

General Certificate of Education
June 2006
Advanced Extension Award



ECONOMICS

6841

Thursday 29 June 2006 9.00 am to 12 noon

For this paper you must have:

- a 16-page answer book

You may use a calculator.

Time allowed: 3 hours

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 6841.
- Answer **all** parts of Question 1 from Section A, **one** question from Section B and **one** question from Section C.
- **At the very start of the examination**, detach page 5 by tearing along the perforations.

Information

- The maximum mark for this paper is 160.
- The marks for questions are shown in brackets.
- Section A carries 50% of the total marks for the paper. Sections B and C each carry 25% of the total marks for the paper.
- 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 90 minutes on Section A, 45 minutes on Section B and 45 minutes on Section C.

SECTION A: Interpreting Economic Data

Study the data on pages 2–4 and then answer **all** parts of Question 1 which follows on page 5.

Total for this question: 80 marks

1 PRICES, VALUE AND CHOICE**Extract A: The marginal revenue and marginal cost pricing rule**

- | | |
|---|---|
| 1 | Profit maximisation requires a firm to produce the level of output at which marginal revenue equals the marginal cost of production, and to set the price accordingly. However, few firms use this rule when choosing levels of output and setting prices. Many firms prefer instead to use a cost-plus pricing rule in which price is set equal to |
| 5 | unit production costs plus a profit margin or mark-up. |

Extract B: Marginalism in economic theory

- | | |
|----|---|
| 1 | More than 200 years ago, Adam Smith asked why water, which is essential to life, costs little, but diamonds, which are useless compared to water, are expensive. Although Adam Smith could not solve the paradox, the solution lies in the distinction between total welfare (or total utility) and marginal welfare (or marginal utility). The |
| 5 | total welfare we get from water is enormous. But remember, the more we consume of something, the smaller the marginal welfare yielded by the last unit consumed. We use so much water that marginal welfare, the benefit we get from one more glass of water, diminishes to a tiny value. Diamonds, on the other hand, contribute less to total welfare than water. But, because we buy few diamonds, the marginal welfare they |
| 10 | yield is high. |
| | Marginal analysis is a fundamental idea that permeates economics. The core of the idea is that people act as if they make incremental choices – choices at the <i>margin</i> . They decide whether to do a little bit more or a little bit less of an activity. In doing so, they compare the cost of a little bit more of the activity against the benefit they |
| 15 | will get from it. |

Source: adapted from PARKIN, POWELL and MATTHEWS, *Economics*, Pearson Education Ltd, 3rd Edition, 1997

Extract C: Why firms charge different prices to different customers

- 1 Charging different prices to different customers is potentially profitable, so businesses have found many ways to do it. Theatres often charge children and students less than adults. Supermarkets charge a lower price to people who bother to cut out and collect coupons from newspapers. Some companies, such as firms selling alcoholic drinks, produce similar products but try to promote one as a prestige brand with a much higher price. Many bars sell alcoholic drinks at higher prices most of the time, but at lower prices in a 'happy hour' early in the evening.

- 10 The ideal way of charging different prices, from a firm's point of view, is to charge each buyer the maximum that the buyer is willing to pay. In the example below, if a firm could do this, it could charge the first buyer £6.01, the second buyer £5.51, etc. In this case the marginal revenue curve becomes identical with the demand curve. The firm captures the entire consumer surplus and substantially increases profits.

Output	Marginal cost	Marginal benefit to buyers
1	£4.00	£6.01
2	£4.00	£5.51
3	£4.00	£5.01
4	£4.00	£4.51
5	£4.00	£4.01
6	£4.00	£3.51

Extract D: Charging for the use of the internet

- 1 On the internet, charging different prices for accessing different services might mean one price for e-mail traffic, and higher prices for telephone calls and for accessing music and films. However, there is a case for not charging different prices. Internet capacity is abundant and the marginal cost of supply is zero or close to zero.
- 5 Customers should be charged solely for accessing the internet. They should not be charged for using the services the internet provides. Yet many of the telecom companies that control the wires connecting consumers to the internet want to charge different prices for the different services provided.

Source: adapted from an article in *The Economist*, 21 October 2004

Extract E: Charging motorists for road congestion

Extract E was text adapted from a newspaper article.
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Extract F: The central London congestion charge, October 2005

Extract F was a list of figures adapted from a website.
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Question 1

- (a) 'Profit maximisation requires a firm to produce the level of output at which marginal revenue equals the marginal cost of production, and to set the price accordingly' (**Extract A**, lines 1–2).
- (i) Explain why a firm may decide **not** to use the $MR = MC$ rule when choosing levels of output and setting prices. (10 marks)
- (ii) Outline **one other** example of the use of marginalist principles in economic decision-making. (10 marks)
- (b) If a firm charges a different price to each consumer, it 'captures the entire consumer surplus and substantially increases profits' (**Extract C**, line 12).
- Assess the significance of this statement from the point of view of both firms **and** consumers. (20 marks)
- (c) Charging lower prices for alcoholic drinks in a 'happy hour' (**Extract C**, line 7) is a form of price discrimination.
- Discuss the economic case **for** and **against** the government banning 'happy hours'. (20 marks)
- (d) Using the data and your economic knowledge, discuss the case for providing goods and services, such as water, the internet and roads, free at the point of use. (20 marks)

See page 7 for Questions 2–5

Turn over ►

There are no questions printed on this page

SECTION B: Markets and Market Failure

Answer **EITHER** Question 2 **OR** Question 3 from this section.

- 2 In 2005, the United Kingdom government was urged to provide significant financial assistance to try to ensure the survival of the Rover car company in the UK.

Discuss the case **for** and **against** a government intervening in the market economy to support manufacturing industries or firms. *(40 marks)*

- 3 Plumbdown District Council is proposing to change the way in which refuse collection is financed in its area. Instead of being paid for out of local taxation, it is proposing to charge separately for the service. Households wanting to have their rubbish collected will have to pay an annual fee to a private waste collection company. A 25 per cent discount will be available to households which separate paper, plastics, glass and garden rubbish from general household waste. Households which do not pay the charge will have to find alternative ways of disposing of their rubbish.

Evaluate the case **for** and **against** this proposal. *(40 marks)*

SECTION C: The National and International Economy

Answer **EITHER** Question 4 **OR** Question 5 from this section.

- 4 In the light of the UK economy's recent economic performance, discuss the case **for** and **against** using fiscal policy as well as monetary policy to manage the level of aggregate demand. *(40 marks)*

- 5 In recent years, the United Kingdom's current account deficit on the balance of payments has reached record levels, but the current account has not generally been regarded as an important problem for UK economic policy makers.

Discuss whether current account imbalances pose serious problems, both for individual countries **and** for the global economy. *(40 marks)*

END OF QUESTIONS

There are no questions printed on this page

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