

**OXFORD CAMBRIDGE AND RSA EXAMINATIONS
AS GCE**

F581/01

ECONOMICS

Markets in Action

TUESDAY 13 MAY 2014: Morning

**DURATION: 1 hour 30 minutes
plus your additional time allowance**

MODIFIED ENLARGED

Candidate forename		Candidate surname	
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Centre number						Candidate number				
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Candidates answer on the Question Paper.

OCR SUPPLIED MATERIALS:

None

OTHER MATERIALS REQUIRED:

Calculators may be used

A CALCULATOR MAY BE USED FOR THIS PAPER
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READ INSTRUCTIONS OVERLEAF

INSTRUCTIONS TO CANDIDATES

Write your name, centre number and candidate number in the boxes on the first page. Please write clearly and in capital letters.

Use black ink. HB pencil may be used for graphs and diagrams only.

Answer ALL the questions.

Read each question carefully. Make sure you know what you have to do before starting your answer.

Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets [] at the end of each question or part question.

The total number of marks for this paper is 60.

The quality of your written communication will be taken into account in the marking of your answer to the question labelled with an asterisk (*).

Any blank pages are indicated.

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Airfix – A UK firm making model kits in a competitive market

Airfix is a firm supplying plastic model kits of planes, vehicles and ships to customers who make and paint them. Its main customer type has changed significantly over the years. It has had to adapt to this in the most effective way. This has led the firm to consider very carefully the opportunity cost of its production choices. Fig. 1 below, for example, illustrates how the age profile of its customers has changed.

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FIG. 1 – PERCENTAGE OF SALES

	Aged 16 and under	Aged over 16
1972	77%	23%
2012	18%	82%

This change in demand for model kits has been caused by an increase in the number of substitutes available to those ‘aged 16 and under’ such as computer-based games and social media. However, the Airfix brand has also become more attractive to those ‘aged over 16’ as a result of advertising and television programmes, such as James May’s ‘Toy Stories’, where the presenter built a full scale model of a World War 2 Spitfire plane. This resulted in a significant increase in the demand for Spitfire kits. During the 40-year period, 1972–2012, there have also been significant improvements in the quality of the products, due to technological innovations, which have strengthened the appeal of Airfix products to consumers ‘aged over 16’.

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The Marketing Director of Airfix has always taken a keen interest in how economic theory can be applied to the firm's model kits. He estimated that in the recent UK recession, despite average incomes falling by 10%, the demand for lower priced kits fell by only 2%. He also believes that the demand for these kits is price elastic. One reason for this is the growing number of other model kit manufacturers which operate in this market.

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Airfix has seen the cost of producing its kits reduce significantly as manufacturing has moved from the UK to China, and the production process has become more efficient due to advances in technology. Despite this, Airfix can only produce a limited number of different kits and, therefore, it has had to make choices over which planes and other models it will produce in any year.

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Increased production in China is creating a number of negative externalities including pollution. The Chinese government has been under pressure, both domestically and internationally, to reduce pollution. There are various policy measures available to the Chinese government to internalise the negative externalities and currently it is examining the likely impact of imposing a pollution tax. This could lead to Airfix increasing the price of its model kits.

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Airfix has remained a successful firm by responding to changes in demand and regularly examining its production techniques. It is using many forms of advertising, such as Facebook, YouTube and Twitter, as well as running its own website. The Airfix Club makes special offers to members and the firm has recently started an Airfix magazine.

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Answer ALL questions.

1 (a) Define the term ‘opportunity cost’.

[2]

(b) Explain how Airfix is influenced by opportunity cost when making production decisions.

[2]

2 State TWO factors of production.

1

2

[2]

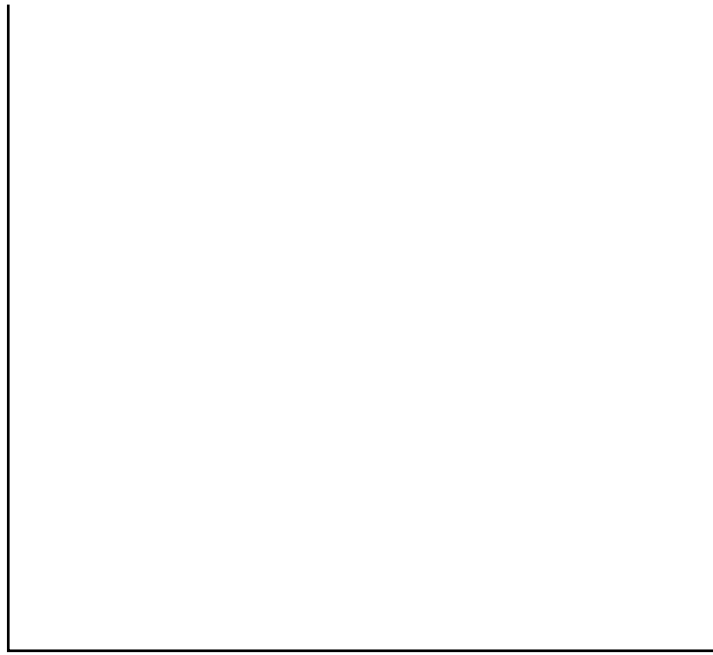
3 Explain ONE advantage and ONE disadvantage of specialisation to a firm such as Airfix.

Advantage _____

Disadvantage _____

[4]

- 4 (a) Using a diagram, show how the market price of model kits is determined.**



[3]

- (b) The success of the programme presented by James May and the move of production to China have each had an effect on the market equilibrium for Airfix Spitfire model kits.**

Using ONE demand and supply diagram, explain the likely impact of these changes on the market equilibrium.



[6]

(c) Other than a change in taste and fashion, state and explain how TWO determinants of demand might shift the demand curve for Airfix model kits.

1 _____

2 _____

[6]

5 (a) Given the Marketing Director's figures as to how the demand for Airfix's model kits was affected by the recession:

(i) calculate the income elasticity of demand for the lower priced model kits.

_____ **[2]**

(ii) explain what the value you have calculated in part 5(a)(i) indicates to Airfix.

_____ **[3]**

(b) The Marketing Director believes that the demand for low priced model kits is ‘price elastic’.

Comment on how a knowledge of price elasticity of demand would be helpful when making business decisions.

[6]

[illegible]

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(b)* Discuss whether indirect taxation is the most effective policy measure to correct the market failure arising from the negative externalities of production. [18]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

END OF QUESTION PAPER

ADDITIONAL ANSWER SPACE

If additional answer space is required, you should use the following lined page(s). The question number(s) must be clearly shown in the margins.

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