wjec cbac

GCE A level

1134/01

S16-1134-01

ECONOMICS – EC4

P.M. THURSDAY, 23 June 2016

2 hours

1134 010001

ADDITIONAL MATERIALS

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

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Answer **one** question from Section A.

You are advised to spend no more than 1 hour and 15 minutes on Section A.

Answer **one** question from Section B.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question. Section A has 40 marks and Section B has 20 marks.

You are reminded that assessment will take into account the quality of written communication used in answers that involve extended writing (Section B).

You are reminded that the essay questions in Section B are synoptic and so will test understanding of the connections between the different elements of the subject.

SECTION A

Answer **one** *question from this section.*

1. Study the information below and then answer the questions that follow.

THE BIG SIX – ARE THEY PLAYING FAIR?

Just six companies supply 92% of the UK's commercial and residential energy market – the so-called 'Big Six'. Before deregulation and privatisation took effect in December 1990, these firms were regionally based, but today location is not important, and anyone anywhere in the UK can be supplied by any of these companies. When I boil the kettle I am using electricity bought from an energy supplier. The supplier, often one of the 'Big Six', will have bought the electricity on the wholesale market or alternatively directly from a generating company. This energy passes through the National Grid before reaching my kettle. A similar system applies to gas.

Figure 1

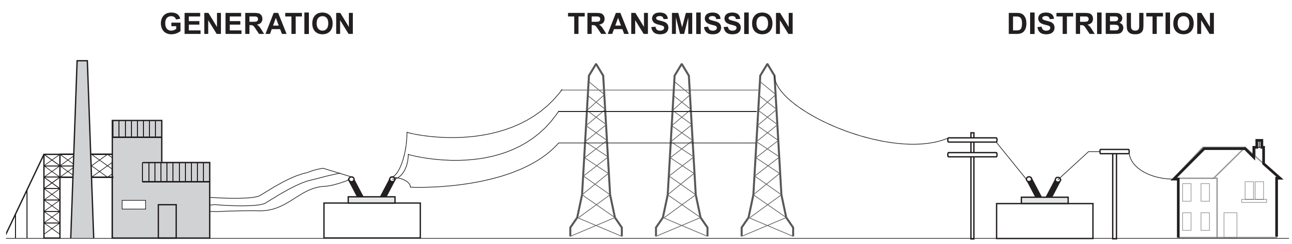

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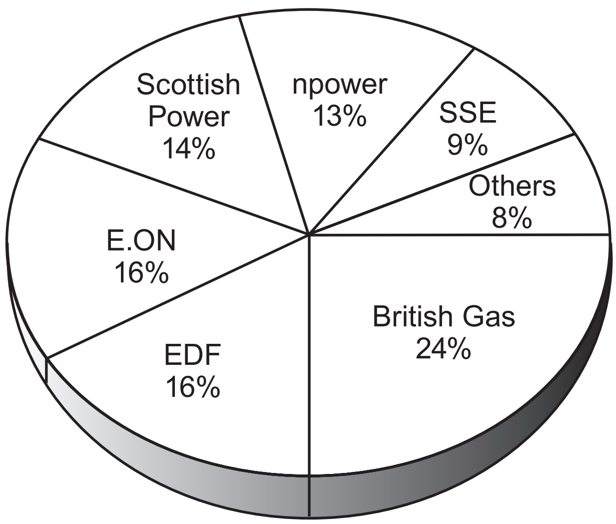
Figure 2

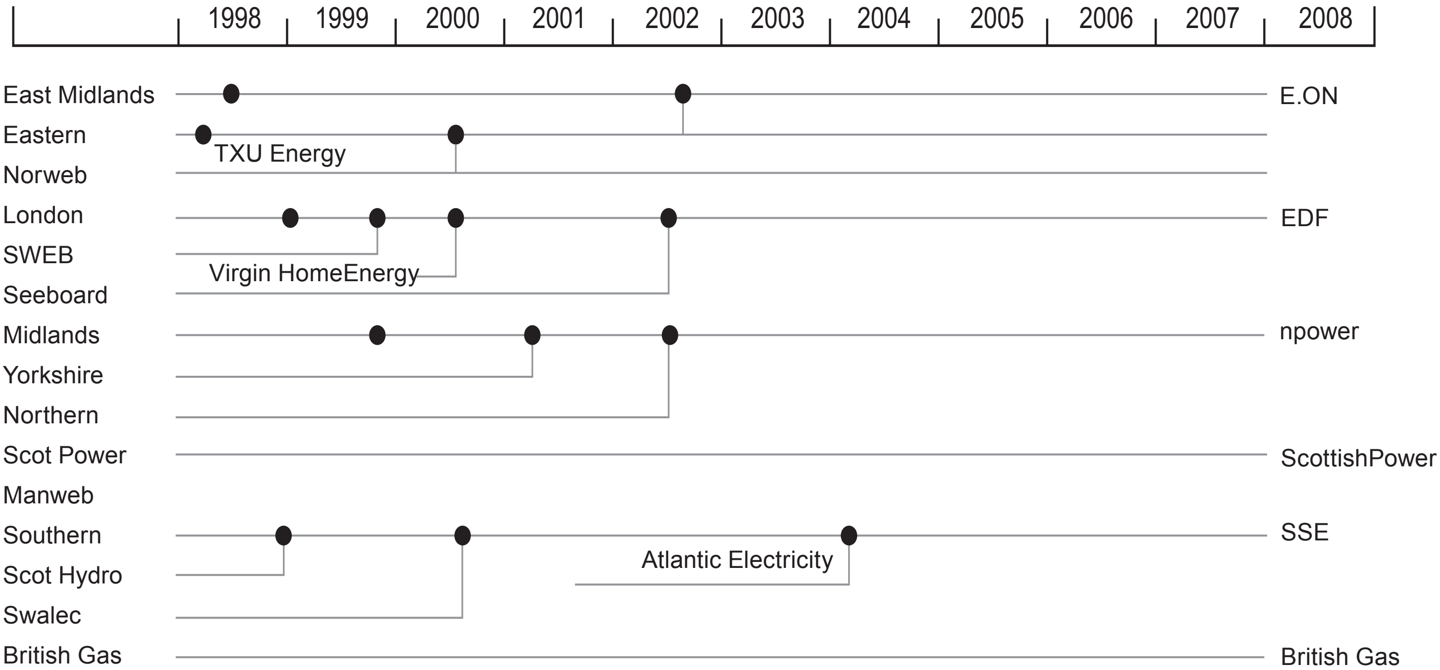
Market shares of UK energy firms



The current market for the supply of Britain's gas and electricity has been in place for about a decade. The previous Labour government continued on the path begun by Margaret Thatcher, who privatised British Gas and regional monopolies for supply and distribution. It took until the late 1990s for competition among these companies to be introduced. Price controls were gradually removed by Ofgem, the regulator. By 2002, when the last controls were removed, Britain had perhaps the most liberal energy market in Europe. The 14 regional monopolies became five companies and together with British Gas, the market leader, became known as the ‘Big Six’ as shown in Figure 3 below.

Figure 3

Mergers of the UK energy suppliers



Source: Ofgem

In recent years the ‘Big Six’ energy suppliers have also been buying generating firms in the electricity sector and now their generation businesses are responsible for about 70 per cent of all electricity generated in the UK. This ‘vertical integration’ gives the firms efficiencies, but it also means that it is impossible for outsiders to know whether retail prices fairly reflect wholesale costs.

As there are no longer retail price controls on gas or electricity, concern has been expressed by consumer groups that the ‘Big Six’ energy suppliers have often raised their prices at the same time or at least followed one another. Consumer watchdog Consumer Futures and the regulator Ofgem have had doubts as to whether there is a genuinely competitive market in energy, although energy suppliers say that 85% of their costs are beyond their control such as the wholesale price of gas and the environmental and green taxes imposed on them by the government. The worry is that gas and electricity are necessities for households and businesses and that open transparent competition is in the consumers’ interests. These concerns led in June 2014 to Ofgem announcing that it was referring the UK energy market to the Competition and Markets Authority (formerly the Competition Commission) for a market investigation. Having considered responses to a consultation, Ofgem felt that there were reasonable grounds for suspecting that features of the UK energy market were preventing, restricting or distorting competition.

Sadly for consumers, the ‘Big Six’ are under little competitive pressure from new entrants. Since the market opened to competition, 16 companies have entered. Seven of these remain, supplying a total of 5 per cent of UK households, but no new company has been able to gain a major foothold in the market. Being in a powerful position prior to deregulation seems to be a big advantage and the 'follow my leader' pricing behaviour of the 'Big Six' also suggests they have few concerns about smaller, newer companies taking customers from them.

Nevertheless, after the giant energy companies' latest round of above inflation price rises hundreds of thousands of customers did turn to the new small independent energy suppliers. In November 2013 alone 600,000 householders switched away from the 'Big Six'. Small players in the market with ambitions to grow much bigger are First Utility with 500,000 customers and Ovo Electricity with 340,000. Independent suppliers are able to offer attractive deals to customers because as new entrants they are exempt from the government's green taxes saving customers about £70 a year.

Energy prices have long been high up the list of economic issues voters care about. They have become more politically important after the Labour Party leader Ed Miliband used a party conference speech to pledge that, if elected in 2015, he would freeze energy prices for 20 months. He said he would use this period to increase competition in the sector. Ultimately, the British retail energy market is based on the idea of consumer pressure i.e. competition + consumer choice = a good deal for everyone. The coalition government is introducing legislation which it says will ensure consumers are put on the "lowest price" automatically. In addition, consumers are urged to "shop around" to exert pressure on energy suppliers.

However, it is hard for consumers to figure out the best deal. There are about 900 different tariffs, a number that suggests an overwhelming complexity for the average consumer, according to consumer watchdog Which? Research from the consumer group suggests that only a small minority of people can select the cheapest tariffs from the information typically provided by energy suppliers. Standard tariffs may sound the cheapest but often they are not. Studies from the Centre for Competition Policy and Ofgem suggest that, even when consumers switch suppliers, 20-40 per cent of consumers do not actually end up with a cheaper deal. 60 per cent of consumers have never switched supplier and 30 per cent said they have, but would not do so again. In the final analysis perhaps the best solution is to bring the energy market back into state ownership and re-nationalise it.

Source: The real Big Six – the problems with Britain's energy market
John McDermott Oct 21 2013 Financial Times blog (adapted)

(a) Using the data explain how the 'Big Six' energy companies may have benefitted from horizontal integration and vertical integration. [8]

(b) With reference to the data explain why the conditions in the UK energy market favour the formation of a cartel. [8]

(c) Assess the extent to which the UK energy market is **'contestable'**. [12]

(d) Evaluate price and non-pricing strategies that the energy suppliers might use to increase their profitability. [12]

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2. Study the information below and then answer the questions that follow.

BURMA – BACK ON THE ROAD?

The economy of Burma, now officially called Myanmar, is growing at 7.8% in 2014 and open for business. That's the message the reformist government of President Thein Sein is sending out, and it has got an overwhelmingly positive response from investors. But behind the impressive headline figures of planned ventures and promised aid, who is actually doing well in Myanmar? There have been some high-profile announcements – Nissan and Suzuki want to manufacture cars, Ford has opened a dealership, Coca-Cola already has a local bottling plant. But many foreign investors are waiting both for infrastructure to improve and for greater political certainty before jumping in – corruption is still rife and the companies best placed to profit from the new opportunities are the so-called cronies – those who built up their businesses through close co-operation with the old military regime which once controlled the country.

Figure 1

With a population of 60 million, a wealth of natural resources, including timber, oil and natural gas, Myanmar is one of the world's last untapped markets and there is a need for just about everything. And yet, while foreign direct investment has increased substantially since most sanctions were lifted last year, the amounts of real money arriving in the country are far smaller than Myanmar's needs and nowhere near the impressive numbers being talked about. There are a number of reasons for this caution, the most common of which offered by potential manufacturers is a lack of reliable energy supplies. What power there is comes from hydroelectric dams. A few months into the dry season, capacity drops sharply, resulting in frequent and long-lasting power cuts. Per capita power consumption is only one-sixth of that in Indonesia, and one-twentieth of Thailand's and over two-thirds of the country does not have access to electricity. Out at the Hlaingtharyar industrial zone, west of the largest city Yangon, garment manufacturing has expanded rapidly with some of the lowest wages in Asia. This is one area where foreign investment is coming in quickly, and creating jobs. However, poor power supply remains the biggest headache for firms.

The Myanmar Infrastructure Summit 2014 is designed to provide a platform for international firms and potential investors to gather in Yangon to help improve the country's inadequate infrastructure – roads, bridges, canals, railways, ports and communication facilities.

Smaller companies, though, are cashing in on booming demand for property, consumer goods and services. Wai Thit Lwin, a graduate from Berkeley in her 20s, juggles looking after her two young daughters, expanding a local chain of fifty convenience stores, and helping manage a company that operates hospitals, hotels, and markets brands such as Sony and LG in Myanmar. Everything she is involved in is growing fast, but she has concerns, in particular the inadequacy of Myanmar's banking system (local companies have to pay punishing interest rates for loans) and the threat of competition from the US convenience store giant 7-11.

Myanmar lacks sufficient entrepreneurs and a network of business executives. After fifty years of economic and political isolation the education system needs overhauling and talented exiles who left the country during military rule need to be enticed to come back.

The banking system is unsophisticated and needs to modernise with a restructuring of banking regulations a priority. Loans requiring no guarantees are impossible to obtain and there is a limit of 50% loans against the value of secured assets. Hence entrepreneurs with no assets will get nowhere unless they use hugely expensive loan sharks. There are few cash machines and only 5% of the population have a bank account. Most transactions are completed in cash and thus there is not enough deposited in the banking system to finance development projects.

On the positive side a noticeable improvement in consumer choice is the availability of mobile phones. Sim cards are now available, although still in limited numbers and for a much higher price than in neighbouring countries. Mobile providers Telenor and Ooredoo are aiming to get 97% network coverage over the coming years, but Myanmar has a difficult terrain to work with and inevitable problems posed by the rainy season. The growth of the mobile network and the internet will help to develop the banking system as well as boost economic development.

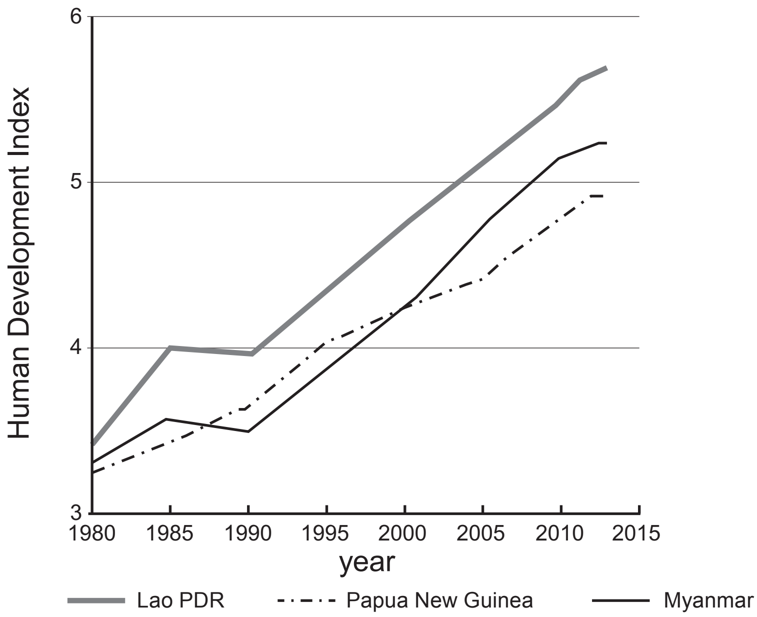
Figure 2

Myanmar's HDI indicators for 2013 relative to selected countries and groups

	HDI value	HDI rank	Life expectancy at birth	Expected years of schooling	Mean years of schooling	GNI per capita (PPP US$)
Myanmar	0.524	150	65.2	8.6	4.0	3 998
Cambodia	0.584	137	71.9	10.9	5.8	2 805
Lao People's Democratic Republic	0.569	139	68.3	10.2	4.6	4 351
Thailand	0.69	103	74.3	12.3	6.6	7 722
East Asia and the Pacific	0.703	–	74.0	12.5	7.4	10 499
Low HDI countries average	0.493	–	59.4	9.0	4.2	2 904

Figure 3

Trends in Myanmar, Papua New Guinea and Lao PDR's HDI 1980-2013



A few kilometres from downtown Yangon is south Dagon, designated an industrial zone back in the days of military rule. Part of it is given over to rows of small iron foundries, operating the most primitive technology. Sweat-grimed workers pull glowing strips of metal from open furnaces, and toss them expertly to others who catch them with tongs, and run them through clattering presses. One factory assembles small pick-up trucks with the workers welding them by hand. In the days of military rule, when car imports were tightly restricted, it was a good business. Now as cheap vehicle imports flood in, it is no longer a viable business.

As incomes rise Myanmar will become an expanding market for consumer goods and the shopping malls in Yangon are early evidence of the potential for foreign firms. However, outside Yangon there is evidence the majority of the population have yet to feel any material benefits from the reforms. Most people live in the countryside and are involved in farming and microfinance schemes have helped farmers (especially women) to buy seeds to grow the betel plant. Small loans of about $150 are repaid in instalments over a one year period.

Myanmar remains a very poor country and while economic progress has been made the country's aim to be at a similar stage of economic development as Thailand by 2025 seems to be rather ambitious. Myanmar is trying to attract more tourists and numbers are growing but with only 1 million visitors compared to Thailand's 24 million the gap in this area of economic activity alone shows just how far the country has to travel on the long road it has embarked on.

Source: BBC news website and Radio 4 World Business.

(a) Using the data briefly describe the current level of economic development in Myanmar. [8]

(b) Explain why Myanmar may be an attractive location for foreign direct investment. [8]

(c) To what extent is foreign direct investment likely to be beneficial for Myanmar? [12]

(d) How likely is Myanmar to be 'at a similar stage of economic development as Thailand by 2025'? (line 64) [12]

SECTION B

Answer **one** *question from this section.*

3. 'Supply-side policies offer the best strategy for a government seeking to reduce unemployment.' Discuss. [20]

4. To what extent is economic growth desirable? [20]

5. 'The principle of comparative advantage means that no country can ever justify using protectionist policies.' Discuss. [20]

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