



Rewarding Learning

ADVANCED
General Certificate of Education
2012

Economics

Assessment Unit A2 1

Business Economics

[AE211]

FRIDAY 18 MAY, AFTERNOON



TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **Question 1** and **one** question from **Questions 2, 3 or 4**.

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.

Quality of written communication will be assessed in **all** questions **except 1(a)**.

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time.

Question 1

These articles were compiled in November 2010. Please read them carefully and answer the questions which follow.

Case study: BP oil spill

Source 1: Death and devastation in the Gulf

On the 20th April 2010 the Deepwater Horizon oil rig exploded in the Gulf of Mexico killing 11 workers and injuring 17 more. The explosion caused oil to leak from the deep sea oil well into the surrounding area. Experts estimated that up to 5 million barrels of oil leaked from the well before it was finally sealed in June 2010. The spill caused extensive damage to marine and wildlife habitats as well as the Gulf's fishing and tourism industries, US president, Barack Obama, claimed the oil spill was the worst environmental disaster the US had ever faced.

The oil leak cost BP dearly too. The company spent over \$4bn in trying to seal the well and in paying for the subsequent clean up operation. BP was also forced to create a \$20bn fund to deal with the huge number of compensation claims from all of those both directly and indirectly affected by the disaster.

Before the oil spill, BP was the UK's largest company with a stock market valuation of over £120bn. Since then, however, more than £50bn has been wiped off its value as traders cashed in their holdings in the wake of the disaster. This lack of investor confidence in BP's ability to manage the disaster led to its share price falling below the 350 pence mark for the first time in over 10 years.

This collapse in its share price has made BP a prime target for a hostile takeover bid, with a number of potential bidders rumoured to be circling to take advantage of BP's weakened state. US oil industry sources were quoted as saying that ExxonMobil, the world's largest non-government owned oil firm, had "been given the green light by the US administration to launch a takeover bid". Normally, tough US competition laws would have made such a move impossible.

Source 2: Measuring the true cost of the oil spill

The catastrophic explosion on the Deepwater Horizon oil rig may have been extinguished quickly but the political and economic fallout from the subsequent spill has been unparalleled. Experts said the unprecedented depth of the spill, combined with the use of chemicals to break the oil down before it reached the surface, posed an unknown threat to the local ecosystem.

Louisiana, the nearest state to the leaking well, has been the most affected. The State's Governor, Bobby Jindal, said more than 100 miles of its 400-mile coast had been polluted. A quarter of US waters in the Gulf of Mexico were closed to fishing, hitting the livelihoods of shrimpers, oyster-catchers and charter boat operators. At one point, analysts were estimating the cost to be in excess of \$70bn.

However, one hundred days on from the original blow-out, the question is beginning to be asked: might the scale of the potential environmental damage have been exaggerated? Was BP boss Tony Hayward right when he predicted that the environmental impact of the spill would be "very, very modest"? For many marine scientists, the answer seems to be yes – and now that some of the initial fury has died down, they are putting their heads above the parapet to say so.

Dr Simon Boxall, an expert in marine pollution said "People think 'oil spill' and think 'disaster', but it is not always the case. It is not all about the size of the leak. It is the type of oil and where it happens, that matter. When Tony Hayward said it was a drop in the ocean, it might have been the wrong thing to say at the time, but it was the truth. This spill is the equivalent of less than a drop in an Olympic-sized swimming pool. For all but a tiny bit of the Gulf, it will be back to normal within a year".

An analyst at Goldman Sachs stated that "calculating the social cost of any economic activity is not an easy task, as it is very difficult to put a value on costs to the environment and the local economy. There is no doubt, however, that these costs have been hyped up by lawyers who see the potential to make big money on the back of those affected by the oil spill".

Sources - adapted from articles : "BP oil spill: death and devastation - and it's just the start" by Davis Adam and agencies, The Guardian, 31 May 2010 and "Was Tony Hayward right after all?" by Richard Alleyne, The Telegraph, 30 July 2010

Source 3: Beyond petroleum

Oil Giant BP is planning to invest more than £600 million in alternative energy this year as it looks to accelerate efforts to diversify its operations. While declining to give details of where any future investment might go, the company admitted that the main focus would remain on wind, solar, carbon capture and storage, and bio-fuels.

A company spokesman stated “This investment reflects BP’s commitment to a future beyond petroleum. We aim to play a leading role in the growing low-carbon energy sector by developing large-scale businesses that are able to compete with traditional energy providers”.

However, not everyone is so impressed by BP’s claim to support alternative energy. Environmentalist, Fred Pearce, stated that BP is keen to play up its investment in alternative energy as this helps to improve its image in the minds of consumers. “BP likes to say that it is investing millions of pounds a year in alternative energy, but this is nothing more than green-washing; investment in alternative energy still makes up just a tiny fraction of its investment in fossil fuels.”

Others have argued that BP’s investment in alternative energy is driven mainly by a fear of further government regulation or taxation on fossil fuels and by a desire to access a share of the £1 billion set aside by the government each year to subsidise green energy projects.

However, a spokesman for BP stated “obviously our investment in alternative energy is driven in part by selfish commercial interests and the need to diversify our product range, but it is also driven by genuine concerns for the environment and for energy security in the UK”.

Source 4: UK Government promises £2 billion for green investment

Chancellor George Osborne announced that the Government will provide £1 billion in funding for a green investment bank. He also said that up to £1 billion would go towards building one of the first power stations in the world with technology to capture and permanently store carbon emissions, to help cut greenhouse gases from electricity generation. He announced that £200 million would go to develop offshore wind technology and manufacturing, and support the upgrade of ports to sustain the industry. Setting out the green measures in the comprehensive spending review, Mr Osborne said he was committed to ensuring that the coalition government would be the “greenest government ever”.

However, Kevin Todd, a corporate finance adviser working in the energy sector, has questioned the viability of the proposed subsidies for green investment. “In my view, subsidies are the least efficient method of encouraging companies to reduce pollution. The significant costs of setting up and running a government department or agency to allocate subsidies would be better invested in the companies directly,” he said. “I would anticipate that less than half of the money allocated to promoting green technology will actually reach the companies that need it.”

Todd said he welcomed any initiative that encouraged green investment methods, but he had grave concerns about the ability of a government-run agency to deliver results. “Government organisations have a very poor track record when it comes to making investments on behalf of the public,” he said. “This is largely due to the fact that they get bogged down in the red tape that plagues all government bodies. A much more effective method is to use the tax system to punish those companies who pollute and use the money raised to support companies who invest in green technology.”

- (a) Explain why BP was considered to be a prime target for a hostile takeover bid in June 2010. [5]
- (b) Explain why it is difficult for economists to accurately calculate the social cost of economic activity such as drilling for oil. [10]
- (c) Examine why a company such as BP would invest in alternative energy. [10]
- (d) Evaluate the effectiveness of government policy in encouraging the oil industry to reduce pollution. [15]

Essays:

Answer **one** question from **Questions 2, 3 or 4**.

2 Top economist defends oligopoly

(a) Compare the main features of monopoly and oligopoly. [15]

(b) Critically examine the view that oligopoly is the most desirable market structure. [25]

3 MPs angry at huge profits earned by UK banks

(a) Explain how an economist would determine whether a firm was earning supernormal profits. [15]

(b) Discuss how government should respond to the huge profits earned by banks. [25]

4 Contestable markets are most realistic

(a) With the aid of appropriate diagrams, explain how a perfectly competitive industry responds to an increase in demand. [15]

(b) Critically examine the view that the theory of contestable markets is the most useful model of firms' behaviour. [25]

THIS IS THE END OF THE QUESTION PAPER

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