

Centre No.						Paper Reference	Surname	Initial(s)
Candidate No.						6   3   5   4   /   0   1	Signature	

Paper Reference(s)

**6354/01**

Examiner's use only

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Team Leader's use only

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Question Number	Leave Blank
Section A	
Section B	
Total	

# **Edexcel GCE**

## **Economics**

## **Advanced**

Unit 4 – Industrial Economics

Thursday 26 January 2006 – Afternoon

Time: 1 hour 15 minutes

**Materials required for examination**

Nil

**Items included with question papers**

Nil

**Instructions to Candidates**

In the boxes above, write your centre number, candidate number, your surname, initials and signature. Check that you have the correct question paper.

Answer ALL the questions in Section A in the spaces provided in this question paper.

- For each question there are five suggested answers: A, B, C, D or E.
- When you have selected your answer to the question, write the chosen letter in the box provided.
- You can only offer one answer to each question.
- After making your selection you should offer an explanation of why you have made that choice. Your explanation may include a diagram.

Answer ONE question from Section B in the spaces provided in this question paper.

**Information for Candidates**

The marks for individual questions and the parts of questions are shown in round brackets: e.g. (2). The paper is divided into two sections, A and B; both sections are equally weighted. The total mark for this paper is 80.

There are 24 pages in this question paper. Any blank pages are indicated.

**Advice to Candidates**

You will be assessed on your ability to organise and present information, ideas, descriptions and arguments clearly and logically, including your use of grammar, punctuation and spelling. You are advised to divide your time equally between Section A and Section B.

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## **SECTION A**

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**Answer ALL questions in this section.**

**Write the letter of your chosen answer in the box and then  
explain your choice in the space provided.**

**You are advised to spend approximately 35 minutes on this section.**

**You are encouraged to use a diagram in your explanation where appropriate.**

1. In March 2004, the supermarket business Morrisons made a successful takeover bid for Safeway. This increased Morrisons' share of the UK grocery market to 13.9%. A possible motive for the takeover was to
  - A increase profits from internal growth.
  - B increase revenue from conglomerate integration.
  - C gain more economies of scale.
  - D increase its monopoly power.
  - E reduce costs through vertical integration.

**(a) Answer**

**(1)**

**(b) Explanation**

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**(3)**

**Q1**

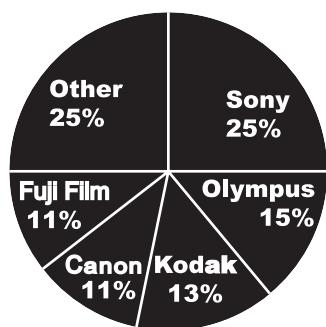
**(Total 4 marks)**



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2.

The US digital camera market



Source: Deutsche Bank 2003

The chart shows the percentage shares of the US digital camera market in 2002.

Which of the following can be inferred from the data?

- A The market has an oligopolistic structure.
- B Barriers to entry are likely to be very low.
- C It is unlikely that significant economies of scale exist in the market.
- D The three firm concentration ratio is below 50%.
- E The market is characterised by monopolistic competition.

(a) Answer

(1)

(b) Explanation

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(3)

Q2

(Total 4 marks)



3

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3.

Total output loaves of bread (daily)	Total cost (£)	Total revenue (£)
0	40	0
100	60	100
200	90	190
300	130	270
400	180	340
500	240	400
600	310	450

The data in the table relate to the daily costs and revenue for a small bakery producing loaves of bread. It can be inferred from the data that the firm is operating under conditions of

- A imperfect competition and constant marginal costs.
- B perfect competition and rising marginal costs.
- C imperfect competition and falling marginal costs.
- D perfect competition and falling marginal costs.
- E imperfect competition and rising marginal costs.

(a) Answer

(1)

(b) Explanation

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(3)

Q3

(Total 4 marks)



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4. In the short run, a train operator might continue to offer off-peak services at reduced prices provided that the total revenue from those off-peak fares covers at least
- A the fixed and variable costs of these train services.
  - B the sales receipts of rival train operators.
  - C the fixed costs of these train services.
  - D the overhead costs of the network.
  - E the variable costs of these train services.

(a) Answer

(1)

(b) Explanation

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(3)

Q4

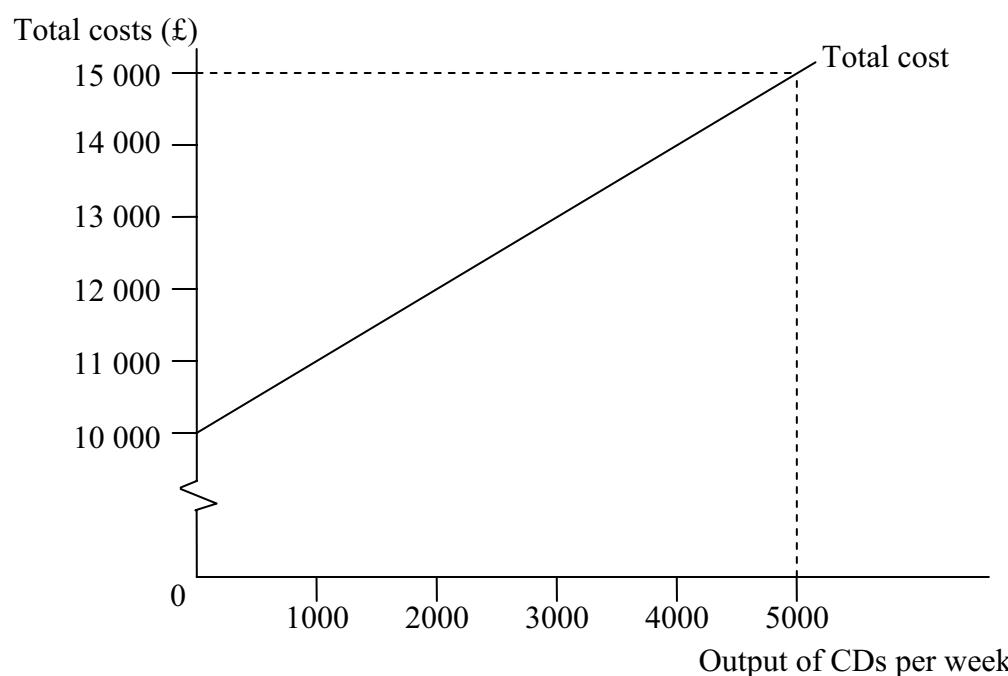
(Total 4 marks)

5

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5.



The diagram shows the total cost function for a music company producing CDs. At an output of 5000 units, average variable cost is

- A £15,000.
- B £5,000.
- C £3.
- D £2.
- E £1.

(a) Answer

(1)

(b) Explanation

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(3)  
(Total 4 marks)

Q5



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6. A profit maximising firm owns the patent rights of a pharmaceutical product. However, it is concerned that, after the patent rights expire, new firms may enter the market. In order to prevent competition the most effective pricing policy might be

- A limit pricing.
- B revenue maximising pricing.
- C allocatively efficient pricing.
- D profit maximising pricing.
- E welfare maximisation.

(a) Answer

(1)

(b) Explanation

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(3)

Q6

(Total 4 marks)



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7. In 2005 Sony launched the ‘Play Station Portable’ to compete with Nintendo’s ‘Game Boy’ in the handheld computer games market. Which of the following is most likely to make it difficult for other firms to enter this market?

- A High levels of contestability
- B The absence of customer loyalty for handheld computer games
- C High sunk costs
- D Strong government laws on anti-competitive practices
- E High profit margins on each handheld computer game sold

(a) Answer

(1)

(b) Explanation

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(3)

Q7

(Total 4 marks)



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8. A soap powder firm in an oligopolistic market may prefer to engage in non-price competition rather than price competition when selling its product because
- A there is limited scope for creating brand loyalty for soap powder.
  - B the demand curve for its soap powder is likely to be inelastic in relation to a price fall.
  - C its marginal revenue is equal to average revenue.
  - D the demand curve for its soap powder is likely to be inelastic in relation to a price rise.
  - E a change in price of soap powder will have no effect on the behaviour of other firms in the market.

(a) Answer

(1)

(b) Explanation

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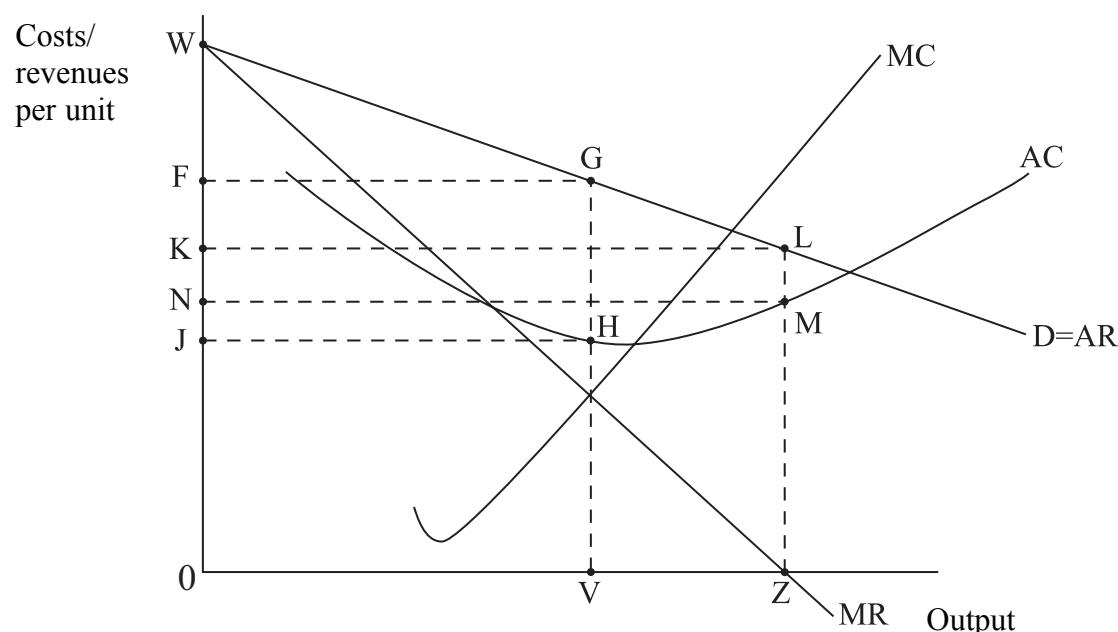
Q8

(Total 4 marks)



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9.



The diagram shows a monopoly's costs and revenues.

Which of the following areas represent its supernormal profits when following a policy of revenue maximisation?

- A FGHJ
- B KLMN
- C WLK
- D FGVO
- E KLZO

(a) Answer

(1)

(b) Explanation

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Q9

(Total 4 marks)



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10. In June 2004, the EU Competition Commissioner, Mario Monti, blocked a proposed £2.7 billion merger between two giant global music companies, Sony and Bertelsmann Music Group. By preventing this merger, the EU Competition Commissioner intended to
- A maintain competition between the major music companies.
  - B avoid unnecessary waste in advertising and sales promotion budgets of the proposed new company.
  - C decrease the rate of technological change in the EU market.
  - D strengthen the collective position of the dominant music companies in the EU market.
  - E increase the ability of music companies to cooperate in price fixing agreements.

(a) Answer

(1)

(b) Explanation

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(3)

Q10

(Total 4 marks)

TOTAL FOR SECTION A: 40 MARKS



11  
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## SECTION B

Answer EITHER Question 11 OR Question 12.

Indicate which question you are answering by marking the box (☒).

If you change your mind, put a line through the box (☒)  
and then indicate your new question with a cross (☒).

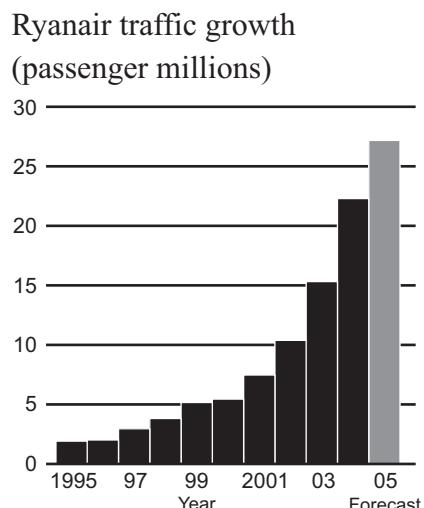
You are advised to spend approximately 35 minutes on this section.

If you answer Question 11 put a cross in this box ☒.

### Question 11

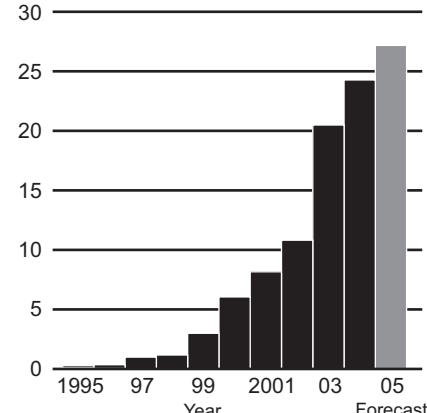
### The Low Cost European Airline Market

Figure 1: Low cost airline passenger numbers



Source: © The Financial Times  
3 November 2004

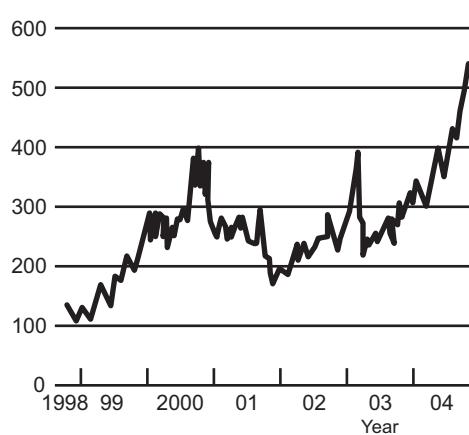
Easy Jet traffic growth  
(passenger millions)



Source: www.easyjet.com

Figure 2: Air fuel price

(\$ per tonne)



Source: © The Financial Times  
3 November 2004



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### Extract 1

European airlines faced mounting turmoil yesterday as Easy Jet shares fell by 25 per cent in response to intense price competition from a host of new low-cost carriers. Ray Webster, chief executive of Easy Jet, one of the two leading European low-cost airlines,

- 5 said: ‘We are seeing unprofitable and unrealistic pricing by airlines as they seek to increase their market share. Greater competition could undermine Easy Jet’s performance in the second half of the year, when it typically generates all its profits’.

In Italy shares in Alitalia, the Italian state-owned airline, were suspended amid falling revenues and rising fuel costs, leading to large financial losses. Several small airlines have already collapsed in France, Germany and Belgium in recent months. Duo, launched in  
10 10 Birmingham last year, is the latest casualty, collapsing at the weekend.

In spite of the failures, firms are poised to enter the low-cost market, attracted by the high profits previously achieved by market leaders Ryanair and Easy Jet. The expansion of the European Union eastwards has also opened up more opportunities. However, there are already more than fifty low-cost carriers in Europe and excess capacity clearly exists,  
15 undermining productive efficiency. There will inevitably be a period of rationalisation and consolidation.

In the short term, the pressures of lower air fares and increased competition are likely to remain, promoting increased efficiency among successful firms. Easy Jet and Ryanair are well placed to cope with these pressures due to their substantial economies of scale, strong  
20 brands and established route networks.

Source: adapted from Kevin Done, ‘Easy Jet takes brunt of airline sector woes’, © *The Financial Times*,  
6 May 2004

- (a) Explain why a low cost airline company such as Easy Jet ‘typically generates all its profits’ in the second half of the year (line 6).

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13

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- (b) With the aid of an appropriate cost and revenue diagram, analyse the reasons that might explain Alitalia's 'large financial losses' (line 8).

Leave  
blank

(8)



- (c) Examine the extent to which the low cost airline market has achieved economic efficiency.

Leave  
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(8)



15

Turn over

- (d) Examine the ability of Easy Jet and Ryanair to survive the pressures of 'lower air fares and increased competition' (line 17).

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**(10)**



(e) Assess the extent to which the European airline industry is contestable.

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(10)

Q11

(Total 40 marks)



17  
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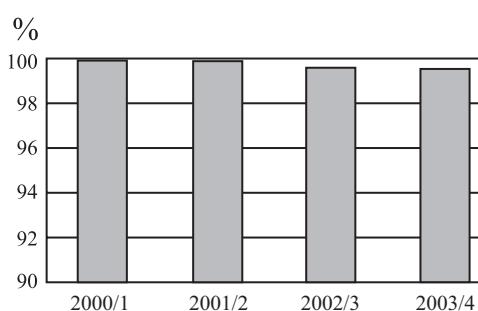
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If you answer Question 12 put a cross in this box .

### Question 12

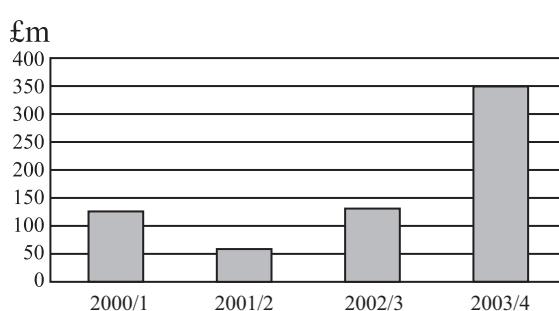
### The Regulation of Royal Mail

**Figure 1: Royal Mail's market share – letter delivery services**



Source: Postal Services Commission,  
[www.psc.gov.uk](http://www.psc.gov.uk)

**Figure 2: Royal Mail's profits – letter delivery services**



Source: Postal Services Commission,  
[www.psc.gov.uk](http://www.psc.gov.uk)

The principal aim of Postcomm (the Postal Services Commission) is to protect the interests of consumers. It believes this is best achieved through promoting competition whilst maintaining a universal postal service at an affordable uniform price.

- 5 In April 2001 Postcomm imposed a series of price-capping measures on the main supplier of postal services, Royal Mail, to last until March 2006. The effect will be to reduce the price of letter delivery services in real terms by 5% over the period. Within the overall price cap, Royal Mail is allowed to increase individual prices as long as it reduces other prices to compensate. It is likely that bulk mailers will be the main beneficiaries of reduced prices rather than small users. However, cost-cutting measures might reduce the 10 quality of service.

Postcomm has set the Royal Mail a number of performance targets which include achieving a 92.5% next-day delivery for First Class mail. In 2002-03, the company achieved just 84% and was duly fined £7.5 million.

- 15 In January 2003, Postcomm opened up 40% of Royal Mail's market to competition. This is likely to be followed by a further 30% in 2005 and a final 30% in 2007. After more than a year of deregulation, Royal Mail has maintained almost a 100% market share. There are a number of reasons for this, including significant economies of scale, brand recognition and customer inertia. Furthermore, all potential competitors need Royal Mail to deliver some of their mail while they are building up their businesses.
- 20 Deutsche Post, the German postal group, has just announced an access agreement with Royal Mail for entry into the UK market. It will pay Royal Mail 13 pence for each letter delivered on its behalf. The German company has agreed to avoid 'cherry-picking' the lucrative urban delivery services, the profits of which Royal Mail uses to subsidise loss-making rural services.

Source: adapted from 'The UK Postal Regulatory Regime: Key Indicators', Postcomm, 10 May 2004; [www.psc.gov.uk](http://www.psc.gov.uk)



(a) (i) Using a diagram, explain the concept of monopoly.

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(4)



19

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- (ii) To what extent is the Royal Mail letter delivery service a monopoly?

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(6)

- (b) (i) Royal Mail charges different prices to bulk mailers and small users of the letter delivery service. Analyse **two** possible objectives of this policy.

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- (ii) Outline the conditions necessary for Royal Mail to undertake successful price discrimination.

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- (c) Examine the likely impact of ‘price-capping’ (line 4) and ‘performance targets’ (line 11) on the efficiency of the UK’s postal services.

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blank

(10)



- (d) Assess the extent to which Postcomm's decision to open up the letter delivery market to competition is in the interests of consumers.

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Q12

(Total 40 marks)

**TOTAL FOR SECTION B: 40 MARKS**

**TOTAL FOR PAPER: 80 MARKS**



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