Rewarding Learning

**ADVANCED**
**General Certificate of Education**
**2024**

**Centre Number**

**Candidate Number**

# Economics

## Assessment Unit A2 1
*assessing*
Business Economics

## [AEC11]

*AEC11*

## MONDAY 20 MAY, AFTERNOON

**TIME**

2 hours.

**INSTRUCTIONS TO CANDIDATES**

Write your Centre Number and Candidate Number in the spaces provided at the top of this page. Answer **all** questions in Sections **A** and **B**, and **one** question in Section **C**.
You are permitted to use a calculator in this paper.
**You must answer the questions in the spaces provided.**
**Do not write outside the boxed area on each page or on blank pages.**
Complete in black ink only. **Do not write with a gel pen.**

**INFORMATION FOR CANDIDATES**

The total mark for this paper is 90.

- Section A: 20 marks
- Section B: 40 marks
- Section C: 30 marks

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question. This paper is accompanied by a Case Study Booklet.

**ADVICE TO CANDIDATES**

You are advised to take account of the marks for each part question in allocating the available examination time. In questions involving calculations, you are advised to show your workings.
Quality of written communication will be assessed in Questions **4**, **5(b)**, **(c)** and **(d)**, **6** and **7**.
Quantitative skills will be assessed where appropriate.

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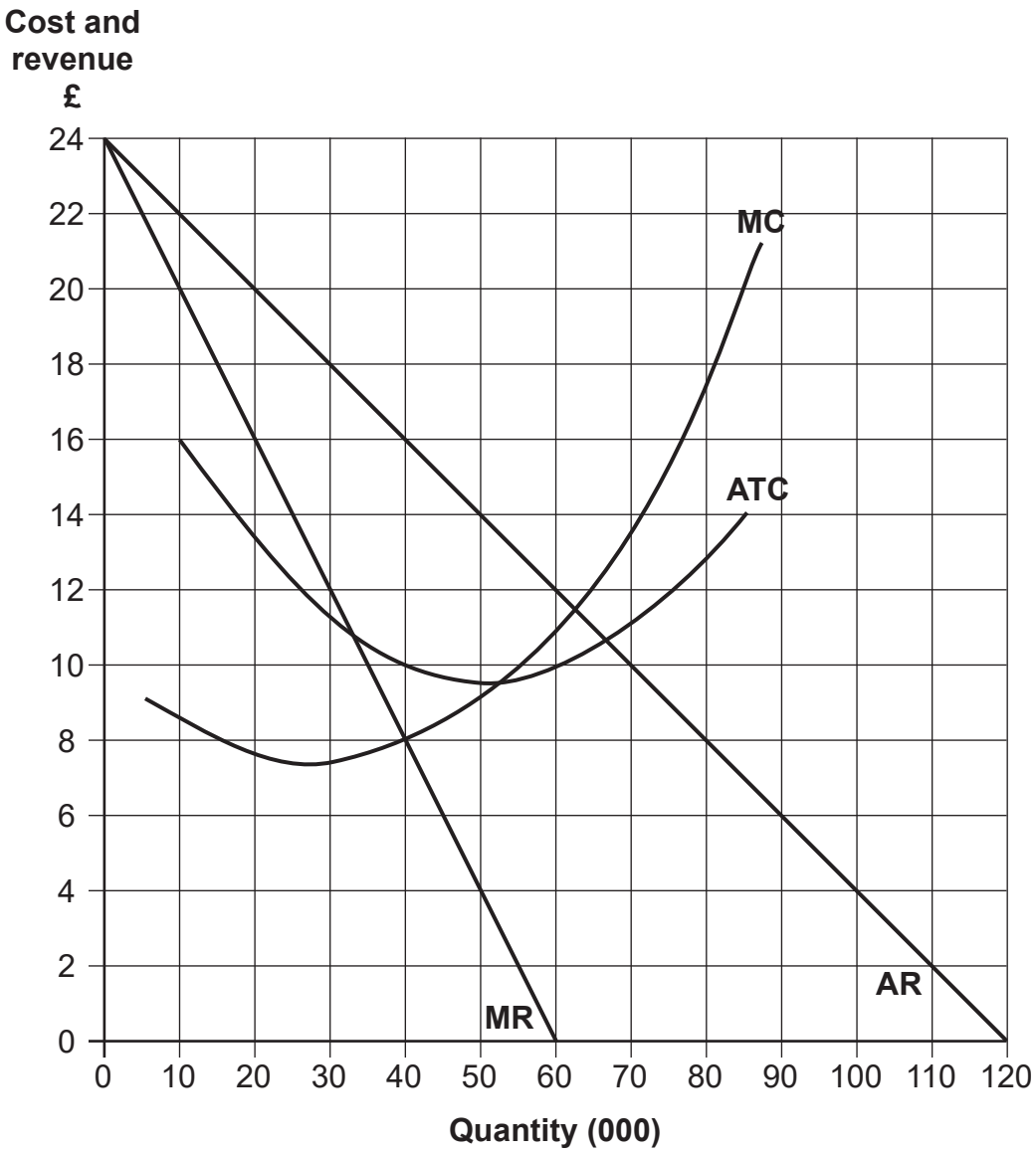
## Section A

### Answer all questions

**1** Metal Frames Ltd is a steel fabrication business which produces metal products for the construction industry. Projections suggest that demand for its products will increase by 46% over the next year. To meet this increased demand, Metal Frames Ltd intends to employ additional workers and invest in a new metal fabrication plant. The new plant will take 10 months to become operational.

Using the information in the passage above, explain the difference between the long-run and the short-run in the theory of the firm. [4]

**2** The diagram below shows the short-run average and marginal cost and revenue curves for a firm operating in a monopolistic market.




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Using the information in the diagram opposite, calculate the change in the level of supernormal profit the firm would make if it moved from a policy of profit maximisation to a policy of revenue maximisation. [4]

**[Turn over**

**3** Garden Rooms Ltd is a construction firm specialising in the construction of outdoor rooms. It produces only one type of product, which is a 3 m × 3 m garden room. In 2022, the firm had annual fixed costs of £3.6 million. It produced and sold 15 000 garden rooms with an average variable cost of £3,500. The garden rooms sell for £6,500 each.

**(a)** Using the information above, calculate the **average total cost** of producing 15 000 garden rooms. [3]

**(b)** Using the information opposite, calculate the total level of profit made by the firm in 2022. [3]

**4** While 2022 will be remembered as a year of rapid inflation, there were a number of industries where firms absorbed the cost increase and kept their prices remarkably stable. In many cases, these industries were dominated by a small number of suppliers, each of whom had significant market share.

With the aid of an appropriate diagram, explain why prices in oligopolistic markets often remain unchanged despite rising input costs. [6]

**Quality of written communication will be assessed in this question.**

**[Turn over**

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## Section B (Case Study)

### Answer all questions

**Read the information in the Case Study Booklet and answer the questions below**

**5** **(a)** Using the information in **Fig. 1**, describe the trend in corporate profits over the period shown. [4]

**(b)** Explain the difference between market share and market power (Source 2). [9]

**Quality of written communication will be assessed in this question.**

**[Turn over**

**(c)** Critically examine the difficulties an economist might face in trying to determine whether a given level of profit was supernormal. [12]

**Quality of written communication will be assessed in this question.**

**[Turn over**

**(d)** Evaluate the arguments for and against the imposition of windfall taxes on the profits of UK energy companies. [15]

**Quality of written communication will be assessed in this question.**

**[Turn over**

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**(Questions continue overleaf)**

## Section C

Answer **either** question 6 **or** question 7

**Quality of written communication will be assessed in these questions.**

**6** In July 2022, the UK government used the National Security and Investment Act to block a Chinese technology company's planned purchase of a British electronic design company. The act allows ministers to intervene in deals where a foreign-led takeover could affect areas such as economic stability, media impartiality, or national security.

Critically examine the view that the UK government should ban all foreign takeovers of important UK firms. [30]

**or**

**7** In a report entitled "There Are No Limits to Growth", researchers concluded that firms which utilise recent advances in technology and apply effective management techniques can grow indefinitely, without facing the increasing average total costs that are predicted in traditional economic theory.

Critically examine the view that firms can grow indefinitely without experiencing internal diseconomies of scale. [30]

Write the number of the question you have chosen in the box below:

[ ]

**[Turn over**

**[Turn over**

**[Turn over**

**[Turn over**

**THIS IS THE END OF THE QUESTION PAPER**

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| For Examiner's use only | |
|---|---|
| Question Number | Marks |
| **Section A** | |
| 1 | |
| 2 | |
| 3 | |
| 4 | |
| **Section B** | |
| 5 | |
| **Section c** | |
| 6 | |
| 7 | |
| Total Marks | |

Examiner Number

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# Economics

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# CASE STUDY BOOKLET

# For use with Section B

The following passages were compiled in March 2023.

## Case Study: Profiteering Britain

### Source 1: Company profits soar amid cost-of-living crisis

A recently published report showed that profit margins for some of the UK's largest listed companies increased by over 70% on pre-pandemic levels. The oil and gas sector particularly saw profits soar throughout 2022, as the conflict in Ukraine, combined with bottlenecks caused by pandemic lockdowns, led to a surge in oil and gas prices. In June 2022, oil and gas giant Shell posted record quarterly profits of almost £10 bn and promised to give shareholders pay-outs worth £6.5 bn. At the same time Centrica, owner of British Gas, reported operating profits of £1.6 bn for the first half of 2022, an increase of over 300% on the same period in the previous year.

However, soaring profits are not confined to the oil and gas sector. Even when we exclude energy companies from our calculations, profits in the remaining FTSE 350 companies increased on average by 42% between 2019 and 2022. Annual profits increased by 41% for the RBS bank and doubled for the retailer Tesco between 2021 and 2022.

Nor is the increase in profits a recent phenomenon. As **Fig. 1** below illustrates, company profits in the UK have been on the increase since 2015. Gary Douglas, economic analyst and trade unionist, claimed that "while profits have really taken off over the last twelve to eighteen months, this is simply a continuation of a trend that began with the shift to the right in British politics and the election of a Tory government in 2015".

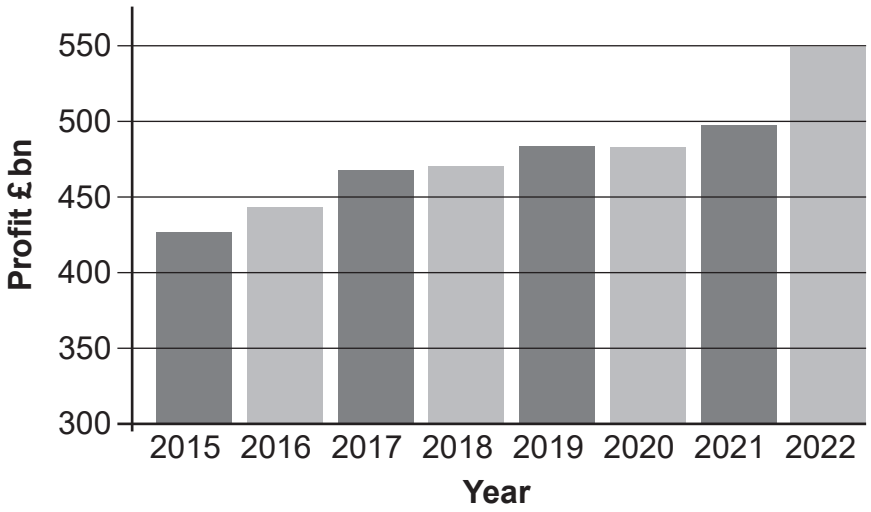



**Fig. 1: UK Corporate profits, 2015–2022 (£billion)**

## Source 2: What's driving company profits?

While rapidly rising wholesale gas and oil prices account for much of the increased profits in the energy sector, some commentators are asking themselves how it can be that firms in non-energy related sectors are also seeing profits soar. At a time of low economic growth, falling living standards and fears that the next great recession is just around the corner, we would normally expect profits to be squeezed.

Daniel Copeland, independent market analyst, claims to have the answer. "The excessive or supernormal profits that we are seeing across a range of sectors in the UK is a direct result of the increased concentration in these industries over the last 10–15 years. While market power and market share are not the same thing, there is no doubt that the concentrated nature of these markets allows the firms to increase prices beyond what would be the case in less concentrated markets. If you look at the sectors which have recorded the biggest increases in profits, they typically have five-firm concentration ratios in excess of 50%."

| **Industry** | **5-firm concentration ratio (% of industry revenue)** |
|---|---|
| Electricity distribution | 91 |
| Programming and broadcasting | 79 |
| Insurance | 76 |
| Other financial | 70 |
| Retail banking | 65 |
| Mining and quarrying | 62 |
| Rail transport | 60 |
| Water | 50 |

**Fig. 2: Five-firm concentration ratios in selected UK industries 2022**

Mr Copeland continued: "Successive governments and regulators have permitted a culture of market consolidation and merger, which has given large firms ever-increasing market or monopoly power and the ability to earn supernormal profit at the expense of consumers. If we compare the profits these firms make with those of their counterparts in the EU, we can see that they are well above what could be considered normal."

However, retail investor Declan Brown countered these claims and stated, "The left-wing media have made profit a dirty word. Profits benefit us all since they fund investment and higher incomes. The belief that any level of profit could be regarded as excessive is preposterous. The term supernormal profit is nothing but an arbitrary academic concept, which is neither definable nor measurable in any real sense."

**Source 3: How to deal with the rising energy prices and the cost-of-living crisis?**

In 2022, politicians right across the political spectrum were divided over how best to deal with the cost-of-energy crisis affecting the UK economy. In 2020, the average UK household energy bill was just less than £1,000 per year. By the middle of 2022, this had more than doubled to £2,300, with analysts predicting the average bill would rise to over £3,500 by the end of the year.

Whilst an adjustable energy price cap has been in place in the UK since 2019, it had proven to be ineffective in protecting consumers from rising bills caused by increased wholesale energy costs.

Labour leader Sir Keir Starmer had called for bills to be frozen and for the £130 bn it was estimated to cost to be paid for by an extension of the so-called windfall tax on the excess profits of oil and gas companies.

However, Liz Truss, Prime Minister at the time, opposed windfall taxes, despite more than three quarters of Tory voters being in favour, claiming they would reduce investment and growth in the UK. She declared, “I think it is wrong to be putting companies off investing in the UK.” In contrast, Paul Johnson of the Institute of Fiscal Studies claimed that it was “nonsense to suggest that a windfall tax on energy companies would hit investment in the UK”.

Labour MP Richard Burgon claimed it was “totally unacceptable that oil and gas companies were raking in record profits on the back of high energy bills for millions of people”. He argued that by refusing to increase windfall taxes, the Prime Minister was leaving these companies free to pocket billions in excess profits and pay out eye-watering bonuses to their bosses, whilst ordinary people face crippling bills and pay cuts.

**THIS IS THE END OF THE CASE STUDY BOOKLET**

**Sources**

"All sources have been adapted"

**Source 1**:
BP sees biggest profit in 14 years as energy bills soar by Michael Race. 02 August 2022. BBC News
https://www.bbc.co.uk/news/business-62382624#:~:text=BP%20has%20reported%20its%20biggest,the%20same%20period%20last%20year.

**Source 2:**
'Insult to millions': Shell and Centrica profits cause outrage as energy bills soar by Rob Davies. 28 July 2022 The Guardian
https://www.theguardian.com/business/2022/jul/28/an-insult-soaring-profits-at-shell-and-centrica-cause-outrage

**Source 3:**
Liz Truss 'has left energy firms free to pocket billions' by refusing windfall tax by Josh Layton. 08 September 2022. Metro.co.uk
Liz Truss 'has left energy firms free to pocket billions' by refusing windfall tax | News UK | Metro News

**Source 4: Figure 1:**
https://tradingeconomics.com/united-kingdom/corporate-profits

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