

375/01

ECONOMICS EC5

A.M. WEDNESDAY, 14 June 2006

(1 hour 30 minutes)

ADDITIONAL MATERIALS

In addition to this examination paper, you will need a 12 page answer book.

INSTRUCTIONS TO CANDIDATES

Read the information in the case study carefully then answer the following questions.

Answer the questions in the separate answer book provided.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question.

You are reminded of the necessity for good written communication and orderly presentation in your answers.

Study the following information and then answer the questions which follow.

Article 1 - Motor Industry Submission to the House of Commons 2004

In 2004 the Motor Industry Association, representing UK businesses in car manufacturing and retail trades, sent a report to the House of Commons Select Committee on Transport, outlining its views on the state of the UK motor industry.

Figure 1 – UK car sales 1980-2003

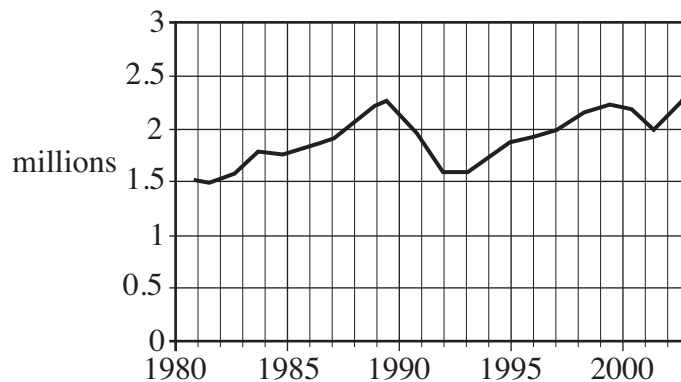


Figure 2 – Real income and motoring cost 1994-2003

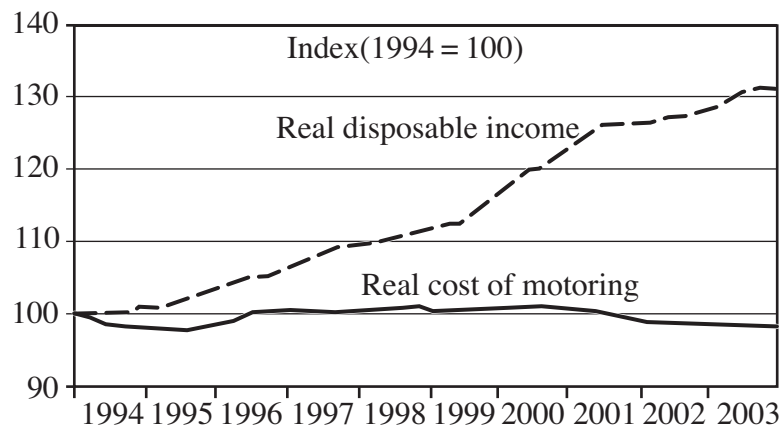


Figure 3 – Economic forecasts and world trade

	<u>Percentage changes on a year earlier unless otherwise stated</u>				
	2003	Forecast			
		2004	2005	2006	2007
<i>Major 7 countries¹</i>					
Real GDP	2¼	3½	3	2¾	2¾
Consumer price inflation	1½	3	2¼	1¾	1¾
<i>Euro area</i>					
Real GDP	½	2	2	2¼	2¼
World trade in good and services	5	9½	8½	7¾	7¼
UK export markets	3¾	8¾	8	7¼	6¾

¹ G7:US, Japan, Germany, France, UK, Italy and Canada.

- 5 The story of the modern UK automotive sector is a remarkable one - unique in Europe - of a sector which has fully embraced the challenges and opportunities of globalisation (the increasing volume of international trade in cars and car parts) and not only survived, but thrived. At vehicle manufacture and larger component level the industry is based almost entirely on inward investment by foreign owned manufacturers such as Ford, General Motors, Toyota, Nissan, Honda and BMW.



15 The UK car industry has two distinct parts; manufacture of vehicles and components (parts such as batteries, tyres and gearboxes) and the 'motor trade' (sales, service and after sales services) each having their own characteristics. Manufacturing is subject to global demand issues, whilst the motor trade exists to satisfy UK consumer needs.

20 The UK car manufacturing sector has been subject to increasing globalisation. Altogether eight companies manufacture cars in volume in the UK, together with many of the world's major component manufacturers. No other European country has anything like this number or range of car manufacturers. The UK exports some 68% of its vehicle production, whilst UK consumers are also global in their buying habits; over 80% of new cars bought in the UK are imported. Supply chains for car parts have also become much more multinational, so that the volume of car parts made in the UK has declined but the volume of parts exported has increased.

25 The degree of globalisation brings risks as well as opportunities, and the UK has suffered more than its fair share of rationalisation and much-publicised closures, but overall the picture is one of remarkable resilience, based on continuous development and openness to world markets.

30 UK car firms are leaders in global best practice in many areas of manufacturing. The UK car industry as a whole needs to make up ground in terms of productivity but the productivity record of the best firms here show that UK based operations can match and exceed the best of their rivals. Typical recent improvements have been in the region of a 30% reduction in costs and corresponding improvements in quality and delivery. Overall, the future looks bright for the UK car industry despite its many problems.

UK Car Manufacturing

The global car manufacturing industry

The car manufacturing industry is dominated by a few huge firms, which operate on a global basis. Six global groups account for over 80 per cent of world car production. Large multi-national firms increasingly dominate the component sector, with a global presence to match that of the manufacturers. The industry suffers from global over-supply, leading to fierce competition.

UK car manufacturers

Around 243,000 people work in some 3,200 car and component businesses. The sector contributes around £8.5bn value added to the UK economy, and accounts for 1.1% of GDP, 6.2% of manufacturing value added and 9.5% of total UK exports of goods. The UK produces around 3% of global vehicle output (9% of European output) ranking 4th in Europe behind Germany, France and Spain, and 9th globally.

The UK provides a manufacturing base for BMW (Mini, Rolls Royce), Ford (including Jaguar, Land Rover and Aston Martin), Honda, Nissan, Peugeot, Toyota, and GM (Vauxhall) as well as a range of smaller producers serving specialist markets such as sports and luxury cars, and London taxis. After declining in recent years production is increasing at most of the major UK producers, driven by good export demand in Europe, US, and many other markets. Decisions on future products are mostly taken abroad by foreign-owned multinational parent companies.

UK car production peaked in 1972 at just over 1.9 million cars, but a steady decline set in and within 10 years production had more than halved to under 900,000 units. However, growth has again returned with new investments at carmakers around the country. In 2003, over 1.65 million cars were produced in the UK. Of these over 1.1 million were exported to a variety of markets. This is in stark contrast to the industry of 40 years ago, when most cars sold in the UK were designed and built in the UK, specifically for the UK market.

UK Car Components

Major global businesses dominate the UK car components sector, together with a large number of small to medium sized companies. Over 2500 companies are active in the sector, contributing over £4.7bn added value and employing about 148,000 people. The component sector exported £7.6bn worth of goods in 2002, three quarters of this destined for Europe, and over £1billion-worth to the Americas. UK engine manufacturing output is rising, and represents substantial net exports.

The UK Motor Trade sector

The 'motor trade' includes new vehicle sales through new car dealers, traders in used vehicles, vehicle maintenance, servicing and repair, and aftermarket sales of spare parts. Around 544,000 people are recorded as employed in the motor trades in some 65,000 businesses, contributing over £20bn to the UK economy and accounting for 1.9% of GDP.

The mood is upbeat for new vehicle sales in a strong market, with 2003 car sales at a new record level in excess of 2.5 million units. Vehicle manufacturers and retailers are price-cutting to maintain market shares, and this has undoubtedly helped drive sales to their current level. The used car market is also strong, with second-hand prices holding well.

Profit margins on vehicle sales are very low with dealers achieving a return on capital of around 2% (only slightly up on 1.4%) in 2002. After-sales profits are under pressure due to longer intervals between services required for new cars, price competition, rising labour costs and stricter environmental regulations. These could force some dealers out of the market, although the main impact could be additional red tape and cost.

Article 2 – Business to keep up fuel pressure



Hauliers say UK fuel taxes are out of line with the rest of Europe

Business groups are to keep up the pressure on the government over fuel taxes as a series of low-key protests about rising fuel prices got underway.

They want the UK to follow the lead of France, Austria and Poland which are either cutting fuel excise duties or have announced rebates for key industries.

80
85 The average cost of unleaded petrol is now 4.6% higher than three weeks ago, while diesel prices have risen 2.5%. The average price of a litre of unleaded petrol rose to 96.05p on 13 September.

Chancellor Gordon Brown has ruled out cutting duty on fuel. Speaking on Tuesday, Mr Brown said rising oil prices were a global phenomenon which required global solutions - including increased output by oil-producing countries and added investment in new refineries.

90 The Institute of Directors and The Forum of Private Business have been among groups calling for a cut in fuel duty which they say now accounts for 65% of the cost of a litre of diesel. One leading haulage company said fuel prices had risen 20% this year and fuel duties in the UK were out of line with the rest of Europe, leaving British firms at a disadvantage.

95 “We are now in a situation where many haulage companies are struggling because of increased competition and a slowdown in the economy,” said Ian Baxter, managing director of RH Freight. “Many smaller businesses are likely to go bust unless the Chancellor reduces duty very soon.”

It emerged on Tuesday that Virgin boss Sir Richard Branson could commit £55m to building a new oil refinery, potentially in the UK. Sir Richard - whose Virgin Atlantic airline has been hit by rising fuel costs - is forming a new company to pursue the project and said he had held informal discussions with British Airways about the idea.

Adapted from BBC News September 14 2005

Figure 4 – Petrol prices and taxes

Fuel taxes as % of price

1996	76.1
1997	77.1
1998	81.5
1999	81.4
2000	75.1
2001	75.3
2002	76.6
2003	75.3
2004	73.2
2005	67.0

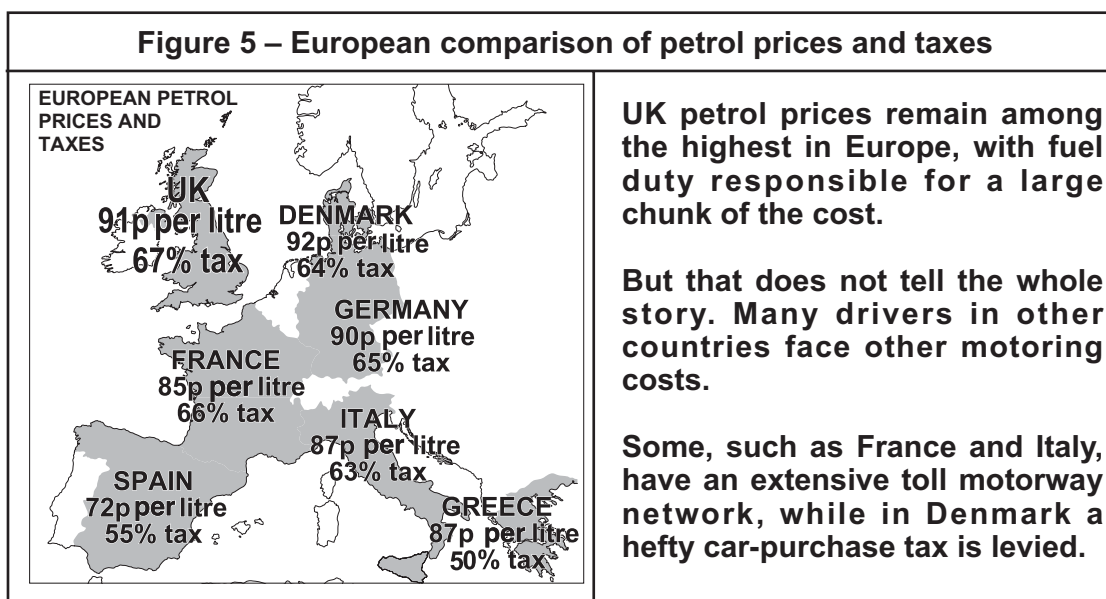
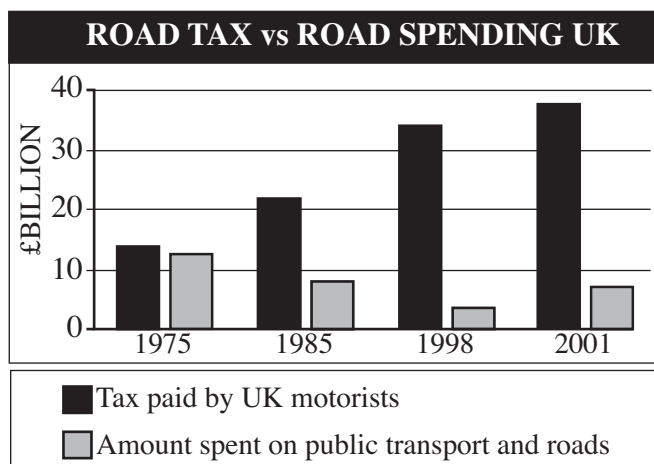


Figure 6 – Road taxes and road spending



The chart compares the tax paid by UK motorists with the amount spent on public transport and roads by the government.

Since 1975, revenue from VAT, fuel duty and road tax has jumped by almost £24bn, yet spending on transport has dropped by almost £5.5bn.

From BBC News 14 September 2005

- (a) To what extent has the globalisation of the car industry been good for car manufacturers and the motor trade in the UK? [20]
- (b) Discuss the statement that ‘the future looks bright for the UK car industry’. (Article 1 Line 31) [20]
- (c) With the aid of the data, discuss the view that the Government should reduce fuel taxes. [20]