

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

Paper Reference(s)

6354/01

**Edexcel GCE
Economics
Advanced**

**Unit 4 – Industrial Economics
Friday 25 January 2008 – Afternoon
Time: 1 hour 15 minutes**

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	

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, initial(s) and signature.

Check that you have the correct question paper.
Answer ALL 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 28 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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Turn over



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.** Which of the following markets has characteristics closest to the model of perfect competition?
- A** Pharmaceuticals
 - B** Wheat
 - C** Telephone services
 - D** Banking services
 - E** Steel

(a) **Answer:**

(1)

(b) **Explanation**

(3)

Q1

(Total 4 marks)



2. Market Share for National Daily Quality Newspapers

National Daily Quality Newspaper	Ownership	Market share % 1999*	Market share % 2006*
The Daily Telegraph	Telegraph Group Ltd	36.24	34.38
The Times	News Corporation plc	24.89	25.58
Financial Times	Pearson Group plc	17.42	16.23
The Guardian	Guardian Newspapers Ltd	14.25	14.20
The Independent	Independent Newspapers Ltd	7.20	9.61
Total	-----	100%	100%
Total daily circulation	-----	2.673 million	2.609 million

* Average daily sales for the months of December 1999 and July 2006

Source: *abc.org.uk*

The table shows the market shares for national daily quality newspapers in 1999 and 2006. It can be deduced that over the period shown

- A sales revenue for The Times increased by 0.69%
- B the total daily circulation of quality newspapers increased
- C the newspaper industry became more perfectly competitive
- D The Guardian newspaper experienced a larger fall in sales than The Daily Telegraph
- E the three-firm concentration ratio decreased.

(a) **Answer:**

(1)

(b) **Explanation**

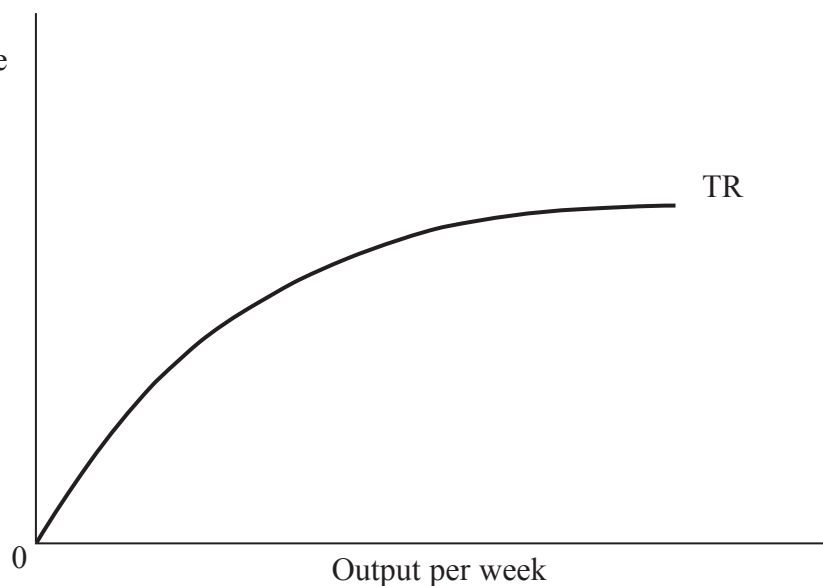
(3)

Q2

(Total 4 marks)



3. Total Revenue (£)



The diagram shows a firm's total revenue as output increases. Which of the following best characterises such a firm?

- | | Average Revenue | Marginal Revenue |
|----------|------------------------|-------------------------|
| A | Constant | Constant |
| B | Rising | Falling |
| C | Falling | Falling |
| D | Falling | Rising |
| E | Rising | Rising |

(a) **Answer:**

(1)

(b) **Explanation**

(3)

Q3

(Total 4 marks)



Leave
blank

4. The government sold the state-owned design and servicing division of British Nuclear Fuels Limited to Toshiba for £3 billion in 2006. The most likely reason for the sale was to

- A** reduce contestability within the industry
- B** achieve *x* inefficiency
- C** open up the industry to ‘hit and run’ competition
- D** achieve benefits from privatisation
- E** avoid an investigation from the Competition Commission.

(a) Answer:

(1)

(b) Explanation

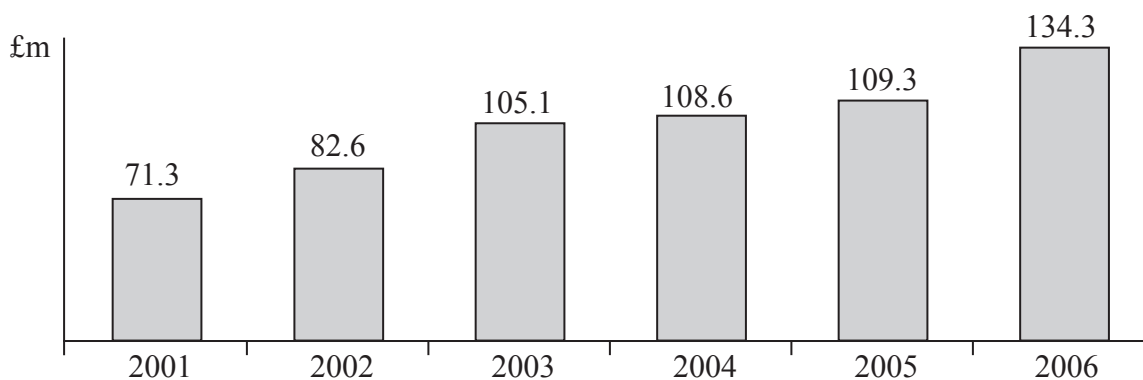
(3)

Q4

(Total 4 marks)



5. Proctor & Gamble's Advertising Expenditure on Beauty Products in the UK



Source: *The Times*, 27 February 2006

The chart shows Proctor & Gamble's advertising expenditure on its beauty products (such as Max Factor, Olay and Pantene) in the UK between 2001 and 2006. This trend in advertising expenditure is likely to

- A reduce market concentration
- B increase hit and run competition in the beauty industry
- C reduce contestability
- D decrease sunk costs for beauty products
- E reduce entry barriers.

(a) **Answer:**

(1)

(b) **Explanation**

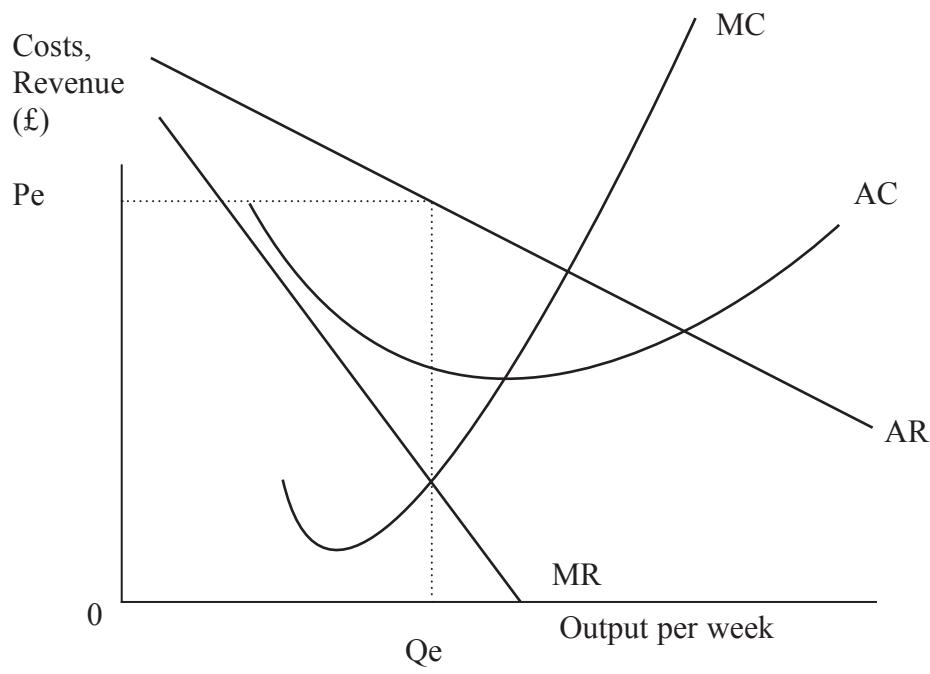
(3)

Q5

(Total 4 marks)



6.



The diagram shows a profit-maximising dry cleaning business with monopoly power in a small town operating at output Q_e and price P_e . Other things remaining equal, a significant increase in the cost of materials used for dry cleaning clothes is likely to cause:

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

(a) **Answer:**

(1)

(b) **Explanation**

(3)

Q6

(Total 4 marks)



7. In 2006 Great Universal Stores (GUS) split into two separate businesses, Argos Retail Group (ARG) and Experian. ARG took control of Argos and Homebase retail stores whereas Experian took control of the credit checking and marketing businesses. The most likely reason for the demerger might have been that GUS was facing
- A increasing long-run average costs
 - B an increase in exit barriers
 - C constant returns to scale
 - D predatory pricing from its competitors
 - E decreasing long-run average costs.

(a) **Answer:**

(1)

(b) **Explanation**

(3)

Q7

(Total 4 marks)



8. Minicab taxi firms are best described by the model of monopolistic competition. Which of the following will be true for such firms in long-run equilibrium?

	Productive efficiency	Profit	Product
A	Yes	Supernormal	Homogenous
B	No	Normal	Differentiated
C	Yes	Normal	Homogenous
D	No	Supernormal	Differentiated
E	Yes	Normal	Differentiated

(a) Answer:

(1)

(b) Explanation

(3)

(Total 4 marks)

Q8



9. Ofcom, the telecommunications regulator, ended more than twenty years of price controls for telephone calls and line rentals on British Telecom in August 2006. The most likely reason for Ofcom's decision is that
- A British Telecom is no longer required to raise prices by less than mortgage interest payments
 - B profit capping is ineffective in protecting consumer interests
 - C British Telecom's prices have increased above the rate of inflation over recent years
 - D significant competition now exists in the industry
 - E the rate of technological change in the industry is set to increase.

(a) Answer:

(1)

(b) Explanation

(3)

Q9

(Total 4 marks)



10. An investigation into store cards by the Competition Commission in 2006 found that most retailers were charging their customers an annual interest rate of around 30%, far greater than the rate required to cover costs. The Commission proposed a series of measures to reduce interest rate charges on store cards. A likely intention of these measures was to make the retail store card market

- A less contestable
- B more allocatively efficient
- C more concentrated
- D more profitable
- E less regulated.

(a) **Answer:**

(1)

(b) **Explanation**

(3)

Q10

(Total 4 marks)

TOTAL FOR SECTION A: 40 MARKS



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 are advised to spend 35 minutes on this question.

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

Question 11 Price Fixing in the Air Travel Industry

Figure 1

Economy return ticket prices for British Airways and Virgin Atlantic – from London Heathrow to:

Destination	British Airways	Virgin Atlantic
New York	£377.60	£377.60
Washington	£542.60	£542.60
Shanghai	£524.10	£524.10
Tokyo	£827.60	£827.60
Johannesburg	£698.30	£698.30
Delhi	£446.10	£446.10
Sydney	£804.40	£804.40
Beijing	£764.10	£687.10
Singapore	£731.10	£723.10
Los Angeles	£766.60	£796.60

Note: the figures refer to fares on selected dates between July and November 2006.

Source: *The Times*, 23 June 2006

Figure 2

Economy return ticket prices for British Airways from London Heathrow to Boston Airport, USA

Date of flight 2007	Return price
Friday 6th April	£527.30
Saturday 7th April	£557.30
Sunday 8th April	£298.30
Monday 9th April	£268.30
Tuesday 10th April	£268.30

Source www.britishairways.com



Extract 1

British Airways faces investigation

British Airways (BA) is facing fines of up to £850 million and a criminal investigation after allegations of price fixing on flights. The Office of Fair Trading has launched an investigation into a series of fuel surcharges added on to ticket prices by BA, Virgin Atlantic, American Airlines and United Airlines. The four airlines have broadly increased ticket prices at the same time and by the same amount on transatlantic flights. Noel Josephides, director of Independent Tour Operators stated: ‘Why is it that when BA put up fares all the others follow suit with very similar numbers? You pay it when you book, though you may not be travelling until later in the year. None of us know what the cost of fuel will be then. The suspicion is that it is a big money-making exercise’.

However, a spokesman for Virgin Atlantic said it was not surprising that the four airlines had announced ticket price increases by the same amount and on the same day because they were reacting to movements in the price of oil. ‘No one questions airlines ending up with the same air fares following a period of price cutting – so why should we see price increases any differently if they are responding to changing market conditions?’

Under a long-standing agreement between the British and American governments, the four companies are the only airlines allowed to fly between London Heathrow and US airports. Investigations into price fixing are almost always triggered by one company confessing its involvement in collusive practices in return for leniency. If found guilty, the companies face heavy fines and their directors risk up to five years imprisonment. A spokeswoman for the Office of Fair Trading said that the investigation could take years to complete.

Source: adapted from ‘British Airways face £850 million fine over price-fixing claim’ by Ben Webster, *The Times*, 23 June 2006



(b) (i) To what extent does the information provided indicate that airlines have entered into price-fixing agreements?

Lined area for writing the answer to question (b) (i).

(6)

(ii) **Apart from price fixing**, explain **one** collusive practice that firms in an industry might undertake.

Lined area for writing the answer to question (b) (ii).

(3)

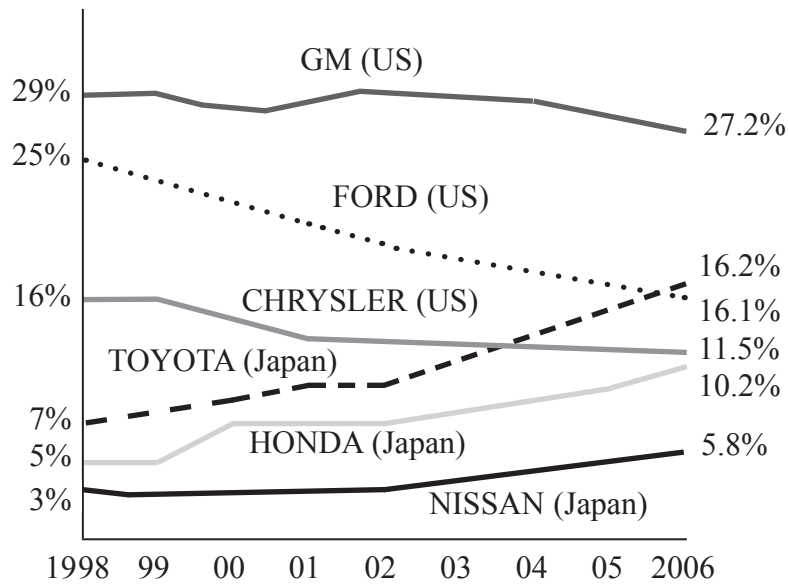


If you answer Question 12 put a cross in this box .

Question 12

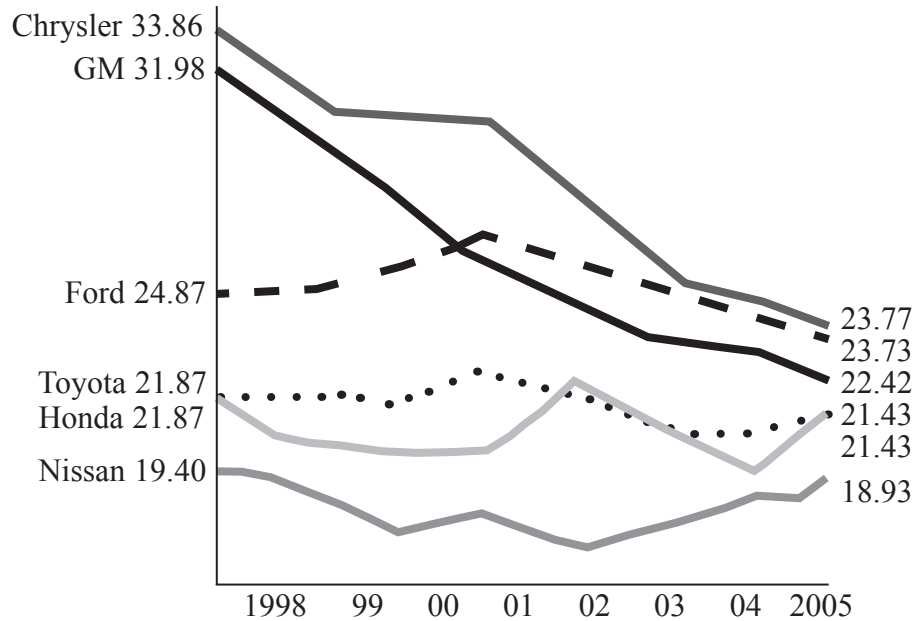
The US Motor Vehicle Market

Figure 1
US market share of major motor vehicle manufacturers



Source: www.autodata.com

Figure 2
Assembly hours per vehicle



Source: Harbour Consulting, reported in *The Guardian*, 13 September 2006



Extract 1

Problems among US car manufacturers

The US motor vehicle industry, once viewed as the proud cornerstone of America's economy, is in a mess. In the first half of 2006 General Motors (GM) lost \$2.7bn and Ford \$1.4bn. At Chrysler, a loss of \$1.7bn is predicted in the third quarter of 2006. Rising costs and falling demand for American motor vehicles are to blame. American consumers have lost confidence in their own 'big three' car manufacturers. While new vehicle sales have remained stable between 16.5m and 17m annually, US manufacturers' market share continues to fall at the expense of the Japanese firms, Toyota, Honda and Nissan. 5

The American firms have been slow to react to rising petrol prices and the consequent growing demand for smaller vehicles. GM's Hummer and Jeep Grand Cherokee models are built like tanks to withstand accidents rather than to win awards for fuel-efficiency. Similarly, Ford's pick-up trucks and sports utility vehicles are well known petrol guzzlers. The ten most popular fuel-efficient vehicles sold in the US are all made by Japanese and German car manufacturers. 10

Another major problem among US car manufacturers rests with employee costs. According to David Cole from the Centre for Automotive Research, employee costs have risen much faster than inflation for many years. He blames high company healthcare costs (GM's alone came to \$5.6bn in 2005) and agreements with trade unions which mean staff still receive 90% of their wages even when factories are temporarily closed due to low demand. Mr Cole says US cars typically cost \$2,000 to \$2,500 more to make than international competitors. However, he believes there is a sufficient sense of urgency to overcome the problems. 15 20

The American firms intend to reduce their workforces drastically and cut production costs in other ways. Ford is set to reduce its workforce by 30,000 over the next few months. It is also considering selling off Britain's Aston Martin, Land Rover and Jaguar cars to raise cash. They need to respond quickly as competition is set to increase by the entry of Chinese manufactured cars to the American market. 25

Source: adapted from 'The wheels fall off Motor City: US car firms search for a new model' by Andrew Clark, *The Guardian*, 13 September 2006





Leave blank

(a) With reference to Figure 1, describe the changing market shares of US and Japanese motor vehicle manufacturing firms from 1998 to 2006.

Lined area for answer (a)

(3)

(b) Discuss **one** reason why many motor vehicle manufacturing firms have become multinational companies.

Lined area for answer (b)

(5)



M 2 9 2 7 3 A 0 2 2 2 8



(f) Discuss the entry barriers that Chinese firms may face in selling cars in the US motor vehicle market.

[Lined area for student response]



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