

General Certificate of Education
June 2006
Advanced Level Examination



ECONOMICS **ECN5**
Unit 5 Business Economics and the Distribution of Income

Monday 26 June 2006 1.30 pm to 3.00 pm

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 are reminded of the need for good English and clear presentation in your answers. All questions should be answered in continuous prose. Quality of Written Communication will be assessed in all answers.

Advice

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

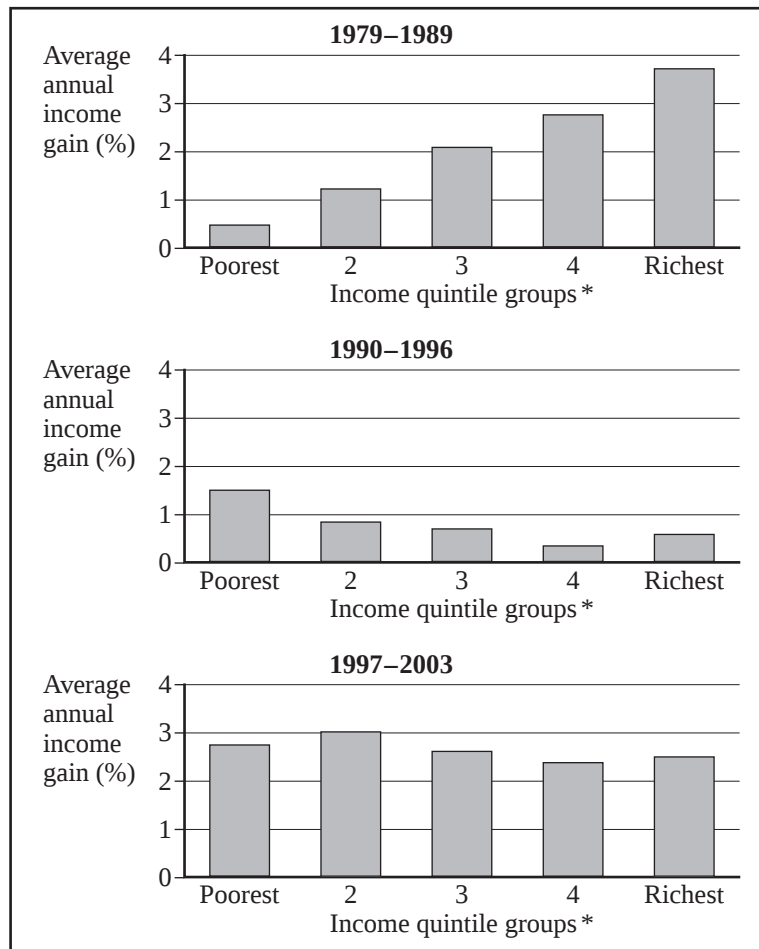
SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

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

Extract A: Real income growth of UK household groups, 1979-2003



* Extract A divides households into five equal-sized groups known as quintile groups. The bottom quintile group consists of the poorest 20 per cent of households and the top quintile group consists of the richest 20 per cent of households.

Source: adapted from BREWER, GOODMAN ET AL, *Poverty and inequality in Britain*, The Institute for Fiscal Studies, March 2004

Extract B: Changes in income inequality

- 1 In the 1980s, growing income inequality was partly caused by changes taking place in labour markets. A growing gap emerged between the fortunes of those who had jobs and those who did not. In the 1990s, falling unemployment and labour inactivity rates caused the growth in income inequality to slow. Since 1992, employment
- 5 growth in a continuously growing UK economy has halted the increase in the number of workless households.

- 10 Tax and benefit policy has also had an effect, increasing inequality in the 1980s, but halting its growth in the late 1990s. In the 1980s, reductions in top rates of income tax, increases in indirect taxes and the freezing of a number of welfare benefits, all contributed to rising inequality. The redistributive policies of Labour governments since the late 1990s have had the opposite effect, slowing what would otherwise have been a much bigger growth in income inequality.

Source: adapted from GOODMAN and OLDFIELD, *Permanent differences? Income and expenditure inequality in the 1990s and 2000s*, The Institute for Fiscal Studies, June 2004

Extract C: Rich nations wary about taking more from the wealthy

- 1 The UK government is reluctant to increase income tax rates for high earners because this would buck an international trend. Governments in most of the world's industrialised countries have cut their top tax rates because of worries about the disincentives they create.
- 5 High marginal income tax rates affect people's work effort, and this can reduce the total amount of tax people pay. But not everyone accepts that higher marginal tax rates reduce work incentives for high earners. Recent US tax cuts have so far reduced, rather than increased, the share of tax revenues from high earners.
- 10 Supporters of higher taxes argue that high earners have done exceptionally well from the tax system over recent decades. The income of the UK's top 1 per cent has grown much faster than that of other groups, and the group's share of national income now stands at a level not seen since the 1950s. The 500 000 people in this group have incomes, after tax, of more than £82 000 a year.

Source: adapted from an article by VANESSA HOULDER in the *Financial Times*, 21 January 2005

Question 1

- (a) Using **Extract A**, briefly compare the real income growth of the poorest and richest households for the periods 1979–1989 and 1997–2003. (4 marks)
- (b) Explain why changes in unemployment and labour inactivity rates caused the growth of income inequality in the UK to slow in the 1990s. (6 marks)
- (c) 'High marginal income tax rates affect people's work effort, and this can reduce the total amount of tax people pay' (**Extract C**, lines 5 and 6). Analyse how an increase in income tax rates can affect total tax revenue. (10 marks)
- (d) Using the data and your economic knowledge, evaluate the view that the benefits resulting from a more equal distribution of income exceed the costs. (30 marks)

SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

- 2 (a) With the use of examples, explain the various ways in which a business may grow in size. (20 marks)
- (b) Evaluate the view that the economic advantages resulting from the growth of firms always exceed the disadvantages. (30 marks)
- 3 (a) Explain the functions of profit in an economy. (20 marks)
- (b) The Office of Water Regulation (OFWAT) regulates the prices charged by companies in the water industry. Do you think that prices charged by all firms in an economy should be regulated by government agencies? Justify your answer. (30 marks)
- 4 (a) Explain the various causes of environmental market failure. (20 marks)
- (b) 'Intervention by the state to correct an environmental market failure inevitably leads to government failure.' Evaluate this view. (30 marks)

END OF QUESTIONS