

SECTION A**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 35 minutes on this section.****You are encouraged to use a diagram in your explanation where appropriate.****1. Orders for New Container Ships**

Container capacity (number of containers a ship can carry)	Orders for new container ships
Under 2000	264
2000–3999	520
4000–5999	904
6000+	1485
Total	3173

Source: © *Financial Times*, 17 December 2004

The table shows orders for new container ships by carrying capacity. It can be inferred from the data that the transport of containers by ship has

- A** significant economies of scale.
- B** low start-up costs.
- C** constant returns to scale.
- D** increasing marginal costs.
- E** diseconomies of scale.

Please write your answer and explanation on the next page.

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(a) **Answer**

(1)

(b) **Explanation**

(3)

(Total 4 marks)

Q1

3

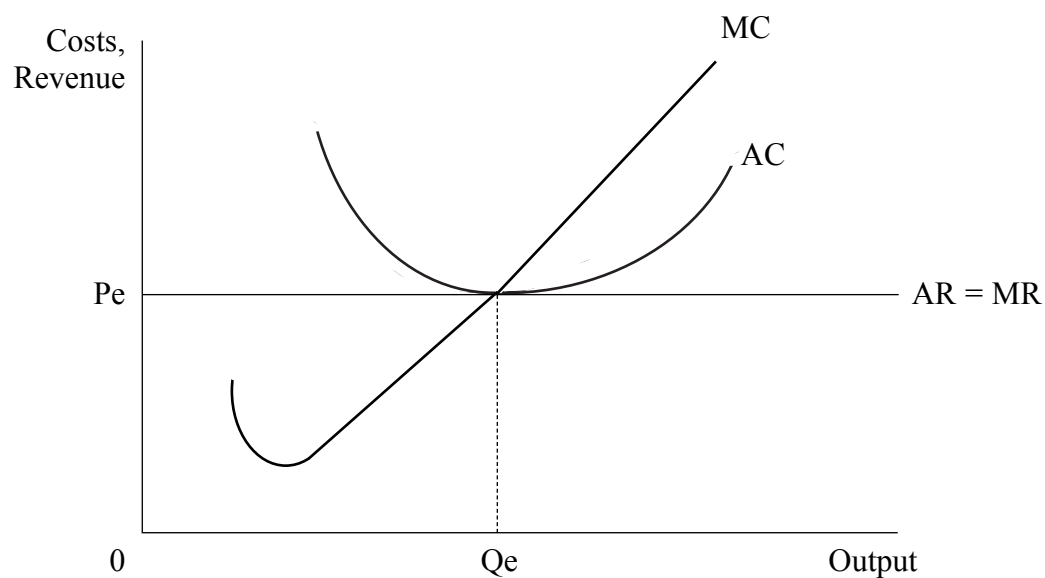
Turn over



M 2 2 2 4 8 A 0 3 2 8

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2.



The diagram shows a firm producing at output $0Q_e$. Which of the following applies to such a firm?

- | Market Structure | Profit |
|-----------------------------------|---------------|
| A Monopolistic Competition | Normal |
| B Perfect Competition | Supernormal |
| C Monopolistic Competition | Supernormal |
| D Perfect Competition | Normal |
| E Contestable Market | Supernormal |

Please write your answer and explanation on the next page.



Leave blank

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q2



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3. A manufacturer of jeans has constant average costs over its normal range of output. It decides to operate a cost-plus pricing policy. The most likely objective of this pricing policy is to
- A achieve allocative efficiency in pricing.
 - B minimise consumer surplus.
 - C discourage new entrants to the market for jeans.
 - D achieve sales maximisation.
 - E achieve a target level of profit.

(a) **Answer** (1)

(b) **Explanation**

(3)

(Total 4 marks) Q3



Leave blank

4. A manufacturer of high-grade flat glass enjoys monopoly power and operates at a profit-maximising level of output. Which of the following statements must be true?

- A Marginal revenue is positive.
- B Raising output will reduce the manufacturer's total revenue.
- C Marginal revenue is negative.
- D Demand is price inelastic.
- E Marginal cost will be above average cost at this level of output.

(a) Answer

(1)

(b) Explanation

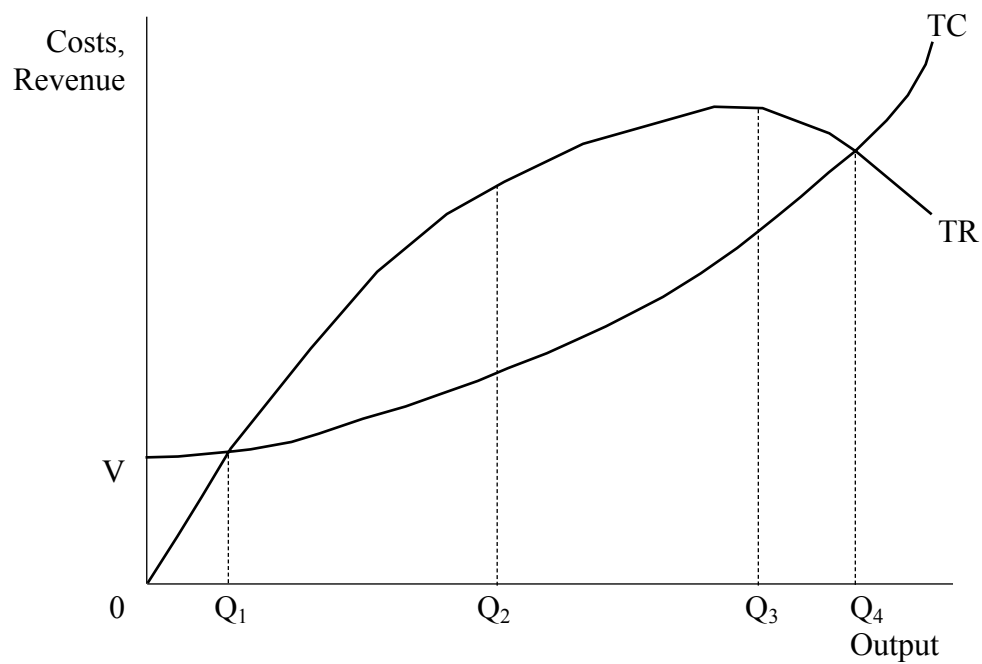
(3)

(Total 4 marks)

Q4



5.

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The diagram shows the costs and revenue curves for a small airline company. Which of the following statements is true?

- A Total revenue equals total variable cost at output Q1.
- B Revenue maximisation is at output Q2.
- C Profit maximisation is at output Q3.
- D Sales maximisation is at output Q4.
- E Marginal revenue is positive but falling between output Q3 and Q4.

Please write your answer and explanation on the next page.



Leave
blank

(a) **Answer**

(1)

(b) **Explanation**

(3)

Q5

(Total 4 marks)



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6. A profit-maximising monopolist with constant average costs experiences a decrease in demand. Other things remaining equal, which of the following is likely to happen?

	Output	Profit	Price
A	Fall	Fall	Rise
B	Stay constant	Fall	Stay constant
C	Fall	Fall	Fall
D	Stay constant	Fall	Fall
E	Fall	Rise	Stay constant

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q6



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7. An Indian restaurant operates in a monopolistically competitive market. The restaurant is likely to
- A have a wide choice of dishes and develop customer loyalty.
 - B operate at the output which gives the lowest cost per dish.
 - C collude with other Indian restaurants and make supernormal profits in the long run.
 - D charge a price equal to the cost of the ingredients.
 - E offer identical menus to other Indian restaurants and set the same prices.

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q7



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8. In December 2004 the supermarket Tesco charged £5.99 for a copy of the book *Bridget Jones's Diary* to its internet customers, but only £3.73 to its in-store shoppers. This information suggests that

- A resale exists between Tesco's internet and in-store customers.
- B Tesco is using limit pricing policies for its internet customers.
- C there is a higher price elasticity of demand for the book among Tesco's internet shoppers than its in-store customers.
- D it costs less to supply internet shoppers than in-store customers.
- E there is a difference between the price elasticity of demand for Tesco's internet customers and its in-store shoppers.

(a) Answer

(1)

(b) Explanation

(3)

Q8

(Total 4 marks)



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9. A light aircraft manufacturer finds that by lowering the price of its planes from £1.2 million to £1.1 million each, annual sales increase from four to five. The marginal revenue gained from the sale of one extra plane is

- A £0.3 million.
- B £0.5 million.
- C £0.7 million.
- D £0.9 million.
- E £1.1 million.

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q9



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10. In December 2004, EU Competition Commissioner Neelie Kroes announced that she would block the proposed merger between the state-owned gas and electricity industries in France. The most likely reason for her decision was to

- A enable both industries to achieve the minimum efficiency of scale.
- B prevent a further increase in barriers to entry.
- C avoid diseconomies of scale associated with mergers between large firms.
- D increase profits in both industries.
- E protect the producer surplus in each industry.

(a) Answer

(1)

(b) Explanation

(3)

(Total 4 marks)

Q10

TOTAL FOR SECTION A: 40 MARKS



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SECTION B

Answer EITHER Question 11 OR Question 12.

Write your answers in the spaces provided.

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 should spend approximately 35 minutes on this section.

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

Question 11

The Water Industry

Figure 1: Permitted increases in average household water and sewerage bills

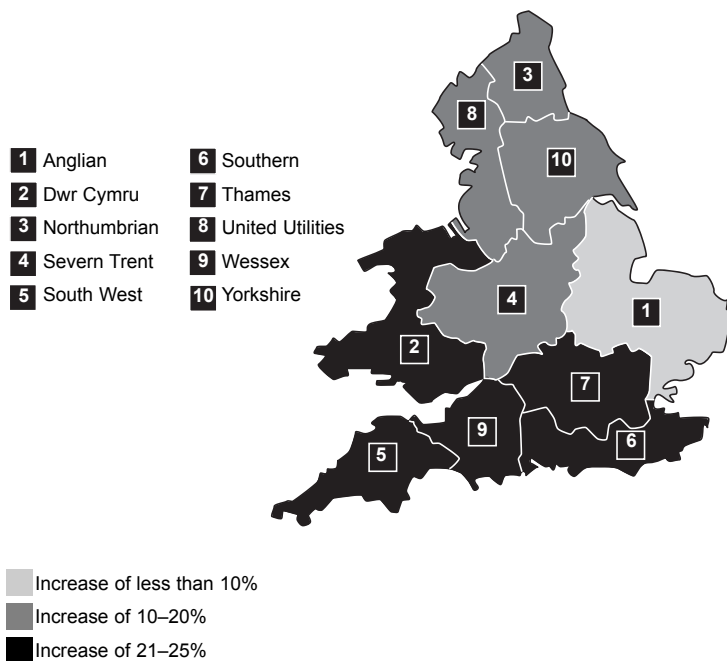


Figure 2: Capital expenditure targets

Company	£m
Anglian	1466
Dwr Cymru	1145
Northumbrian	839
Severn Trent	2201
South West	762
Southern	1563
Thames	3092
United Utilities	2505
Wessex	755
Yorkshire	1453
Other	1055
Industry total	16,836

Source: Andrew Taylor, 'Regulator has a difficult balancing act', © *Financial Times*, 3 December 2004



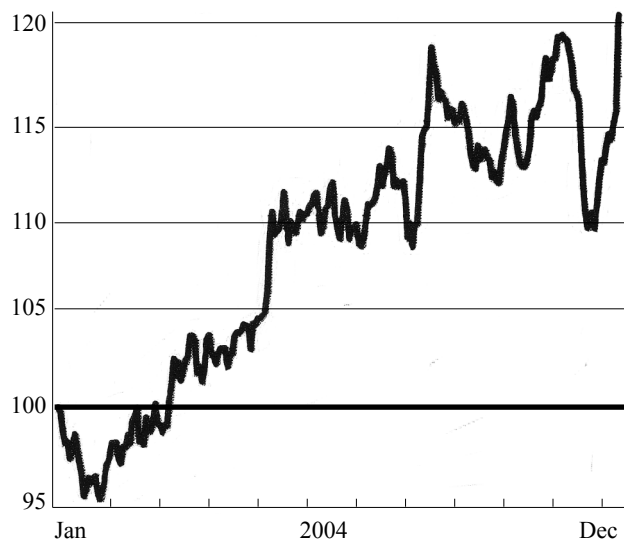
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Figure 3
Customer service and water supply

	1993	2003
Written complaints answered in 10 working days	81.9%	99.8%
Bill enquiries answered in 5 working days	78.8%	99.5%
Unplanned interruptions to household water supply for over 12 hours	0.42%	0.05%

Source: www.ofwat.gov.uk

Figure 4
UK water companies' average share price, 2004 (relative to FTSE 100)



Source: © *Financial Times*, 3 December 2004

Extract 1

The price of water and sewerage services for households in England and Wales will rise in real terms by an average of 18 per cent over the next five years, the industry regulator, Ofwat (Office for Water Services), said yesterday. The announcement came as a surprise since the regulator had previously signalled a smaller real price rise of 13 per cent. However, Philip Fletcher, the Director-General of Ofwat, came under intense pressure from water companies and environmental groups to allow the greater price increase.

5

The higher water bills will pay for a huge £16.8 billion five-year investment programme to increase efficiency and improve water quality and sewerage treatment. In recent years significant improvements have been made, for example water leakage rates have fallen by 33 per cent since 1995 – enough to supply the daily needs of more than 12 million people. The quality of drinking water has also increased, with 99.87 per cent of tests meeting the minimum standards set.

10

However, not everyone was pleased with the price increases. Peter Bowler, campaigns director at Water Watch, an independent watchdog, said: ‘These increases are way above inflation’ and show that the ‘regulatory system protects water companies and their profits at the expense of consumers’.

15

Source: adapted from Andrew Taylor, ‘Water bill rises surprise City’, © *Financial Times*, 3 December 2004; and © Valerie Elliott, ‘Water watchdog goes with the flow of 18% price rise’, *The Times*, London, 3 December 2004



Leave blank

(a) Explain **two** aims of an industry regulator such as Ofwat.

Handwriting lines for question (a)

(6)

(b) (i) Explain the meaning of the sentence ‘The price of water and sewerage services ... will rise in real terms by an average of 18 per cent over the next five years’ (Extract 1, lines 1 and 2).

Handwriting lines for question (b) (i)

(2)

(ii) With reference to Figures 1 and 2, analyse **one** possible reason why the permitted price increases in household water and sewerage vary between regions.

Handwriting lines for question (b) (ii)



Leave blank

Five horizontal lines for writing.

(4)

(c) Examine **one** advantage and **one** disadvantage a water company might experience from a regulatory price control period which lasts for five years.

Twenty horizontal lines for writing.

(8)



Leave blank

(d) Examine the extent to which the 'regulatory system protects water companies and their profits at the expense of consumers' (*Extract 1, lines 16 and 17*).

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(10)



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

Question 12 The Brewing Industry (Producers of Beer)

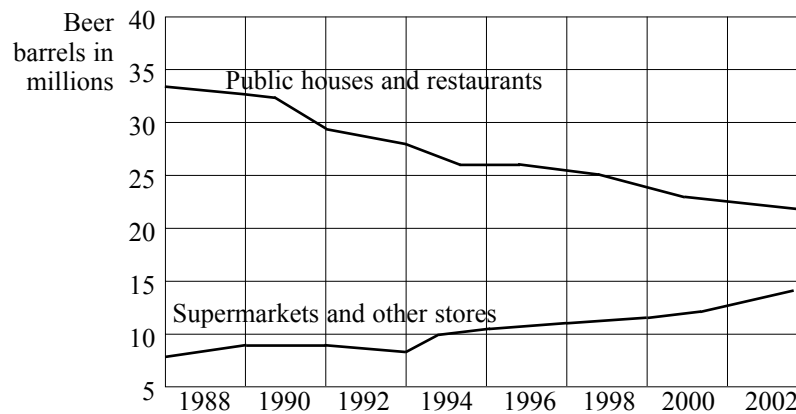
Figure 1 Market share of brewery firms (producers of beer)

(percentage value of sales)

Scottish Courage	26.4
Coors	18.7
Interbrew	17.1
Carlsberg-Tetley	12.8
Diageo	6.5
Anheuser-Busch	2.9
Others	15.6

Source: *www.interbrew.com*

Figure 2 Beer sales (Great Britain) Public House and restaurant sales of beer compared to home consumption from supermarkets and other stores selling beer



Source: *www.interbrew.com*

Extract 1

Beer producers have faced two major problems over the past decade:

First, the competition authorities forced the breweries to sell off most of their public houses (pubs) to protect consumer interests by promoting competition. This broke up a vertically integrated industry and led to the creation of large companies that owned pubs, who were able to drive down the price at which they purchased beer from the breweries. The decision may have promoted competition between the companies which owned pubs, but it also led to the closure of more than forty smaller breweries and an increase in industrial concentration. Several major brewing firms including Bass and Whitbread even sold their beer production facilities and diversified into other leisure interests, such as hotels, restaurants and health clubs.

Second, the consumption of beer is falling as fewer people visit pubs. Consumer tastes have become more sophisticated, with many preferring wine. Wine bars, coffee bars and health clubs now compete with the pub trade on high streets. However, the 'take home' market for beer is still growing, with sales in supermarkets and other stores performing well, helping to offset the overall decline in consumption.

The breweries are fighting back through advertising campaigns and the launch of new brands, including multi-coloured and flavoured beers. Every attention to detail is given including the design and branding of beer glasses. The pub companies have also been active, undertaking costly refurbishment programmes to create popular themes, ranging from Irish to Japanese pubs. Furthermore, many small breweries still survive, despite market trends.

Source: adapted from © Jamie Doward, 'It will never be the same down your local boozer', *The Observer*, London, 11 February 2001



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(a) With reference to Figure 1, identify the market structure of beer production. Justify your answer.

(4)

(b) (i) Explain the meaning of a 'vertically integrated industry' (*Extract 1, line 4*).

(2)



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Lined writing area for the answer to Question 12.

(10)

Q12

(Total 40 marks)

TOTAL FOR SECTION B: 40 MARKS

TOTAL FOR PAPER: 80 MARKS

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