; it binds people and communities together. Furthermore, money spent in a supermarket is channelled to directors, shareholders and management staff living in other parts of the country, rather than boosting the local economy. A study by the *New Economics Foundation* found that £10, if spent in a local independent shop, generates £25 for the local economy, compared with only £14 if spent in a supermarket.

Supermarkets argue that they bring jobs to a community. However, a *British Retail Planning Forum* study found that, rather than creating jobs, every time a large supermarket opens, on average 276 jobs are lost within a 15km radius of the new store (through closure of smaller stores and associated services).

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Extract C: Supermarket pricing policies

Are supermarkets really so cheap? In 2000, the Competition Commission found that supermarkets were putting prices up in areas where there was no strong competition. Key items such as bread and milk are certainly cheaper in supermarkets. But they are sold at prices set below average cost. However, not all products are so cheap. A simple comparison of fresh produce shows you can often get it cheaper at a local independent store. 5

Source: adapted from Supermarkets or corporate bullies?, Friends of the Earth, 2003

1

Extract D: The competition authorities have been taken over by the superstores

The domination of the UK supermarket industry by companies such as Tesco and

Asda results from government and regulatory failure. For many years, competition policy has interpreted the public interest as the 'consumer interest', which it has defined in very narrow terms. Regulators such as the Office of Fair Trading (OFT) look at price, but not at issues such as employment, local investment, diversity, social 5 networks, environmental impact or even competition in the wider sense. As long as the superstores are deemed to be competing among themselves, there is no need for other kinds of shops to survive. Over the years, the UK competition authorities have decided that the way in which the superstores use market power against their suppliers to extract special concessions 10 is 'beneficial to competition and to the consumer'. The OFT announced, to the amazement of the businesses that supply the big supermarket firms, that it was 'unable to identify any particular case which amounted to an abuse of buying power or other anti-competitive practice'. In the mid-1990s, after discovering that the superstores were engaged in predatory pricing (setting prices at a level to force competitors out of the 15 market), the OFT decided to take no action. The regulators' refusal to acknowledge any wider public interest made thousands of small shops, farmers and food processors go out of business.

Source: adapted from an article by George Monbiot, The Guardian, 14 March 2006

Question 1

- (a) Using **Extract A**, compare the changes in market shares in the UK grocery market over the period 2002 to 2005. (4 marks)
- (b) '... £10, if spent in a local independent shop, generates £25 for the local economy, compared with only £14 if spent in a supermarket' (**Extract B**, lines 11–12).

Explain this statement. (6 marks)

- (c) Analyse possible reasons why items such as bread and milk are often sold at cheaper prices by supermarket chains than by local independent stores (Extract C, line 3).

 (10 marks)
- (d) In relation to large supermarkets, **Extract D** (lines 12–14) states that the OFT was "unable to identify any particular case which amounted to an abuse of buying power or other anti-competitive practice".

Using the data and your economic knowledge, evaluate the view that the largest supermarket firms in the UK should be free to operate without any government interference.

(30 marks)

SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

- 2 (a) Explain how technological change can affect a firm's costs of production **and** its methods of production. (20 marks)
 - (b) Some firms, such as Amazon, Google, Microsoft and Apple, currently operate in markets undergoing rapid technological change.
 - Evaluate whether technological change leads to more competitive or more monopolistic markets. (30 marks)
- 3 (a) Explain how the wage rate is determined in a competitive labour market. (20 marks)
 - (b) 'The movement of workers from eastern Europe into the UK has plugged gaps in labour markets and improved UK economic performance.'
 - Assess the effects of such a movement of workers upon wage rates, levels of employment **and** the competitiveness of labour markets. (30 marks)
- 4 In the summer of 2006, several UK water companies imposed hosepipe bans which restricted the amount of water that households could consume.
 - (a) Explain the costs **and** benefits that might result from new infrastructure projects, such as the building of new reservoirs in areas suffering from water shortages. (20 marks)
 - (b) Evaluate the view that shortages in markets, such as those for water and health care, can best be prevented by the operation of market forces rather than by government intervention in markets.

 (30 marks)

END OF QUESTIONS

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