

General Certificate of Education  
June 2005  
Advanced Level Examination



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

Monday 27 June 2005 Morning 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**.

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**SECTION A**

Answer **all** parts of this question.

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1

**Total for this question: 50 marks**

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

*Extracts A and B have been adapted from an article published before Concorde flew its first commercial flight in 1976. The UK and French governments had already spent over £1065 million on Concorde's research and development costs. At the time the article was written, airlines operated as a cartel, jointly fixing the price of tickets. Extract C was written just after Concorde flew its last commercial flight in 2003. By 2003, air routes and air fares had largely been deregulated.*

**Extract A: The costs and benefits of Concorde**

Costs	Benefits
1. Research and development costs	1. Export contribution and import saving
2. Production costs	2. Technological benefits for the UK economy
3. Alternative use of the scientists and engineers employed in the Concorde programme	3. Consumer surplus enjoyed by Concorde passengers over and above the consumer surplus enjoyed on other aircraft
4. Excess of Concorde's take-off and landing noise over aircraft Concorde replaced	4. Producer surplus of UK airlines operating Concorde over and above the producer surplus obtained from other aircraft
5. Atmospheric pollution	5. Provision of employment

Source: adapted from P K WOOLLEY, *The Open University Case studies: Concorde* (The Open University) 1974

**Extract B: The demand for flights on Concorde**

Long-haul passenger air transport is a service with no close substitute and, because of the time savings it offers, supersonic air travel provided by Concorde is a market segment clearly differentiated from subsonic travel. The time saving will both generate new traffic on any route on which it is introduced and cause a transfer of demand for subsonic air travel.	1
The extent of this transfer will depend on the fares charged for Concorde relative to those for subsonic flight, and whether the value that potential passengers place on time saved on any route exceeds or falls short of the fare differential. The demand for Concorde flights is likely to be more price elastic than that for long-haul air flights in general.	5
It is impossible to estimate the demand for Concorde, without considering the role and reactions of airlines considering buying Concorde. On each air route, the airlines are colluding oligopolists. Uniform prices are agreed and fixed, and restrictions are imposed on various forms of non-price competition such as meals and in-flight entertainment.	10

Source: adapted from P K WOOLLEY, *The Open University Case studies: Concorde* (The Open University) 1974

**Extract C: Concorde's last commercial flight**

Concorde has had its last commercial flight. What the market was looking for was a lumbering workhorse that could satisfy the urge of the post-war consumer generation for travel and tourism. Concorde was not this. When Concorde first flew, estimates of the costs of the project were too low and projections of possible orders were far too high. 1

The falling price of air travel means that the demand is for flying buses which are cramped and uncomfortable, but cheap. Put simply, given the choice, between 40 trips across the Atlantic at £200 per trip or one round trip on Concorde at £8000, most of us plump for the former. The British and French governments tried to second-guess the market and got it wrong, which is why only 14 Concorde, as opposed to wild estimates of 300, entered service. 5

Once the governments had written off the colossal development costs of Concorde, it was possible to make a profit on Concorde by charging fares that put the plane beyond the pockets of most members of the public. As a result, Concorde became “an aircraft used by wealthy people on expense accounts, whose fares were subsidised by much poorer taxpayers”. 10

But the cost of safety upgrades, and the threat of terrorism causing a fall in passenger numbers, mean that this option is no longer available. For Concorde to continue flying, it has to make a profit, unless we are prepared to accept that the family travelling economy class to Malaga should subsidise for a second time the business person swallowing champagne at 57 000 feet. 15

*Source:* adapted from LARRY ELLIOTT, *The Guardian*, 27 October 2003.  
(Copyright Guardian Newspapers Limited 2003)

*Question 1*

- (a) Using **Extract A**, identify **one** external cost and **one** external benefit resulting from the development and introduction of Concorde, **and** briefly explain why each is an external cost or benefit. (4 marks)
- (b) Explain why the demand for Concorde flights was thought to be “more price elastic than that for long-haul air flights in general” (**Extract B**, lines 7 and 8). (6 marks)
- (c) Shortly after the information in **Extract B** was published, and before most governments deregulated routes, individual airlines began to break collusive agreements they had made with other airlines.

Analyse why an airline might wish to break the collusive agreement described in lines 9–12 of **Extract B**. (10 marks)

- (d) Before investing in the development of Concorde, the United Kingdom government decided against undertaking a cost benefit analysis of the project.

Using the data and your economic knowledge, evaluate the case **for** and **against** a government undertaking cost benefit analysis of projects such as Concorde. (30 marks)

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**SECTION B**

Answer **one** question from this Section.

Each question carries 50 marks.

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- 2 (a) Explain why economists usually regard monopoly as an undesirable form of market structure. (20 marks)
- (b) Evaluate policies a government might use to reduce the problems caused by monopoly. (30 marks)
- 3 The following table shows an index of average costs per car for a manufacturing company producing different numbers of cars per year.

Output of cars per year	Index of average costs per car
100 000	100
250 000	83
500 000	74
1 000 000	70
2 000 000	66

Source: G RHYS (ed. B ATKINSON) *The Motor Industry: an economic overview, Developments in Economics, Volume 15* (Pearson Education) 1999

- (a) Draw a long run average cost curve on a diagram to illustrate the information in the table, **and** then explain the shape of the long run average cost curve. (20 marks)
- (b) Evaluate the view that the government should give financial assistance to firms producing cars in the UK to increase their competitiveness. (30 marks)
- 4 “Workers in pleasant occupations, such as ‘soap celebrities’, often receive high pay, while those in disagreeable occupations, such as road sweepers, are among the most lowly paid.”
- (a) How does economic theory explain such differences in pay? (20 marks)
- (b) Assess the case **for** and **against** the government intervening to raise the disposable income of workers on low pay. (30 marks)

**END OF QUESTIONS**

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