



Rewarding Learning

ADVANCED

General Certificate of Education

2018

Economics

Assessment Unit A2 1
assessing
Business Economics



AEC11

[AEC11]

TUESDAY 5 JUNE, AFTERNOON

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **all** questions in Section **A** and **B** and **one** question in Section **C**.
You are permitted to use a calculator in this paper.

INFORMATION FOR CANDIDATES

The total mark for this paper is 90.

- Section A: 20 marks
- Section B: 40 marks
- Section C: 30 marks

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

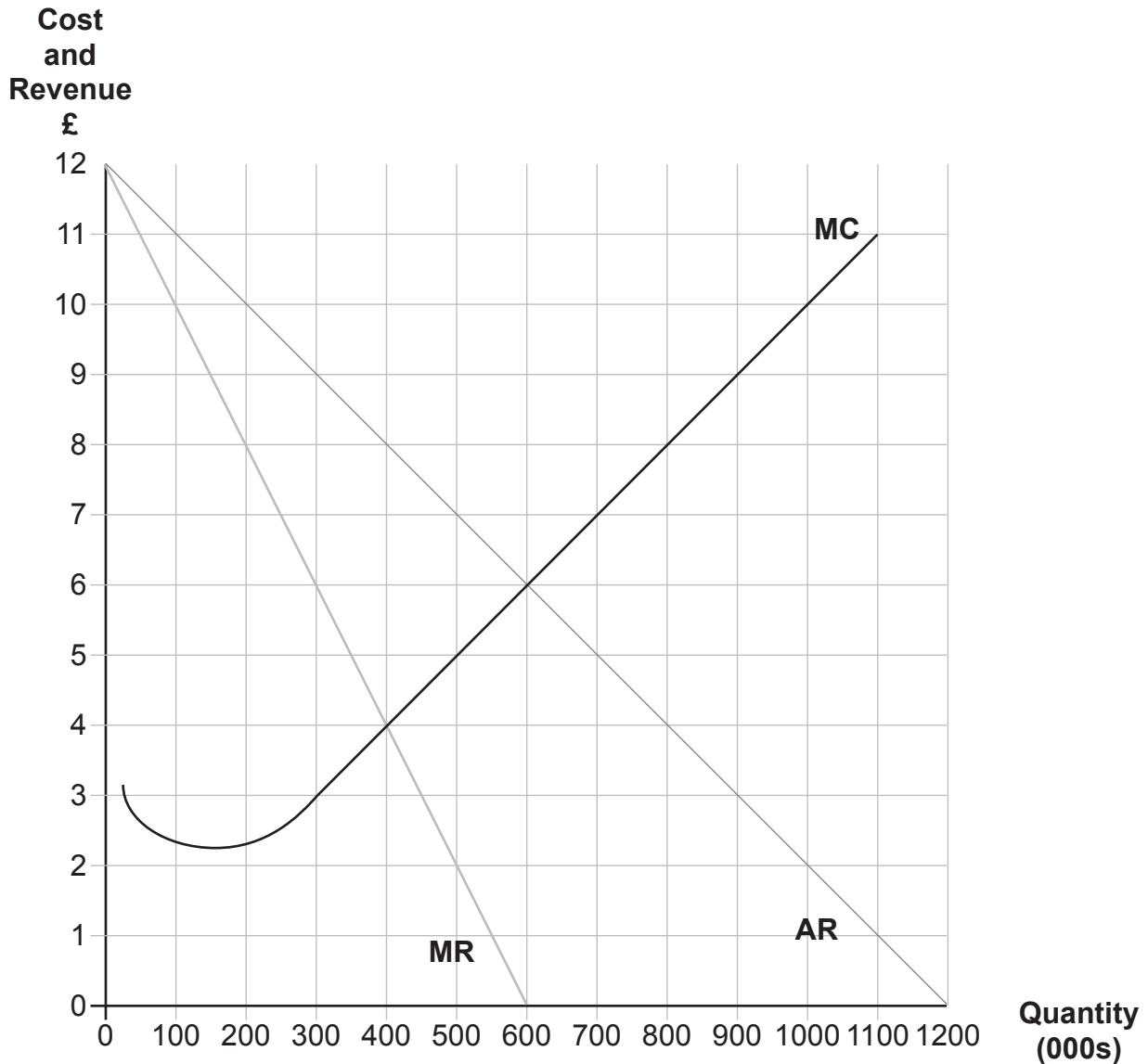
ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time. In questions involving calculations, you are advised to show your workings. Quality of written communication will be assessed in Questions **4**, **5 (b)**, **(c)** and **(d)**, **6** and **7**. Quantitative skills will be assessed where appropriate.

Section A

Answer all questions (20 marks)

- 1 The diagram below depicts the average revenue, marginal revenue and marginal cost curves for a firm operating in a monopolistically competitive market.



Using the diagram, calculate the following.

- (a) The total revenue the firm would earn if it operated at the profit maximising point. [3]
- (b) The **increase** in total revenue the firm would gain if it switched from a policy of maximising profits to a policy of maximising revenue. [3]

- 2** Castle Engineering Ltd is a company which manufactures unique precision components for the medical industry. They have recently developed an innovative laser cutting device. Manufacture of this device involves total fixed costs of £90,000 and variable costs of £250 per unit. The firm intends to use a cost plus pricing strategy with a 30% mark-up on the average total cost of each unit.

(a) Calculate the average total cost to the firm of producing 300 units. [3]

(b) Calculate the price the firm will charge for each device at this production level. [2]

- 3** A report published recently has suggested that public sector workers in Northern Ireland earn almost 40% more than those employed in the private sector.

With the aid of appropriate examples, explain the distinction between the private sector and public sector. [3]

- 4** Shagpile Mats is a small independent retailer which sells mats for household and industrial use. The firm has traditionally operated by selling its mats from a high street unit at the market equilibrium price. However, it has recently set up an online auction site and intends to close down the shop and only sell online using perfect price discrimination.

With the aid of an appropriate diagram, analyse the likely impact on total revenue if Shagpile Mats switches from selling at the market equilibrium price to using perfect price discrimination. [6]

Section B

Answer all questions (40 marks)

The following passages were compiled in August 2016.
Read them carefully and answer the questions which follow.

Case study: To merge or not to merge?

Source 1: The UK mobile phone market

The UK mobile phone market is one of the most developed in the world and, in many respects, it is also one of the most competitive and successful: 93% of adults in the UK have a mobile phone contract, with almost 30% having more than one. Approximately three-quarters of the adult population own a smartphone and the UK is one of the most advanced countries in terms of roll-out of fourth generation (4G) technologies and take-up of 4G services.

There are about thirty mobile phone providers in the UK who compete intensely for customers. This competition helps to ensure that UK customers have access to a wide variety of bundles and services at prices which are lower than most other rich countries.

Fig. 1 below shows the monthly price of a standard mobile contract in the UK and five other major economies.

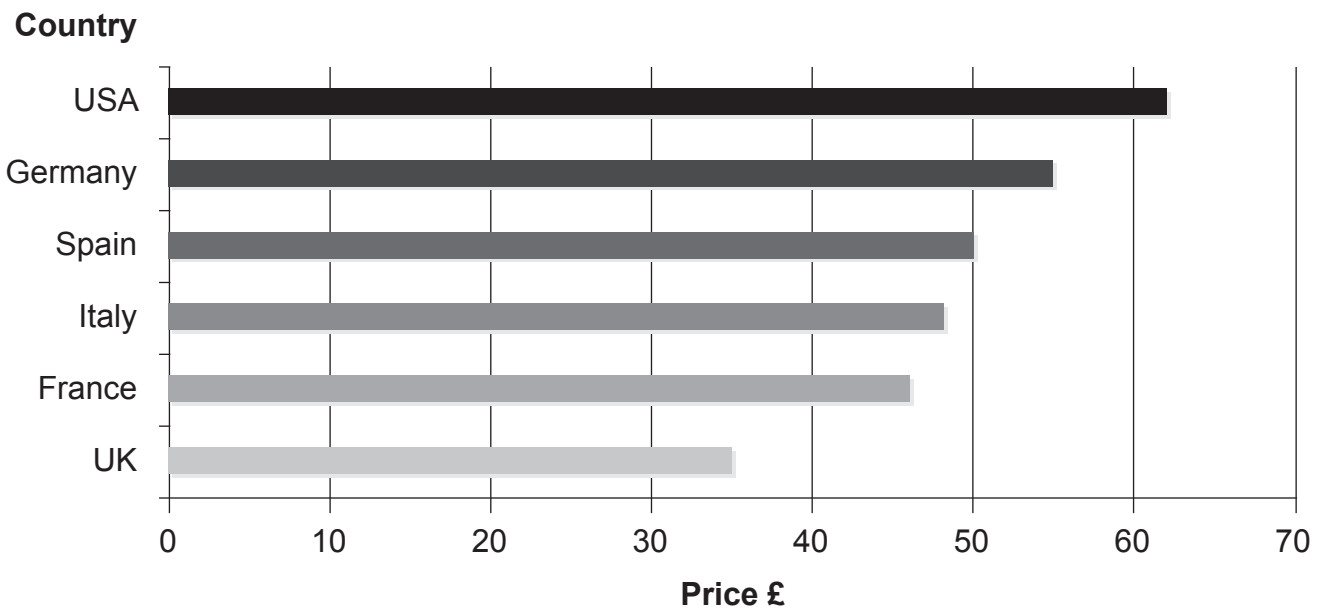


Fig. 1: Estimated monthly price of standard mobile phone contract in selected countries, July 2016

While there may be thirty mobile phone providers, the market is dominated by four large companies (EE, O2, Three and Vodafone) who actually own, run and maintain a physical network infrastructure. **Fig. 2** below shows two separate estimates of market share for the UK mobile phone market in 2016.

Company	Market share % (revenues)	Market share % (no. of subscribers)
EE	33	29
O2	21	29
Vodafone	18	23
Three	10	12
Other	18	7

Fig. 2

The other twenty-six companies are known as virtual network operators and include companies such as Virgin Media, Talk Talk and Dixons Carphone's iD. These virtual network operators do not own the networks they use to provide mobile services to UK consumers. Instead, they enter into agreements with one of the four network operators to access their network at wholesale prices.

Source 2: O2 and Three announce merger plans

Hutchison, the Hong Kong-based company that owns the Three network, has confirmed that it is in advanced talks to buy rival network O2 from Spain's Telefonica for a cool £10.25bn. While the deal has been agreed by both companies, it still needs to be approved by the relevant regulatory authorities. Once completed, the Three/O2 partnership will make it the biggest mobile network in the UK, potentially offering the widest coverage and the fastest speeds.

The potential merger mirrors similar mergers in the UK and abroad, which have reduced the number of alternative network providers available to consumers. Both Three and O2 claim that it is only through consolidation that they can gain the scale required to justify the huge investment needed to roll out high-speed 3G and 4G networks.

Joseph Daly, a telecoms analyst, stated, "The huge fixed costs associated with the development of a network capable of delivering 4G services to the whole of the UK means that the industry can only accommodate two or three big players. Fast-moving, high-tech industries such as telecoms naturally tend towards oligopoly. While regulators may worry about the lack of competition, the reality is that we cannot have an efficient and innovative telecoms industry in the UK with lots of small network providers competing for market share."

Source 3: O2 still for sale as Brussels blocks merger with Three

EU Competition Commissioner Margrethe Vestager has sent shockwaves through the European telecoms market by announcing that the Commission would not allow Hutchison to merge O2 with its own mobile operator Three. In a statement explaining the decision, Commissioner Vestager stated, “Allowing Hutchison to take over O2 at the terms they proposed would have been bad for UK consumers and bad for the UK mobile sector. We had strong concerns that consumers would have had less choice finding a mobile package that suited their needs and would have paid more than without the deal. It would also have hampered innovation and the development of network infrastructure in the UK, which is a serious concern especially in fast-moving markets.”

Not everyone, however, agrees with this assessment of the proposed merger. Market analyst Tom Ridgeway said, “A combined O2/Three would provide a counterbalance to the strength of BT/EE, by offering an alternative source of capacity to the virtual network providers who would provide competition in their own right. The EU’s decision is a short-sighted one that fails to take into account the need for a viable competitor of comparable scale and the potential to use other forms of state intervention to protect consumers. Competition authorities have a range of alternative tools at their disposal. If used properly, these would allow the combined company to benefit from the scale advantages while still protecting consumer choice and maintaining the relatively low mobile phone prices that exist in the UK.”

- 5 (a) Using the information in **Fig. 1**, compare the price of a standard mobile phone contract in the UK with that of the USA and France. [4]
- (b) Using the information in **Fig. 2**, explain why it might be difficult to accurately estimate market share for the UK mobile phone market. [9]
- (c) Examine the extent to which the UK mobile phone market could be described as a natural oligopoly. [12]
- (d) The European competition authorities decided to prohibit the proposed merger of O2 and Three. Critically examine some of the alternative measures that regulators could take to ensure the UK mobile market functions well for consumers. [15]

Section C: Essay section

Answer one question (30 marks)

- 6** The theory of contestable markets was often cited by regulators and academic economists as justification for the deregulation of the US airline industry in the mid 1980s. However, experience since then would suggest that the deregulation did not lead to lower prices and greater efficiency. Instead, it led to a round of mergers and consolidation and accusations of price fixing, all of which would have been predicted by the traditional theory of the firm.

Critically examine the view that the theory of contestable markets is no better at predicting the behaviour of real world firms than the much criticised theory of perfect competition. [30]

- 7** German supermarket Lidl is planning to strategically reposition the company in the UK away from a high-volume discounter towards a mainstream one-stop supermarket. The German giant is actively aiming to boost quality perceptions through store expansions, more careful merchandising, heavy investment in advertising and the introduction of loyalty cards. Critics of the move have suggested that it will ultimately lead to higher prices for UK consumers.

Critically examine the view that consumers benefit more from non-price competition than from price competition. [30]

THIS IS THE END OF THE QUESTION PAPER

Sources

- Source 1: Reference from: EU Commission blocks Three-O2 telecoms merger by Daniel Thomas, Telecoms Correspondent MAY 11, 2016. <https://www.ft.com/content/32018c52-1695-11e6-9d98-00386a18e39d>
- Source 2: Reference from: UK regulator wants European commission to block Three-O2 deal by Sean Farrell. Published by The Guardian, 11 April 2016 <https://www.theguardian.com/business/2016/apr/11/uk-regulator-wants-european-commission-to-block-three-o2-deal>
- Source 3: Reference from: O2-Three merger threatens long-term damage, says CMA. BBC News, 11 April 2016 <https://www.bbc.co.uk/news/business-36013082>