



Rewarding Learning  
ADVANCED  
General Certificate of Education  
2009

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## Economics

Assessment Unit A2 1

*assessing*

Module 3: Production  
and Competition

[A2E11]

TUESDAY 26 MAY, MORNING

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### TIME

1 hour 20 minutes.

### INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.  
Answer Question 1 and **either** Question 2 or Question 3.

### INFORMATION FOR CANDIDATES

The total mark for this paper is 60.

Quality of written communication will be assessed in parts (b), (c) and (e), of  
Question 1 and all parts of Question 2 or 3.

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.

You **must** answer this question.

- 1 The following article was written in July 2008.

Study it carefully and answer the questions which follow.

## **“BA-Iberian merger would create biggest airline in Europe”**

British Airways (BA) has begun merger talks with Iberia, the Spanish national airline. With combined passenger numbers of more than 60 million a year BA-Iberia would overtake Lufthansa, Air France-KLM and Ryanair to become Europe’s biggest airline. 1

This move is the latest in a series of mergers amongst European airlines as they seek to fight the twin threats of soaring fuel costs and falling consumer demand. British Airways has recently announced an 88 per cent fall in pre tax profits for the three months ending in June. Chief Executive, Willy Walsh, described the situation as, “The worst trading environment the industry has ever faced” and predicted, “A number of weak carriers will not survive.” This view was supported by the collapse of the Zoom airline and a rescue of Alitalia by the Italian Government. 2

It is not surprising that, faced with this situation, many airlines are seeking to merge in order to reduce costs and increase revenues. On the cost side, mergers will cut duplication of routes allowing airlines to fly with full or near full planes. There will also be rationalisation of administration and the potential for significant economies of scale in areas such as bulk buying of fuel and aircraft and maintenance. 3

On the revenue side, most carriers have already added fuel surcharges and the budget airlines have introduced a number of stealth price hikes by charging for ancillary services such as baggage check-in and quicker boarding. However, these are only short term expedients and what most airlines are seeking is a permanent increase in ticket prices; something which can only be achieved by reducing competition. 4

Cutting the number of carriers will certainly achieve this and the BA-Iberia merger would give the new super airline control over almost 45 per cent of the total landing slots at Heathrow. Not surprisingly competitors such as Virgin are opposed to the merger. A spokesman said, “We all know that dominant players offer less choice, push up ticket prices and make passengers worse off.” Indeed, high levels of concentration have led to accusations of collusion with the Office of Fair Trading investigating allegations of a price-fixing agreement between British Airways and Virgin Atlantic. 5

One MP went further, and called on the European Commission to completely ban the proposed merger. 6

*Source: Adapted from a variety of sources*

- StudentBounty.com
- (a) Paragraph 1 refers to a proposed merger between BA and Iberia. Explain of  
merger this would represent. [4]
- (b) Explain why the European airline industry might be viewed as oligopolistic.
- (c) Analyse why airlines are experiencing “The worst trading environment the industry has  
ever faced.” (paragraph 2). [6]
- (d) Explain what is meant by “stealth price hikes” (paragraph 4). [4]
- (e) Evaluate the view expressed in paragraph 6 that the proposed merger between British  
Airways and Iberia should be banned. [10]

Answer **either** Question 2 **or** Question 3.

- 2 (a) Explain what is meant by the term “normal profit”.
- (b) Analyse why firms operating under conditions of perfect competition earn only normal profits when in long run equilibrium. [12]
- (c) “The theory of contestable markets provides a better explanation of the behaviour of real world firms than the theory of perfect competition.” Discuss the validity of this view. [12]
- 3 (a) Explain the meaning of the terms short run and long run when referring to firms’ costs. [6]
- (b) Examine the factors which determine the shape of a firm’s long run average cost curve. [12]
- (c) Evaluate the impact of the growth of internet usage and e-commerce on UK firms. [12]

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

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