



Rewarding Learning

ADVANCED
General Certificate of Education
January 2010

Economics

Assessment Unit A2 1

Business Economics

[AE211]



FRIDAY 29 JANUARY, AFTERNOON

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **Question 1** and **one** question from **Questions 2, 3 or 4**

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.

Quality of written communication will be assessed in all questions **except 1(a)**.

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.

Question 1

Study the information below and answer the questions that follow.

Case Study: More turbulence for troubled airline industry

Source 1

The transatlantic price war

The new Open Skies agreement between the European Union and the United States, which came into effect on 30 March 2008, ended decades of strict regulation of transatlantic flights. Under the agreement, any European or American airline will be allowed to fly from anywhere in Europe to anywhere in the US. The agreement cancelled the privileges enjoyed by long-established carriers such as British Airways, which prior to this agreement was one of only four airlines which had the right to fly the lucrative London Heathrow to US routes.

The question, however, is whether the increased competition from the Open Skies policy will benefit consumers?

For economy customers, it seems the answer is no. This is because the basic cost for an airline to fly a passenger to the US is a bit more than £200. If you add taxes to that, it is clear that off-peak fares cannot drop any lower than they already are unless the price of oil falls. The real benefits, however, will be felt at the front of the cabin; in business class, where British Airways and Virgin Atlantic have been able to charge more than £4,000 return between Heathrow and JFK.

As travel writer Simon Calder points out, “the most expensive real estate in the world isn’t in Manhattan or Tokyo; it’s the space in the business class cabin.” The Open Skies agreement will lead to greater competition and as a result, business travellers can expect the airlines to vie for them by offering more choice, lower prices, and improvements in service such as the new Virgin Atlantic VIP check-in at Heathrow.

Adapted from: © BBC News at bbc.co.uk/news – BBC Money Programme, The Transatlantic Price War by Pierre Peron, 21 February 2008

Source 2

Is the end in sight for cheap flights?

Turbulence in the aviation industry has brought down a series of small airlines over the past year (2008). In August low-cost carrier Zoom Airlines announced that it was to go into administration, while in October, Spanish-based airline LTE International suspended operations after telling Spanish authorities it could no longer cover its variable costs.

Industry observers have blamed the crisis on rising fuel costs and the worldwide credit crunch. One observer stated “we have already seen at least 25 airlines go bust this year, and I predict that we will have many more before the year is out. Holiday makers need to realize that the era of cheap flights is well and truly over”.

However, Ryanair’s chief executive Michael O’Leary disagrees. “Higher oil prices won’t end low fare air travel. Ryanair will continue to absorb these higher costs even if it means short-term losses.”

This confidence in the low-cost business model is backed up by recent data which shows that low-cost carriers have seen a 13% increase in passenger numbers, compared with a 1% increase for the industry as a whole.

A spokesman for the Official Airline Guide stated that budget airlines could survive the current crisis by cutting capacity and increasing revenue streams from ancillary items.

Source 3

Calls to control low cost flights

Cheap flights on no-frills airlines may not be a burden on our wallets but they will cost the UK's environment dearly, campaigners believe. With air passenger growth expected to rise at 3–5% a year, it is going to be very hard for Britain to meet its targets for reducing gas emissions.

Agencies such as the Sustainable Development Commission want our air tickets to reflect “the true cost of flying” to the environment. “A starting figure would be the equivalent of tax that is charged per litre on car fuel. Passengers should pay for the environmental damage that they're doing to ensure a safer environment.”

According to Friends of the Earth (FOE), the absence of fuel duty effectively gives the industry a £9bn annual subsidy.

And it gets this “help”, the FOE says, even though planes contribute 5% to the UK's carbon dioxide emissions, with the figure set to more than double by 2020. “The vast majority of flights are discretionary, for leisure,” says Richard Dyer, the FOE's aviation campaigner. “These are not essential, unlike travelling by bus where you don't pay tax on a ticket.”

However, opponents of the plan claim that any policy on aviation fuel tax would have to be agreed internationally if it was to be truly effective. The British Airport Authority states that “any aviation fuel tax will have to be an international one otherwise UK airlines will have to compete against foreign carriers who can offer lower fares because they are not subject to the duty”.

They also argue that although the industry is not taxed on the fuel it uses, the Air Passenger Duty (APD), which raises £800m a year, can be regarded as a form of environmental compensation.

One industry observer stated that “the APD is an environmental tax, albeit a very blunt one, since it takes no account of the different levels of pollution created by different planes. The last thing the industry needs is another tax.”

Adapted from: © BBC News at bbc.co.uk/news – BBC News Online, Calls to control low-cost flights by Daniel Mann, 24 April 2004.

- 1 (a) With reference to Source 1, explain why some customers are expected to benefit more from the Open Skies agreement than others. [5]
- (b) Using diagrams to support your answer, analyse why some loss-making airlines are able to remain in business in the short run while others are forced to shut down. [10]
- (c) Critically examine some of the strategies that loss-making airlines could use to help them return to profitability. [10]
- (d) Evaluate the case outlined in Source 3 for increasing the tax on aviation fuel in line with car fuel. [15]

Essays:

Answer **one** from Questions 2, 3 or 4

2 “Brown faces revolt over windfall tax on oil companies”

- (a) Explain the role of supernormal profits in a market economy. [15]
- (b) Consider the arguments for and against the imposition of windfall taxes on highly profitable companies. [25]

3 “Banking market becomes more concentrated”

- (a) Explain how market concentration can be measured. [15]
- (b) Examine the possible effects of the increased concentration of the UK banking market. [25]

4 “Tradable pollution permits are the way forward”

- (a) Explain some of the ways in which business activity may affect the environment. [15]
- (b) Critically examine the view that tradable pollution permits are the most efficient government policy for protecting the environment. [25]

THIS IS THE END OF THE QUESTION PAPER

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