Write your name here

Surname	Other names

Edexcel GCE

Centre Number | Candidate Number

Economics

Advanced
Unit 3: Business Economics and Economic Efficiency

Friday 17 June 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 ▶

1/1/1/1/1/1/1/
P 3 8 8 1 9 A 0 1 2 8

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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 use diagrams in your answers.

1 Firms are leaving a perfectly competitive industry. This suggests that for these firms:

(1)

A average revenue exceeds marginal revenue

B marginal revenue exceeds average revenue

C average fixed cost exceeds average revenue

D average variable cost exceeds average revenue

E average costs equal average revenue.

Answer ☐

Explanation

(3)

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(Total for Question 1 = 4 marks)

2 Firms tendering for a private finance scheme from the government verbally agree with each other to fix a higher price than if there were independent bids. This is an example of:

(1)

A tacit collusion

B overt collusion

C symmetric information

D monopolistic competition

E regulatory capture.

Answer ☐

Explanation

(3)

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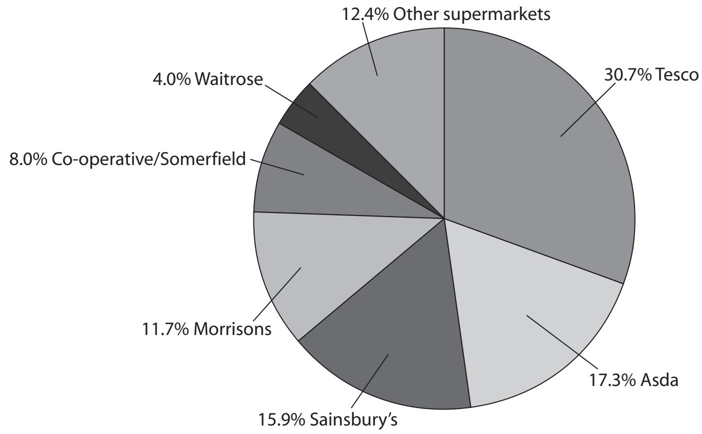
(Total for Question 2 = 4 marks)

3 The following pie chart shows market shares in the UK grocery industry in 2009.



Source: adapted from http://www.tnsglobal.com/news/news-56F59E8A99C8428989E9BE66187D5792.aspx

Which of the following statements is true in the UK grocery market?

(1)

A It is monopolistically competitive

B It has a low level of concentration

C The four firm concentration ratio is 75.6 per cent

D It is perfectly competitive

E The three firm concentration ratio is 60.4 per cent.

Answer ☐

Explanation

(3)

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(Total for Question 3 = 4 marks)

P 3 8 8 1 9 A 0 4 2 8

4 Reliance Industries Ltd (RIL) is an energy group which refines oil into petrol in India. In 2002 it merged with a crude oil extraction firm. What might be RIL's reason for this merger?

(1)

A To gain from the benefits of horizontal integration

B To gain from the benefits of backward vertical integration

C To gain from the benefits of forward vertical integration

D To gain from the benefits of conglomerate integration

E To avoid diseconomies of scale.

Answer ☐

Explanation

(3)

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(Total for Question 4 = 4 marks)

5 If a firm's fixed costs increase by 20 per cent, marginal costs will increase by:

(1)

A zero

B 10%

C 20%

D 100%

E 200%.

Answer ☐

Explanation

(3)

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(Total for Question 5 = 4 marks)

6 A profit maximising monopolist operates at the output level where:

(1)

A average revenue equals average cost

B total revenue is at a maximum

C the price is equal to the marginal cost

D the price is equal to the marginal revenue

E the marginal profit is zero.

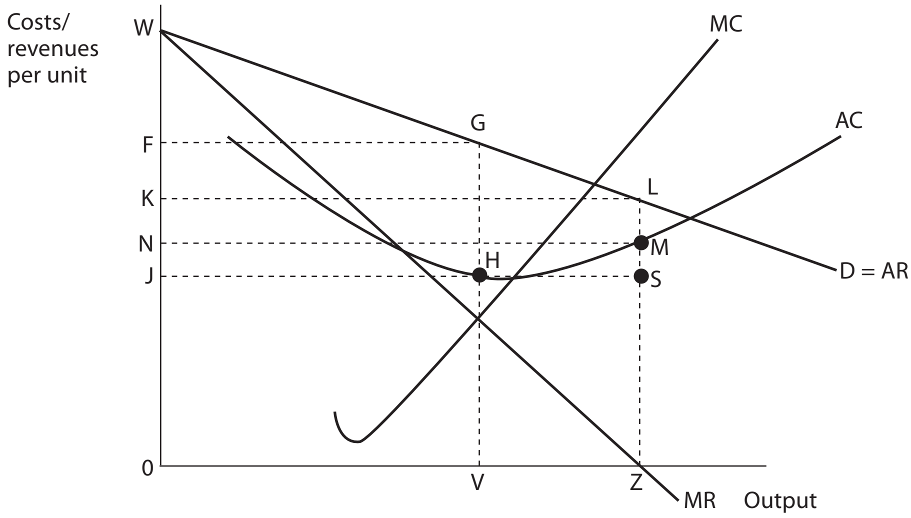
Answer

Explanation

(3)

(Total for Question 6 = 4 marks)

7 The diagram shows a firm in monopolistic competition in the short run.



Which of the following statements is true?

(1)

A New firms will enter the industry in the long run

B Demand for this firm's products will increase in the long run

C Collusion will occur

D The supernormal profit level is NKLM

E The firm is producing where demand is price inelastic.

Answer ☐

Explanation

(3)

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(Total for Question 7 = 4 marks)

8 On 1 November 2009 a new law in the UK gave financial regulators the power to impose fines on banks if they deliver poor service to customers. This method of government intervention in markets is a form of:

(1)

A price capping

B monitoring of prices

C public private partnership

D competitive tendering

E performance targeting.

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 19.

You should spend 55 minutes on this section.

9 Maintaining competition in markets

Extract 1 Reckitt could face £80m fine over Gaviscon 'market abuse'

The household goods giant Reckitt Benckiser (RB) has been accused by the Office of Fair Trading (OFT) of deliberately exploiting its 'dominant market position' to stop National Health Service (NHS) doctors from supplying generic (unbranded) versions of its Gaviscon indigestion medicine. When a patent ends, rival companies can legally copy the ingredients of the drug using the generic formula.

However, RB withdrew Gaviscon Original from the NHS prescription database with the effect that open competition was delayed until 2007. This meant that when doctors tried to prescribe the original product, they could only find the new Gaviscon Advance on the database. This new drug is patent-protected until 2016. An industry informant claimed that generic copies of Gaviscon Original could have saved the NHS about £40 million since 1999, when the patent ended.

If it is found to have abused its power, the OFT could fine RB – which also makes the painkiller Nurofen and the dishwasher powder Finish – up to 10 per cent of its annual sales, which came in at £7.78bn in 2009. The accusation by the OFT is significant because Gaviscon is a major contributor to RB's revenues.

While Gaviscon Original is still available as an over-the-counter product, Reckitt has previously commented that it was the second largest prescribed brand on the NHS. Reckitt said: 'Reckitt Benckiser believes it competes fairly and within the letter and spirit of the law. RB has stated that up to 80% of its revenues and profits from pharmaceutical sales could be lost after the launch of generic competitors.'

Other OFT Investigations

The Office of Fair Trading's assault on the medicines market is the latest example of its increasingly aggressive interventions under chief executive John Fingleton. Since arriving at the OFT in 2006, Mr Fingleton has stepped up the regulator's activities, launching a string of investigations into industries ranging from housebuilding to supermarkets to banking. 'The OFT recently announced a review of barriers to entry, exit and expansion in the retail banking market. We are now talking to various companies about how well some financial markets work. Except where there are serious breaches of the law, the OFT's preference is to seek ways for market problems to be resolved by companies themselves rather than by imposing solutions.'

There have been some OFT failures, for instance the attempt to regulate the banks regarding unauthorised overdraft fees failed when the High Court ruled that the charges were beyond the control of the OFT. However, a string of investigations is continuing, into both market abuse cases and more straightforward competition matters. The OFT is seeking, for example, the right to consider the merger of T-Mobile and Orange in the UK, rather than leaving the decision to Europe's competition watchdogs.

Source: The Independent Online February 24 2010 James Thompson http://www.independent.co.uk/news/business/news/reckitt-could-face-16380m-fine-over-gaviscon-market-abuse-1908493.html' and http://www.telegraph.co.uk/finance/businesslatestnews/7535749/Are-City-markets-working-for-business-and-the-economy.html, 30 March 2010

(a) With reference to Extract 1, explain why governments allow patents to be granted.

(4)

(b) Assess the economic effects on consumers of increased competition from generic (unbranded) products within the healthcare market.

(8)

*(c) With reference to the information provided and your own knowledge, to what extent is the government's competition policy successful in promoting competition between firms?

(12)

*(d) To what extent does the threat of competition affect a firm's behaviour? Answer either with reference to the healthcare product industry or to an industry of your choice.

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(16)

(Total for Question 9 = 40 marks)

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

10 Chocolate Manufacturing and Retailing

Extract 1 Profits rise at Thorntons

Mike Davies, Thorntons' chief executive of the UK's remaining large chocolate manufacturer, reported 25% higher profit, despite a small fall in total sales. As well as from its own shops, Thorntons sells chocolates through its website and to other retailers, such as supermarkets. Sales to other retailers rose by 6.5% to £34.6 million in the 26 weeks to 9 January 2010. In boxed chocolate, Thorntons' sales have grown 82% in the past two years, compared with a 7% decline recorded by Cadbury.

The company hopes that a new range of products will help it to become profitable in the second half of the year, which includes the summer months. Thorntons usually records a loss in the second half of the year, because customers eat less chocolate in warmer weather.

Source: http://business.timesonline.co.uk/tol/business/industry_sectors/retailing/article7031407.ece
The Times February 18, 2010 'Thorntons plays hard ball on the high street as profits rise' Marcus Leroux

Extract 2 Kraft takes over Cadbury to become world's biggest confectioner

Kraft's offer to buy Cadbury was accepted by Cadbury's board on 19 January 2010. Kraft, the US food giant, will pay £11.7 billion for Cadbury in cash and shares, some 50% more than the firm's value before the bidding started in September.

Kraft's acquisition may be a good deal for both companies. Kraft has little presence in Britain's confectionery market, where Cadbury is strong, but it has thriving businesses in mainland Europe and Russia where Cadbury has made minimal progress. Cadbury is strong in India and various Commonwealth countries, and has a booming chewing-gum business, particularly in Europe and Latin America, an area where Kraft has little expertise. Between them they can make up lost ground in China, where Mars holds the upper hand. The deal is also set to yield cost savings of £414m a year for the combined firm, operating at a larger scale in emerging markets. This is a good deal for most Cadbury's workers. However, the fact that so much of the deal is financed by debt is a negative: borrowing that looks cheap today could double in price tomorrow. That would eat up the cost savings on marketing and administration already factored into the purchase price, and perhaps force undesirable cuts to operations. Cadbury is already efficient: under its current management it has reduced costs significantly, for example, by off-shoring more of its operations.

Three-quarters of mergers result in a fall in short run profits. In such a sensitive consumer sector, the risks of a culture clash and brand destruction are high. That is what happened to Terry's, a smaller York-based chocolate company bought by Kraft in 1993. Terry's has lost visibility in Britain since production was relocated to central Europe in 2005. The same problem could await Cadbury.

There are understandable fears that foreign owners will be more likely than domestic ones to axe British jobs or use British profits to pay off their global debts. But all successful big firms, British and foreign alike, respond to the demands and opportunities of the global marketplace these days, and, as Cadbury's current managers have shown, their behaviour is rarely determined by their nationality.

The management practices of multinational companies tend to be better than the average in any country they operate in. In theory, then, Kraft's takeover of a British firm should bring better management to Britain. One problem: Cadbury is itself a multinational, and in no need of lessons from Kraft.

Source: adapted from http://bit.ly/89Azni
'Cadbury goes American. Is this healthy for British manufacturing? ' *The Economist* Jan 19th 2010 and http://bit.ly/aaFiRe Jan 21st 2010 'Manufacturing blues: Another one bites the dust' Jan 21st 2010

Extract 3 Kraft to close Cadbury plant it offered to keep open

Kraft Foods has gone back on its promise to keep open a Cadbury factory in Somerdale near Bristol, just weeks after the British chocolate maker accepted its £11.7 billion offer. The plant, which employs 400 staff, will be closed in 2011. The Unite union said: "This sends the worst possible message to the 6,000 other Cadbury workers in the UK and Ireland. It tells them that Kraft cares little for their workers."

Source: http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/7199322/Kraft-to-close-Cadbury-plant-it-offered-to-keep-open.html Amy Wilson and Jonathan Russell 09 Feb 2010

(a) Using an appropriate cost and revenue diagram, show why 'Thorntons usually records a loss in the second half of the year' (Extract 1, lines 8–9).

(4)

(b) Examine **one** reason why Thorntons is likely to sell its chocolates at a higher price in its retail shops than through its website.

(8)

*(c) Assess how the newly combined Kraft and Cadbury food company could increase its share of the chocolate market in competition with Mars. Refer to game theory in your answer.

(12)

*(d) With reference to the information provided, evaluate whether Kraft's takeover of Cadbury is likely to increase economic efficiency.

(16)

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(16)

(Total for Question 10 = 40 marks)

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