



GCE A level

1134/01

ECONOMICS – EC4

P.M. THURSDAY, 23 June 2011

2 hours

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.

Big bus groups lash out at OFT competition referral

Britain's biggest transport groups have warned that investment may be cut and new laws undermined by the Office of Fair Trading's (OFT) decision to refer the £3.6bn bus market to the Competition Commission.

Figure 1 Local Bus journeys UK except London & N. Ireland 1996-2009

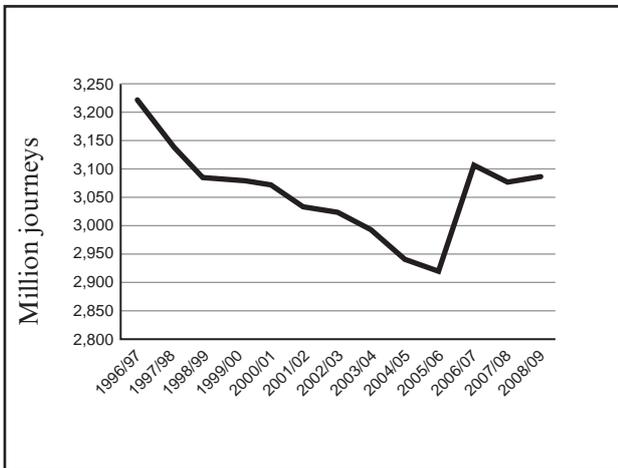


Figure 2 Private cars licensed in UK 1997-2008

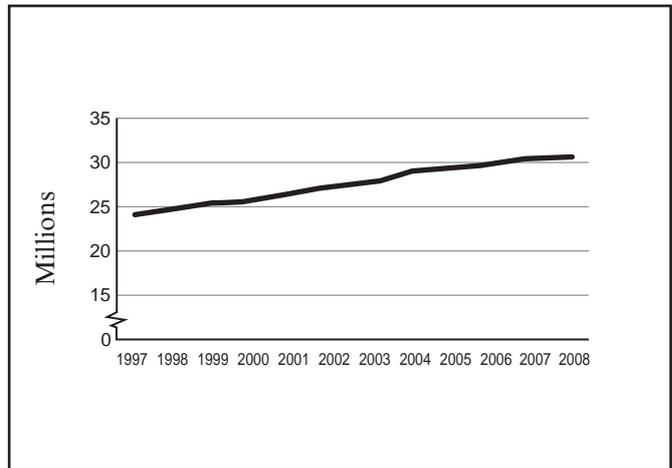


Figure 3 Real disposable income and transport costs 1997-2008

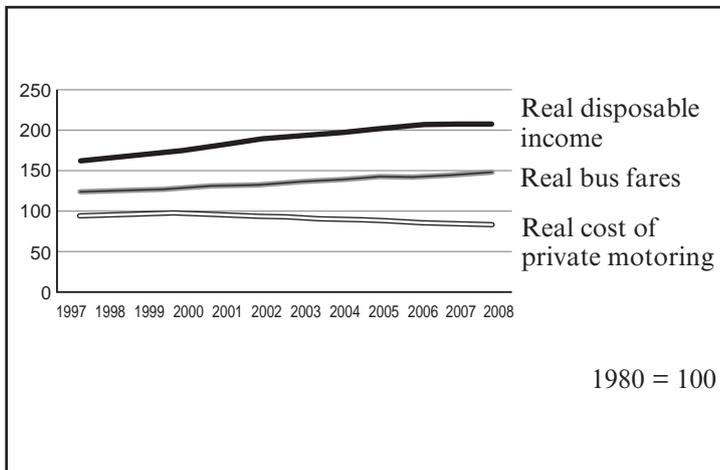
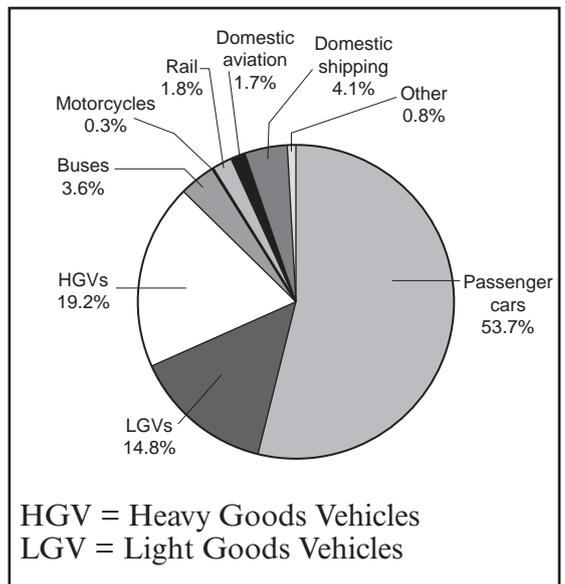


Figure 4 UK greenhouse gas emissions from domestic transport 2008



5 The Office of Fair Trading (OFT) said yesterday that it wanted a full Competition Commission investigation after finding “evidence that limited competition between bus operators tends to result in higher prices and poorer services for bus users”.

Heather Clayton, OFT senior director, said the Commission should “look at the tendency for local areas to become dominated by a single operator”. The OFT claimed fares could be 9 per cent
10 higher in such areas, while it had also found evidence of large existing operators driving out smaller rivals through “predatory behaviour”. The trigger for the OFT’s inquiry was the decision by Cardiff Bus to set up a loss-making rival to new low-cost competitor, *2 Travel*. As a result *2 Travel* was forced out of the market.

“One of the concerns that we think the Competition Commission should take a look at is the
15 tendency for local areas to become dominated by a single operator” said Heather Clayton. “This is certainly not about a return to ‘bus wars’ or competition on every route, but we do think large bus operators should face a healthy level of competition. Given the size and importance of this industry, with at least £1.2 billion coming from Government subsidies every year, the OFT believes that the Competition Commission should investigate how competition can deliver what passengers
20 want and also the best value for money for the tax payer.”

Bus companies’ annual revenue for services outside of London is £3.6 billion. Of this approximately £450 million comes from subsidies for services judged as socially desirable (for example in rural areas). A further £750 million is given to bus companies to provide free or cheap fares for groups such as children, pensioners and people with disabilities. The remaining £2.4
25 billion comes from ordinary fares.

The OFT’s main complaints are that:

- Many routes are served by a single operator. At a national level none of the major operators serve all parts of the country. Many large areas (for example Scotland, the South West and North Wales) are served by only two major national operators. 35 per cent of areas outside
30 London are served by only one of the four national groups. Many counties have one very large bus provider with a high market share. Many towns have only a single bus company.
- Fares are at least 9 per cent higher where there is limited competition;
- Existing large operators act in predatory ways, such as slashing fares, to deter new entrants;
- Large national operators appear to largely respect each others’ territories and do not try to
35 move into other operators’ areas, partly for fear of retaliatory behaviour.

The OFT’s decision to refer the entire industry (outside London and Northern Ireland) to the Commission for an investigation that could take two years and cost £20m drew fierce criticism from the bigger providers. Between them Stagecoach, FirstGroup, Arriva and Go-Ahead have about two-thirds of the bus market outside of London.

40 A Stagecoach spokesman said: “This is a huge waste of taxpayers’ money, a pointless academic exercise for the competition authorities and an unnecessary distraction for the bus industry.” The OFT appears “blind to the fact that bus services face constant competition from the car,” he added. Bus companies view private cars as their main competition, and tend to operate only in areas close to their main depots to keep fuel costs low. Despite the growth of private motoring,
45 since 2005 the number of journeys taken by bus has actually started to rise, reversing a steady downward trend that began in the mid-1990’s (see Figure 1). This was rather different from what might have been expected.

FirstGroup said the referral “could become an unnecessary and costly distraction from the Government’s own objective of reducing traffic congestion” and warned that “it may also delay
 50 further investment in the industry”. The Government’s own advisers, the Commission for Integrated Transport, have recently concluded that “bus operating costs have been driven up by worsening traffic congestion, reducing the average speed achieved by buses which increases the use of fuel”.

Talk to a smaller operator, however, and a different picture emerges. According to Simon Dunn, the chief executive of Rotala, a West Midlands bus operator: “We have experienced unfair
 55 competition on a daily basis.” He claims that a FirstGroup company cut fares in Redditch and Worcester to such an extent that it became impossible for Rotala to compete.

Adapted from, The Daily Telegraph January 8 2010, and Transport Trends 2009

- (a) Explain why the trend in bus journeys after 2005 was “rather different from what might have been expected”. (lines 46-47) [8]
- (b) Explain what the data suggests about the market structure of bus transport in the UK. [8]
- (c) To what extent are bus passengers likely to benefit from the OFT’s referral of the bus market to the Competition Commission? [12]
- (d) Discuss the economic arguments for the Government subsidising bus travel. [12]

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

Our exports may be cheap, but Europe is not buying

Figure 1 UK balance of trade in goods and services 1995-2009 (£ billion)

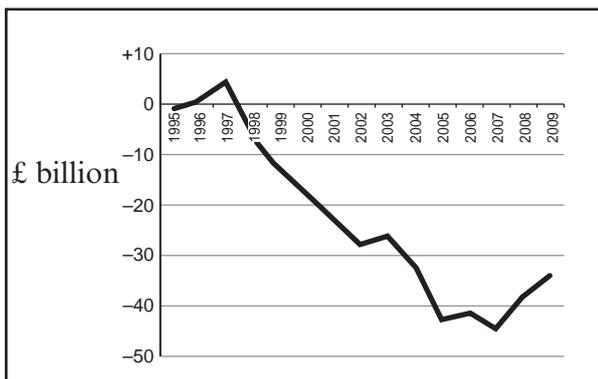


Figure 2 UK exports of goods and services 1995-2009 (£ billion)

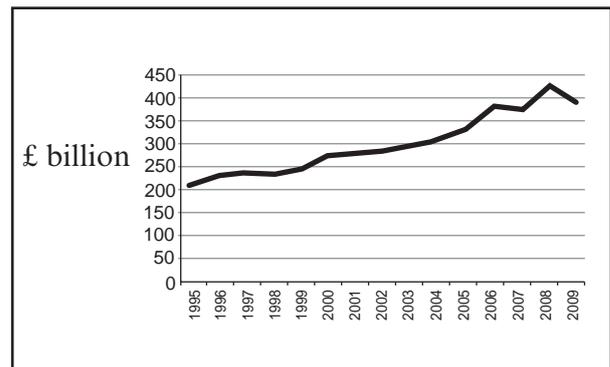
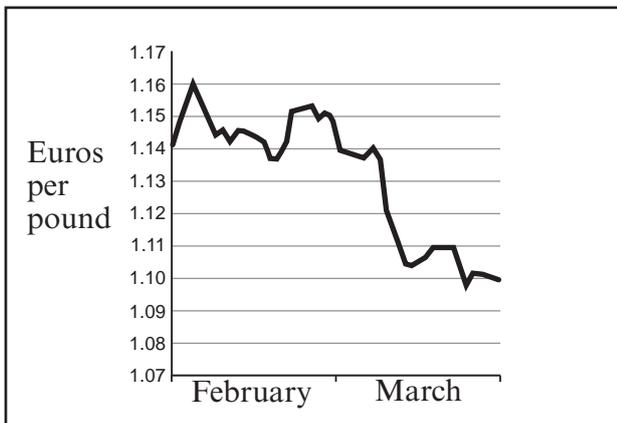


Figure 3 Exchange rate of sterling in euros, February-March 2010



A few days ago, something odd happened. A bad set of monthly trade figures came out and they resulted in sterling falling on the foreign exchanges. Why odd? Because it is a long time since the markets took any notice of the monthly trade figures. In the distant past, they were regarded as the single most important indicator of the economy's health. Later, capital flows took over from trade as the main factor affecting currency movements. Sterling was strong from 1996 to 2007 because of this, despite a deteriorating trade picture that nobody took much notice of. Now, it seems, trade is important again.

So are the markets right to focus on the trade figures again? No and yes. The trade deficit of £3.8 billion on goods and services in January looked dreadful compared with the December figure of £2.6 billion. But part of the problem for sterling at the moment is political uncertainty because of the election in May 2010. The other is the London effect. London is the world's biggest foreign-exchange centre, and is much more vulnerable to currency speculation than other European financial centres.

15 But yes, markets are right to regard trade as more important now. One reason that sterling was strong before the crisis was capital flows into the UK banking system from abroad. Those flows have been greatly reduced and will remain so, which helps to explain sterling's fall.

Despite the huge advantage of a competitive exchange rate, there are two problems for the UK when it comes to exporting. We don't make enough of the right things and we don't sell them to
20 the right places. That is particularly true of goods, in which 2009's UK exports of £228 billion were less than three-quarters of the value of imports, at £309 billion.

On the first problem, a report last week, *Ingenious Britain: Making the UK the leading high-tech exporter*, offered some useful pointers. It was written by Sir James Dyson, the inventor and entrepreneur. Britain does a lot better in high-tech exports than is usually thought. The
25 Engineering Employers' Federation reports a strong revival for high-tech sectors, particularly electronics.

However, there is a lot more that can be done. In 2007 Britain registered only 17,000 international patents, compared with 240,000 registered by America and 330,000 by Japan. Dyson argues that the problem starts in schools, where only 4% of teenage girls want to be engineers compared with
30 32% who want to be models, and he blames the bias against science and technology in education. Paying science, mathematics and technology teachers a lot more might help.

Financing high-tech start-ups is risky and should be rewarded with more generous tax relief. Government support, particularly for research and development, should be refocused on small, high-tech businesses. By their nature, however, these changes will take time.

35 On the second problem, what about shifting the geographical bias of our exports? One possibility is increasing exports to emerging economies such as China and India. The good news is that exports to China are rising. In the latest three months UK exports to China were up by an impressive 48.4% compared with a year earlier. Exports to South Korea rose by 22%.

However, the problem is that China's trade barriers are growing. Lord Mandelson, the UK's
40 Minister for Business believes that "while tariffs have been reduced or have disappeared, more invisible barriers and restrictions and regulatory inhibitions to trade and investment have grown up". China's failure to protect foreign copyrights, national government subsidies to Chinese businesses and regulations that favour Chinese companies are among the methods used to limit the competitiveness of foreign companies in China. The Business Software Alliance, representing
45 computer software manufacturers, estimates that 79 percent of China's computers in 2009 ran on pirated software. Although it is far from the closed market that it was twenty years ago, India still also maintains substantial tariff and non-tariff barriers that hinder EU countries trying to export there.

Adapted from The Sunday Times, 14 March 2010

- (a) Explain what Figures 1 and 2 show about the UK's trade with the rest of the world between 1996 and 2009. [8]
- (b) Explain the factors which appear to have influenced the exchange rate of sterling in early 2010. [8]
- (c) Discuss the likely effectiveness of spending more on education and high-tech start-ups as methods to increase the UK's exports. [12]
- (d) Discuss whether the protectionist methods used by countries such as China and India might damage the development of **their own** economies. [12]

SECTION B

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

3. To what extent do policies for reducing inflation necessarily tend to increase unemployment? [20]
4. “The high level of the Government’s debt means that it must raise taxes sharply and cut Government spending severely.” Discuss. [20]
5. How far do the activities of foreign multinational companies benefit the poor developing countries in which they operate? [20]