



Rewarding Learning

ADVANCED
General Certificate of Education
2011

Economics

Assessment Unit A2 1

Business Economics

[AE211]

FRIDAY 20 MAY, MORNING



TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **Question 1** and **one** question from **Questions 2, 3 or 4**.

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.

Quality of written communication will be assessed in all questions **except 1(a)**.

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks allocated for each part question in allocating the available examination time.

Question 1

These articles were written in March 2010.

Please read them carefully and answer the questions which follow.

Case Study: Car manufacturers struggle in economic downturn

Source 1: New car sales fall

UK new car sales 2008–2009 (10 largest manufacturers)

Make	2008		2009	
	Sales	Market share %	Sales	Market share %
Ford	322 514	15.1	316 369	15.9
Vauxhall	298 912	14.0	237 840	11.9
Volkswagen	179 189	8.4	161 137	8.1
Peugeot	118 701	5.6	102 574	5.1
BMW	113 132	5.3	98 683	5.0
Toyota	105 717	5.0	102 612	5.1
Audi	100 845	4.7	91 172	4.6
Honda	83 805	3.9	74 819	3.8
Citroen	81 237	3.8	72 450	3.6
Nissan	66 336	3.1	77 924	3.9

© Society of Motor Manufacturers and Traders

Fig. 1

The British car industry has recorded its worst year in decades after sales of new cars slumped. According to a spokesman for the Society of Motor Manufacturers and Traders (SMMT), sales of new cars fell “as consumers decided against making big ticket purchases”. He added: “Sharply deteriorating car sales is a further clear sign that households and firms are increasingly cutting back on their spending. The economic recession and consequent tightening of credit conditions have made buying a new car more difficult. Furthermore, the sharp increases in fuel prices have left drivers looking to alternative forms of transport.”

The luxury car segment has been hardest hit with sales of new luxury cars falling by 65% over the year while sales of the smallest, most fuel efficient cars, have fallen least. “The scrappage scheme has helped to arrest the decline in sales of cars in the super mini class but has done very little for those in the luxury segment,” said the SMMT spokesman.

This slump in demand for new cars has led to a wave of promotional offers from car manufacturers as they try to shift stock. Toyota, for example, has cut £3,815 off the price of an Avensis, bringing the cost of a 1.8 litre petrol model down to £13,545. But even these deals are not enough to persuade buyers into the showroom.

However, dealers have reported a huge surge in demand for second hand cars. The National Franchised Dealer Association said its members were reporting a 20% sales increase compared to a year ago. "This shows that people are really pulling their horns in," said Rhys, former professor at Cardiff Business School and one of Britain's leading authorities on the motor industry. "Cars are so well built nowadays that second hand models are merely vehicles with a very long delivery mileage."

Source 2: Fiat plans merger with Opel and Chrysler to create car industry giant

The Italian car maker Fiat is seeking to merge its car division with Opel and ailing US car firm Chrysler to create an automotive giant second only to Japan's Toyota in terms of production. Fiat's chief executive, Sergio Marchionne, will meet German government ministers today to discuss a bid for the German car maker Opel, part of General Motors Europe. Fiat said that the combined company would have an annual revenue of €80 bn (£71 bn). Marchionne described the plan as "an incredibly simple solution to a very thorny problem". He told the *Financial Times*: "From an engineering and industrial point of view, this is a marriage made in heaven".

Marchionne has said Fiat needed a partner to reach an output level of 5.5 million to 6 million units a year, the scale he believes necessary to survive the car industry crisis. "This merger is an extraordinary opportunity for us to reach a scale of production which would allow us to compete internationally."

Source 3: Government extends car scrappage scheme

Lord Mandelson, the Business Secretary, has announced that the government is extending a popular car scrappage scheme. He said the scheme would now cover 400 000 vehicles, more than the 300 000 originally planned.

The car scrappage scheme was introduced in May 2009 and allows anyone owning a car that is more than 10 years old to receive a £2,000 subsidy (half from government and half from the manufacturer) if they buy a new model. The idea is that this will remove an old inefficient car from the roads, reducing the overall carbon footprint of our rolling stock of cars. In principle this could be a sound idea, with most modern cars being far more fuel efficient than their older counterparts, and producing far less toxic emissions.

However, some people are opposed to the scrappage scheme on environmental grounds. One environmentalist stated that “the scrappage scheme is not the environmentally friendly policy it is dressed up to be. Scrapping cars will lead to additional waste going to landfill sites. When calculating the environmental impact of this scheme the government seems to have ignored the carbon cost of building a new car, which is equivalent to driving 50 000 miles.”

Others are opposed to the scheme on more philosophical grounds. One free market economist stated that “the scheme was no more than an attempt by the government to protect its vested interests in the car industry. Government intervention to support failing car firms is a waste of taxpayer money and does nothing but hinder the efficient reallocation of resources through the market mechanism. Surely the government could have found a better use for the £400 million this scheme costs.”

However, a government spokesman criticised these claims and stated that “the scrappage scheme is a cornerstone of the government’s recession-busting policy framework and has saved tens of thousands of jobs while helping us to meet our commitments to cutting carbon emissions”.

- (a) Using the information in **Fig. 1**, compare the five firm concentration ratio in the UK car industry in 2009 with that of 2008. [5]
- (b) Source 1 states that the luxury car segment has been hardest hit by the economic downturn. Explain why this might be the case. [10]
- (c) Examine the likely consequences for Fiat of a merger with Opel and Chrysler. [10]
- (d) Evaluate the view that “government intervention to support failing car firms is a waste of taxpayer money and does nothing but hinder the efficient reallocation of resources through the market mechanism”. [15]

Essays:

Answer **one** question from **Questions 2, 3 or 4.**

2 “UK spends £20 bn on advertising”

(a) Explain the difference between price and non-price competition. [15]

(b) Critically examine the view that advertising should be restricted not least because it is wasteful and distorts markets. [25]

3 “Profit is not the only motive!”

(a) Explain how the price and output of a profit maximising firm would be determined in the short run. [15]

(b) Critically examine the assumption that firms will always aim to maximise profits. [25]

4 “OFT to investigate UK grocery market as industry becomes more concentrated”

(a) With the aid of appropriate examples, explain the main features of oligopoly. [15]

(b) Critically examine the view that the increased concentration of the UK supermarket industry would ultimately hurt the interests of consumers. [25]

THIS IS THE END OF THE QUESTION PAPER

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