Write your name here

Surname	Other names

Centre Number | Candidate Number

Edexcel GCE

Economics

Advanced
Unit 3: Business Economics and Economic Efficiency

Friday 29 January 2010 – 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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M 3 6 3 6 7 A 0 1 3 2

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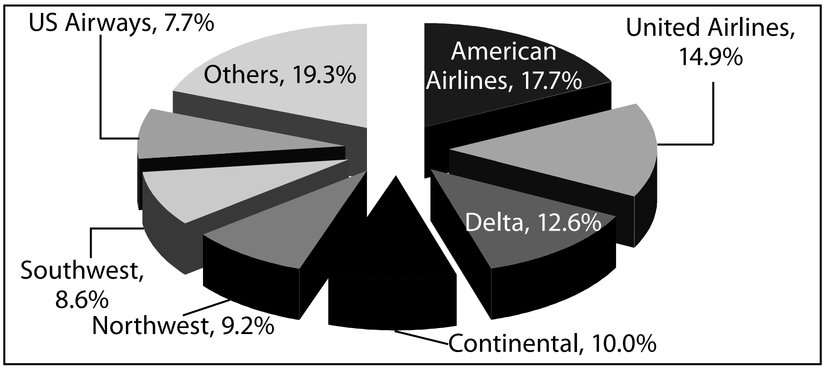
Section A: Answer all the questions in this section

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 The following chart shows the percentage market shares of the US Airline Industry in 2006.



(Source: Adapted from 'Up in the Air' by David Jonas 31 March 2007
http://www.procurement.travel/news.php?cid=airline-procurement-strategy.Mar-07.31)

Which of the following can be deduced from the above information?

(1)

A The four firm concentration ratio is 64.5 per cent

B The US airline industry is monopolistically competitive

C The US airline industry is highly concentrated

D The US airline industry is a natural monopoly

E There are low sunk costs in the US airline industry.

Answer ☐

Explanation

(3)

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(Total for Question 1 = 4 marks)

2 In May 2009 the German airline Deutsche Lufthansa AG took over Austrian Airlines. Which of the following was the most likely motive for this takeover?

(1)

A To avoid diseconomies of scale

B To gain from falling long run average costs

C To avoid an investigation by the Competition Commission

D To increase contestability

E To reduce unemployment.

Answer ☐

Explanation

(3)

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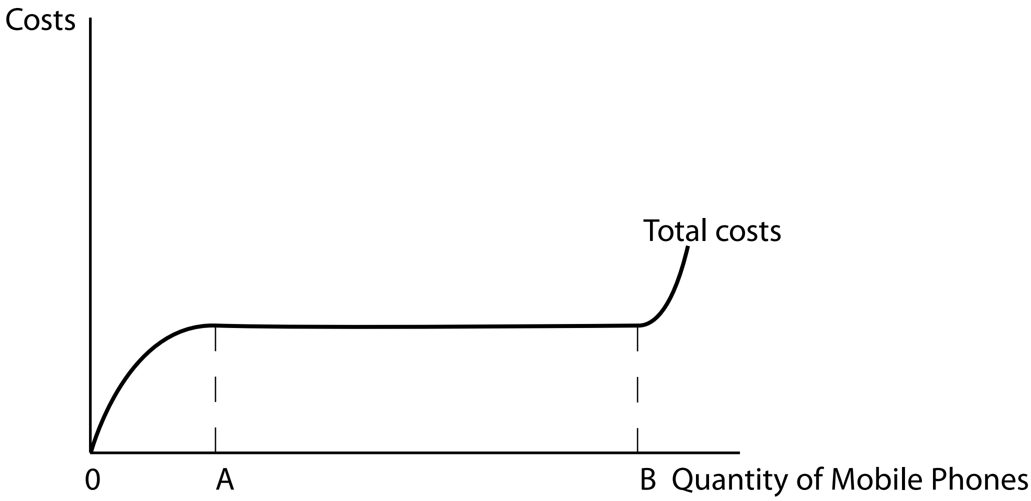
(Total for Question 2 = 4 marks)

3 A mobile phone company finds that its total costs are best illustrated by the following curve. What can be deduced about costs over the usual range of output AB?

(1)



A Total costs are rising

B Marginal costs are zero

C Average costs are constant

D Average costs are rising

E Marginal costs are rising.

Answer ☐

Explanation

(3)

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(Total for Question 3 = 4 marks)

4 Super normal profits being made by a perfectly competitive firm in the short run would disappear in the long run because of

(1)

A freedom of entry into this market

B firms engaging in large scale advertising

C differentiated goods

D allocative inefficiencies

E high sunk costs.

Answer

Explanation

(3)

(Total for Question 4 = 4 marks)

5 A profit maximising monopolist facing constant average costs experiences a decrease in demand. Other things being equal, which of the following is likely to happen?

(1)

	Output	**Price**	**Profit**
A	Stays constant	Falls	Falls
B	Rises	Rises	Stays constant
C	Stays constant	Rises	Falls
D	Falls	Rises	Falls
E	Falls	Falls	Falls

Answer ☐

Explanation

(3)

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(Total for Question 5 = 4 marks)

6 The grid below shows the possible pricing strategies of two ice-cream companies Juju and APJ. Assuming that demand is price inelastic, which of the following strategies shown in the grid would maximise the revenue of the two firms?

(1)

		Juju's price	
		High	Low
APJ's price	High	**A**	**B**
	Low	**C**	**D**

A Both firms set a high price

B APJ sets a high price and Juju a low price

C Juju sets a high price and APJ a low price

D Both firms set a low price

E Both firms set a price to increase consumer surplus.

Answer

Explanation

(3)

(Total for Question 6 = 4 marks)

7 A firm in long run equilibrium under monopolistic competition will be

(1)

A allocatively but not productively efficient

B productively but not allocatively efficient

C productively and allocatively inefficient

D making supernormal profits

E allocatively and productively efficient.

Answer

Explanation

(3)

(Total for Question 7 = 4 marks)

8 In the United States, limits have been placed on profits of recently privatised utilities, relative to the value of their capital assets. What may be considered the biggest disadvantage of this method of regulation?

(1)

A Firms will undervalue their capital assets

B Quality may decline as the regulator forces costs down

C The firm can make unlimited supernormal profits

D Firms have little incentive to become more productively efficient

E Firms are encouraged to make excess profits which they pay out as dividends to shareholders.

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 British Airports

Extract 1 International bidders line up for British Airports Authority (BAA) airport sale

Following a ground-breaking report this week from the Competition Commission, BAA (an airport operator) has been forced to put Gatwick airport up for auction. International infrastructure groups have approached BAA with offers to buy Gatwick, London's second airport, for up to £3 billion. The Spanish company Ferrovial bought BAA for £10.3 billion two years ago.

The competition watchdog says that BAA's ownership of London's three largest airports – Heathrow, Gatwick and Stansted – is against the public interest. It will be the first time the Commission has forced the sale of an asset outside a takeover or merger situation.

The sale process could take two years and could eventually yield a healthy profit for Ferrovial. The sale would end a system of ownership that has existed for more than 40 years. BAA has owned seven of the UK's largest airports, including the London trio, since 1965.

Source: Adapted from 'International Bidders line up for BAA airport sale' by Dominic O'Connell *The Sunday Times* 17 August 2008.

Extract 2 Regulation, not competition, will shape airports

It is quite possible that you could be reading this in an airport lounge sitting out a delay to your flight. You will be irritable and likely to vent your frustration against both the airline and the airport operator which, if you are in southeast England, is most likely to be BAA.

That is why, when the Competition Commission decrees this week that BAA's monopoly of airport ownership should be broken up, the news will be met with almost universal joy.

However, the truth is that even if BAA is forced to sell one of its airports in southeast England – either Gatwick or Stansted, it is unlikely to make any difference to the future of aviation in Britain. The world's big airlines want to go to Heathrow, not to Gatwick or Stansted, and it is doubtful whether a change in ownership will alter that.

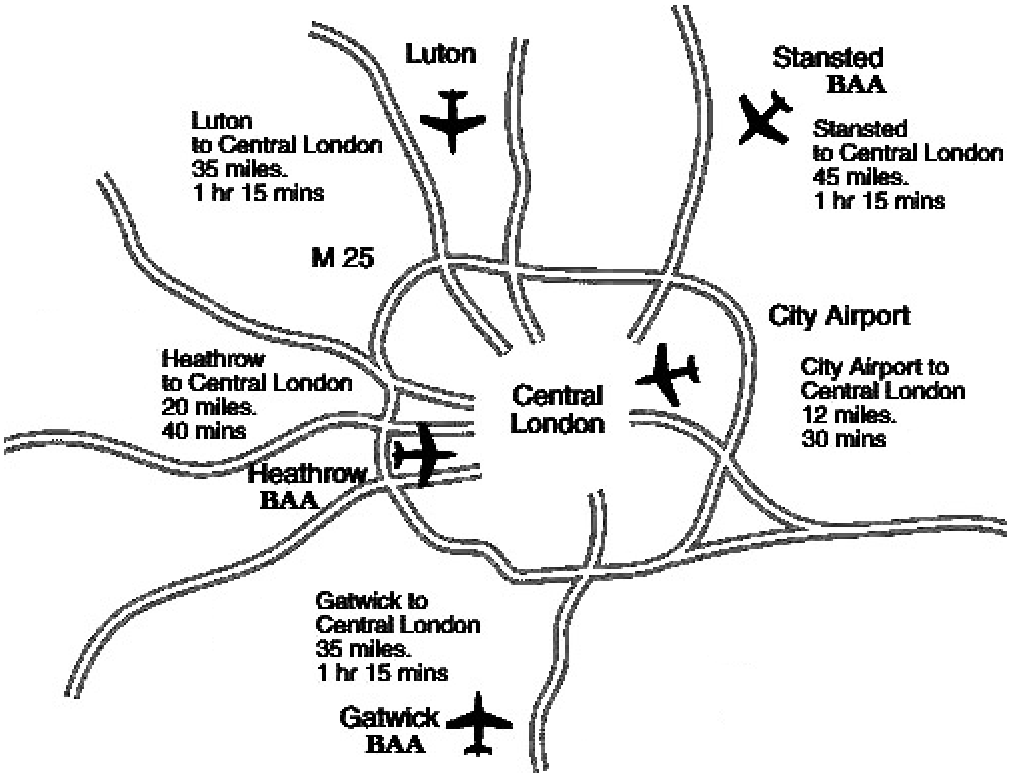
Admittedly it could improve the customer experience and bring in some much-needed competition. However the future of Britain's airports will be determined by regulation and planning rather than by competition.

If a company buys Gatwick it will not alter the fact that BAA is locked in an enormous battle for a second runway at Stansted and a third at Heathrow. The Commission's findings will be welcomed, but they will not address the big picture.

Making airports work financially is about making the best of the asset. That means pressing for more flights and more runways and it is the government that holds the key to that.

Source: Adapted from 'Regulation, not competition, will shape airports' by John Waples *The Times* 16 August 2008.

Figure 1: Map of airports around London



Source: Adapted from http://www.travelguidelondon.co.uk/london-guide/places-and-tourist-sites/london-luton-airport-map-directions-information.html.

(a) What does the information provided suggest is the market structure of the airport industry in London? Explain your answer.

(4)

*(b) Assess the case for increased competition in the airport industry.

(14)

(c) Discuss the effectiveness of the Competition Commission in regulating industries such as the airport industry.

(8)

*(d) BAA charge more for landings at Heathrow than at other airports. Evaluate the reasons for **and** consequences of such a policy.

(14)

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(14)

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(Total for Question 9 = 40 marks)

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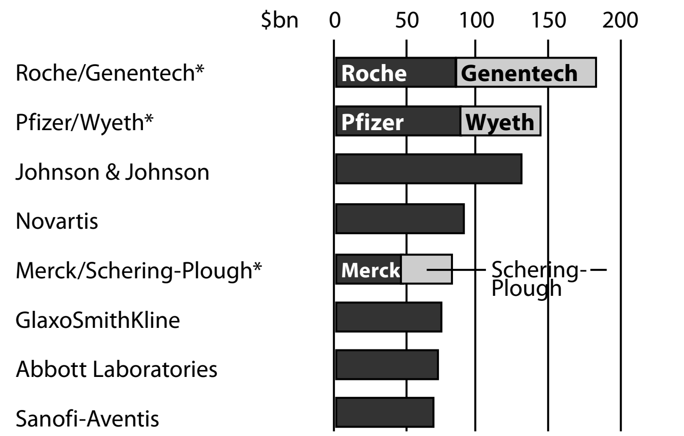
If you answer question 10 put a cross in this box ☒ .

10 The Pharmaceutical Industry

Figure 1: Global Pharmaceutical Companies by market capitalisation, March 2009, $bn



(Source: Thomson Datastream) *Assuming deal goes ahead

Extract 1 Merck's manoeuvres

In recent times there has been a series of mergers between pharmaceutical companies. Merck, a US company, has agreed to take over Schering-Plough; Pfizer is acquiring Wyeth; and Roche, a Swiss pharmaceutical company, is paying $46.8bn for 44% of Genentech, an American firm.

Big drugs companies hope mergers and takeovers will solve their various problems: the lack of new blockbuster drugs coming through their research pipelines; competition from generic (non-brand name) drugs as patents expire, the global economic crisis, and an over-dependence on sales in America, where health-care reforms are likely to reduce profit margins. However, the evidence suggests that many of the supposed benefits of pharmaceutical mega-mergers fail to materialise: bigger firms are no better at innovation, and are often worse. But bosses are pressing ahead anyway.

The main attraction of buying Schering-Plough is that Merck will double (to 18) the number of drugs it has in late-stage development. Merck will also strengthen its international and over-the-counter sales, both areas where Schering is strong (70% of its revenues come from outside America). In addition, Mr Clark promises that there will be cost savings of $3.5 billion a year after 2011. But this sounds unlikely, given that both companies are already cutting costs heavily. And if the two firms' research teams are so complementary and do not overlap much, as Merck claims, who is going to get sacked?

The deal does at least answer critics who complained that Merck was not acting as vigorously as competitors in buying rivals and moving into new markets. But it also represents a change in strategy for Merck, which unlike many of its competitors has stayed on the sidelines during the industry's previous waves of mega-mergers. Instead, the company has always preferred to grow by developing new products in its laboratories. The task for Mr Clark, who will become boss of the new company, will be to make the deal go smoothly, despite his lack of experience with big mergers.

Source: Adapted from 'Merck's manoeuvres' published in *The Economist*, 13 March 2009.

Extract 2 Letter from the Consumers Union to Federal Trade Commission in the USA

Dear Sir:

On behalf of the Consumers Union, we urge you to review carefully the competitive and innovation consequences of the proposed Pfizer-Wyeth pharmaceutical company mergers. Our members consistently tell us that high and ever-rising health care costs are a major household fear, and high brand name prescription drug prices are a particular concern.

We urge the Federal Trade Commission to review this proposed merger and its impact on

– long-run competition in the pharmaceutical industry and its likely impact on drug prices;
– innovation and the development of new, breakthrough drugs.

The merger will result in thousands of employee redundancies. What percent of those lay-offs are in research and development, and are those lay-offs strictly in areas where the two companies were duplicating research, or are new and unique lines of research being terminated?

We are faced with continual abuses of good public policy by many in the industry. For example, some firms use payments to buy delays in the entry of competitive generic drugs into the market.

We hope that you will consider a major study of the entire pharmaceutical industry. Why are prices for consumers so high, why has the breakthrough drug pipeline slowed down, and what policies should we pursue as a nation to encourage the more rapid discovery of affordable medicines? Is this merger between Pfizer and Wyeth good or bad for the goal of affordable, new, life-saving drugs?

Thank you for your consideration of these views.

Sincerely,
William Vaughan
Health Policy Analyst
Consumers Union

Source: http://www.consumersunion.org/pub/campaignprescriptionforchange/009344.html.

(a) What does the information provided suggest is the market structure of the pharmaceutical industry? Explain your answer.

(4)

*(b) Discuss the benefits that Merck might expect to gain through the takeover of Schering-Plough.

(12)

(c) Evaluate **one** pricing and **one** non-pricing strategy that Merck could adopt to increase sales.

(12)

*(d) To what extent would further mergers and takeovers in the pharmaceutical industry be in the best interests of consumers and employees?

(12)

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(4)

Turn over ▶

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(12)

(Total for Question 10 = 40 marks)

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

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