Write your name here

Surname	Other names

Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced
Unit 3: Business Economics and Economic Efficiency

Friday 28 January 2011 – Afternoon
Time: 1 hour 30 minutes

Paper Reference
6EC03/01

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **all** the questions in Section A and **one** question from Section B.
- Answer the questions in the spaces provided – *there may be more space than you need.*

Information

- The total mark for this paper is 72.
- The marks for **each** question are shown in brackets – *use this as a guide as to how much time to spend on each question.*
- Questions labelled with an **asterisk** (*) are ones where the quality of your written communication will be assessed – *you should take particular care on these questions with your spelling, punctuation and grammar, as well as the clarity of expression.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Keep an eye on the time.
- Check your answers if you have time at the end.

Turn over ▶

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N 3 7 9 5 6 A 0 1 3 2

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Section A: Answer all the questions in this section

You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

1 In March 2009 the UK Competition Commission required British Airports Authority to sell off three of its seven airports, starting with Gatwick and then Stansted.

The most likely reason for the Commission's decision was the

(1)

A increased competition from foreign airports

B monopoly power of British Airports Authority

C high level of contestability in the airport industry

D limit pricing used by the airports

E falling average costs resulting from horizontal integration.

Answer ☐

Explanation

(3)

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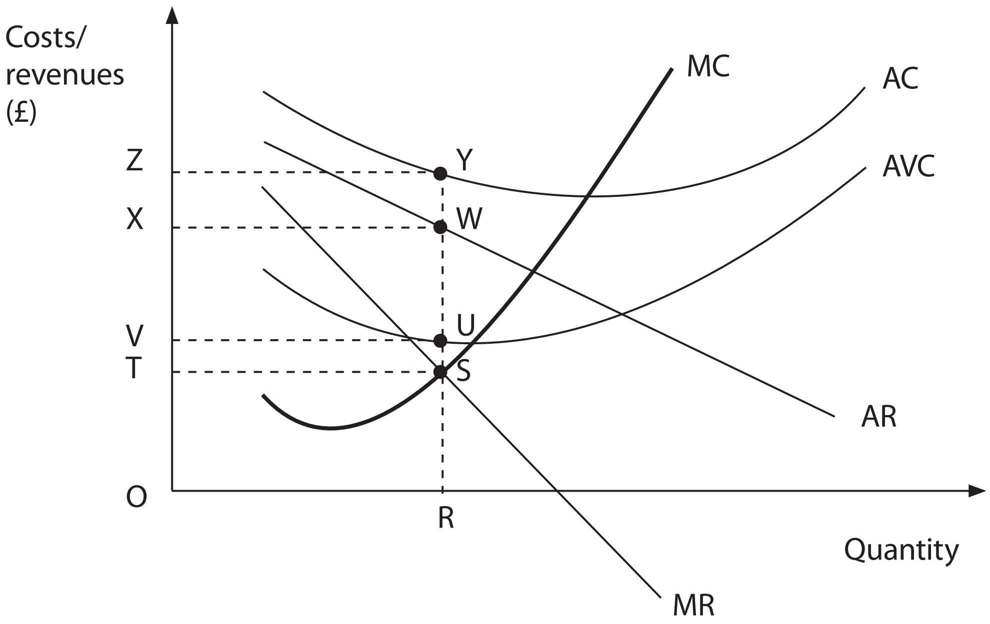
(Total for Question 1 = 4 marks)

2



The diagram shows the costs and revenues for a profit maximising firm in a market. The most likely outcome for the firm, assuming no change in costs or demand, is to

(1)

A continue in business and make supernormal profit ZYWX

B continue in business and raise the price

C continue in business and cut the price

D continue in business in the short run but shut down in the long run

E shut down immediately.

Answer ☐

Explanation

(3)

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(Total for Question 2 = 4 marks)

3 At the end of a day's trading a flower seller cuts the prices of all the stock that has reached its 'sell by' date. This pricing strategy is most likely to be

(1)

A fixed cost pricing

B limit pricing

C revenue maximisation pricing

D predatory pricing

E productive efficiency pricing.

Answer

Explanation

(3)

(Total for Question 3 = 4 marks)

4 In December 2009 the Royal Mail announced that it had made a 4% increase in profits compared to 2008, despite a fall of 3 million items a day in the amount of post being sent. The most likely reason for the increase in profits was

(1)

A an increase in contestability in the postal market

B a fall in the real price of postage stamps

C a rise in nominal wages of postal workers

D a fall in employment in the Royal Mail

E external diseconomies of scale in the postal industry.

Answer

Explanation

(3)

(Total for Question 4 = 4 marks)

5 On 26 November 2009 the water regulator Ofwat announced that water bills must be cut by an average of £3 a year per household over the next five years and that there must be an extra £1 billion investment by water companies. The most likely reason for these decisions was

(1)

A to increase producer surplus

B to increase the returns to investors in water companies

C to reduce contestability in the water industry

D to force unprofitable firms out of business

E to increase efficiency in the water industry.

Answer ☐

Explanation

(3)

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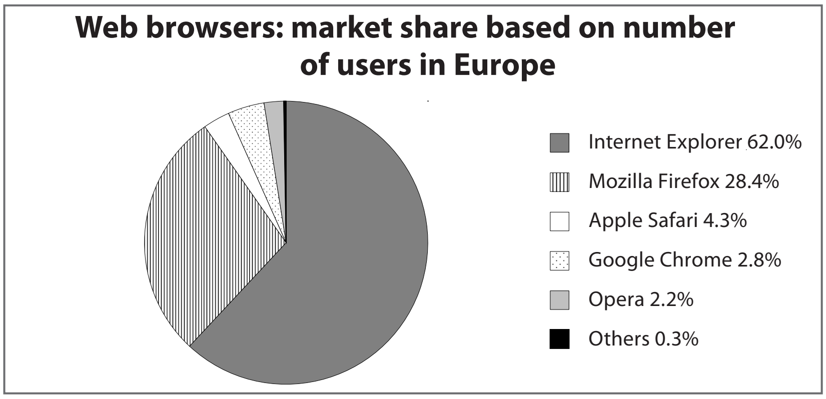
(Total for Question 5 = 4 marks)

6



Source: http://www.atinternet-institute.com/en-us/browsers-barometer/browser-barometer-september-2009/index-1-2-3-180.html

The chart shows the usage-based market share of internet web browsers in Europe. In 2008 the Microsoft computer software company was fined €1.68 billion by the European Competition Commission for pre-installing its browser, Internet Explorer, on computers running the Windows operating system. In December 2009, Microsoft agreed to allow consumers to choose their web browser on setup.

The most likely impact on the market for internet web browsers is

(1)

A an increase in the five-firm concentration ratio in the web browser market

B an increase in profitability for Microsoft

C an increase in advertising revenues for Internet Explorer web space

D a worsening of the quality of the browser products offered in the market

E a decrease in market share for Internet Explorer.

Answer ☐

Explanation

(3)

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(Total for Question 6 = 4 marks)

7 Game theory can be used to illustrate which of the following examples of competitive behaviour?

(1)

A Price leadership in perfect competition

B Revenue maximisation in monopolistic competition

C Limit pricing in monopolistic competition

D Tacit collusion in oligopoly

E Price discrimination by a monopolist.

Answer ☐

Explanation

(3)

(Total for Question 7 = 4 marks)

8 A report by the University of East Anglia into the Private Finance Initiative and the Norfolk and Norwich University Hospital in June 2009 argued that the hospital was costing £20 million a year more than if it were run in the public sector.

Source: http://www.uea.ac.uk/polopoly_fs/1.116276!Three%20page%20briefing%20-%20NNUH%20report%20-%20June%202009.pdf.

Which of the following is a reason why the government has encouraged Public Private Partnerships?

(1)

A It is easy to accurately forecast the future costs of projects

B The government has a fiscal surplus

C To increase x-inefficiency in the public sector

D Performance targets have never been set in the public sector

E To make use of private sector finance to fund major projects.

Answer ☐

Explanation

(3)

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(Total for Question 8 = 4 marks)

TOTAL FOR SECTION A: 32 MARKS

Section B: Answer either Question 9 or Question 10.

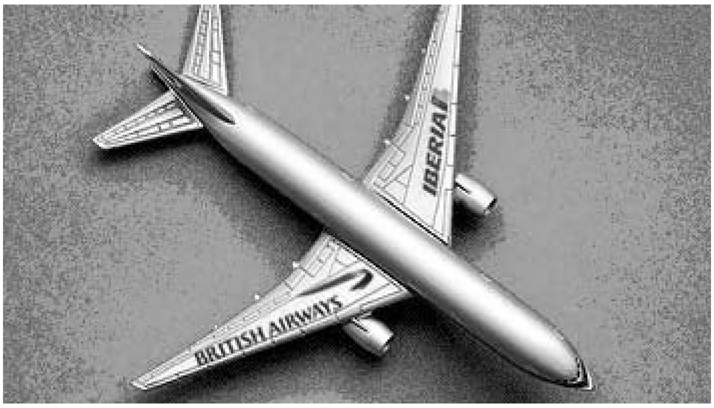
If you answer question 9 put a cross in this box ☒ .

Question 10 starts on page 20.

You should spend 55 minutes on this section.

9 Iberia and BA merger

Extract 1 Uniting in the sky – Iberia and BA at last agree to get together to sort out their problems



Like two drowning men, Iberia and British Airways (BA) have long seen each other as potential means of staying afloat. The rate at which the airlines have been sinking at last forced them into each other's arms on November 12th 2009, when a merger was agreed. BA made big pre-tax losses in the year to the end of March as it suffered from the credit crisis and the global economic slump. Iberia actually managed a small profit in 2008. Just as the terms of the merger were agreed Iberia announced a loss in the latest quarter, which includes the usually profitable summer months. BA said that it had lost £292m in the first half of the year, which includes the summer period.

These airlines are not alone in their concerns. The total losses for the world's airlines this year are estimated to be £17.6 billion. By agreeing to merge, the two firms will join the trend for big European airlines to get bigger. This has become an attractive means to make substantial cost savings as they compete against low-cost rivals and try to cope with a dramatic fall in numbers of the profit-making business passengers. The two companies estimate that within five years the new group will save some £429m a year by cutting overlapping routes, and by combining maintenance, office functions and business-class lounges. They may also have more buying power when it comes to negotiations to buy new planes from Boeing and Airbus.

The deal will put the firms back into the big leagues of European aviation. Their combined revenues will put them closer to Air France-KLM, the product of a similar deal in 2004 and Germany's Lufthansa, which has expanded its operations with a series of smaller takeovers of Swiss and Austrian airlines since 2005. Iberia and BA will combine their businesses but maintain separate corporate operations. This will allow them to maintain their roles as the national flag-carriers in Spain and the UK while keeping valuable bilateral international landing rights that go along with that status.

One reason for keeping pace with European rivals is that size will become an important factor if consolidation among airlines goes global. The two airlines are already seeking permission from the competition authorities in America and in Europe for an agreement with American Airlines, which would see all three co-ordinating over costs and revenues on transatlantic routes. However, BA may be required to give up landing slots at Heathrow, a price it has been unwilling to pay in the past.

A protectionist stance in America over the country's troubled airlines has kept a law in place that prevents foreign airlines from owning more than 25% of an American rival. The European Union is pressing for this restriction to be lifted, though there is little sign that it might happen soon.

Source: adapted from Economist.com *'Uniting the Sky'* Nov 13th 2009, http://www.economist.com/businessfinance/PrinterFriendly.cfm?story_id=14887815.

Extract 2 Strike action in response to BA crew reductions and cost cuts

British Airways was preparing for what could be a damaging strike after workers voted to walk out for nearly two weeks. The airline plans to reduce generous staff levels and benefits for Heathrow-based cabin crew.

The union said 80 per cent of its more than 12,000 BA members had voted, recording a 92.5 per cent vote in favour of a strike. The airline has said the move would cause chaos for hundreds of thousands of passengers.

"We're hoping that the size of this vote will make the company think again," said a spokesperson for the union, who added that it would not back down unless BA gave way on the crew reductions that prompted the strike.

Source: http://www.ft.com/cms/s/0/75a53942-e8aa-11de-9c1f-00144feab49a.html.

(a) Using the evidence, explain the type of integration involved in the agreed merger between BA and Iberia.

(4)

(b) Examine the likely reasons why Iberia made a loss during 'the usually profitable summer months', (Extract 1, line 7). Use a diagram to support your answer.

(8)

*(c) Assess the likely impact on contestability of the airline industry resulting from the mergers and agreements referred to in the evidence.

(12)

*(d) Evaluate the likely benefits of the agreed merger between BA and Iberia.

(16)

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(16)

(Total for Question 9 = 40 marks)

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If you answer question 10 put a cross in this box ☒ .

10 Newspapers online

Extract 1 Did you pay to read this?

Until recently, there were two types of newspaper website: those that made you pay to read many of the articles (*The New York Times*, *The Wall Street Journal* and the *Financial Times*) and those that didn't.

That is changing. *The New York Times* has announced that almost all its online material would now be free. FT.com has moved to a system of free access for occasional visitors. The theory is that increased advertising revenue will replace subscription revenue. Online advertisers are charged only 20% of the print edition equivalent, and the placing of adverts is tailored to readers' profiles.

The big question is whether online advertising makes more money than subscriptions. Research by the University of Chicago Business School on what the profit-maximising price would have been for online access suggests that washingtonpost.com would probably have made more money by charging a few dollars a month back in 2001 or 2002, when it offered free access. But by 2004, as the online advertising market improved, charging for access no longer increased total revenues.

Source: adapted from FT.com 20 October 2007 *Undercover Economist: Did you pay to read this?* Tim Harford.

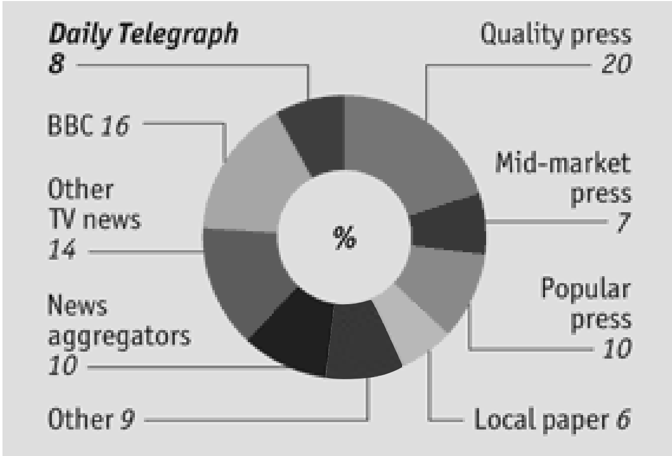
Extract 2 More bad news for the newspaper business

The decision to give away newspaper content free online is increasingly viewed as one of the world's worst-ever business decisions. But any newspaper firm which wants to undo this error has a problem. If one newspaper starts charging, readers may migrate to those that remain free. If, on the other hand, a lot of papers begin charging at the same time, readers might be pushed into paying. This plan has always seemed optimistic. A study released this week suggests it may be completely wrong.

Oliver & Ohlbaum, a media consultancy, asked people what newspaper they tended to read and whether they subscribed to it (most get their papers from shops). Then they asked readers about where they went for news on the internet. The results were consistent: when it comes to online news, Britons are shamelessly disloyal.

The theory underlying most papers' online strategies is that people will buy a favourite newspaper and then go to its website for breaking news and extras such as blogs. But fans of the *Daily Telegraph*, for example, the most popular quality daily paper, got just 8% of their online news from its website (see Figure 1). They spent twice as much time visiting the BBC's news website and more than twice as much reading other quality papers.

Figure 1 Percentage of time spent reading online news sources by *Daily Telegraph* readers



Source: Oliver & Ohlbaum Trends November 2009, used in *The Economist*, 3 December 2009.

The survey also contained bad news for those publishers hoping to co-ordinate attempts to charge. When *Guardian* readers were asked whether they would pay £2 a month to read their favourite paper online, 26% said yes. But what if all newspapers charged? The proportion prepared to pay for the *Guardian* might have been expected to rise. Instead it fell to 16%. This seems odd, until one considers readers' disloyalty. Readers protested at the prospect of having to pay repeatedly to continue to access a wide variety of news sources. The questions are hypothetical, and people may react differently if and when charges for online news are introduced. However, this survey will hardly encourage newspaper owners to charge for online services.

Source: adapted from *The Economist* print edition 'The promiscuity problem', 3 December 2009.

Figure 2 Newspaper sales (hard copy) circulation, daily

Title	2001	2005	2009
The Financial Times	478 161	422 519	426 676
The Telegraph	1 022 263	920 745	783 210
The Times	734 220	686 327	617 483
The Sun	3 636 561	3 382 509	3 146 006
Total of all daily newspapers (rounded)	15 500 000	13 300 000	13 000 000

Source: Audit Bureau of Circulations http://www.abc.org.uk/ accessed via http://en.wikipedia.org/wiki/List_of_newspapers_in_the_United_Kingdom_by_circulation#Circulation_1950.E2.80.931999.

(a) Explain **one** possible reason for the trend in newspaper sales as shown in Figure 2.

(4)

(b) Assess the possibility of some printed newspapers shutting down as a result of the trend in newspaper sales.

(8)

*(c) To what extent might the contestability of the markets for online news and printed newspapers differ?

(12)

*(d) Evaluate price and non-price strategies newspaper organisations may pursue to increase profitability.

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(16)

Turn over

(Total for Question 10 = 40 marks)

TOTAL FOR SECTION B: 40 MARKS
TOTAL FOR PAPER: 72 MARKS

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