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Revision Worksheet Answers

A2 Economics

Answer: Barriers to entry and exit

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WORKSHEET ..Answer..

Revision Topic : Barriers to entry and exit

Question 1

Correct Answer C (**1 mark**)

Answer Guide :
Definition of sunk cost in terms of irretrievable expenditure on exit **(1 mark).** Application to water industry example by identifying and explaining one sunk cost e.g. pipelines, advertising. **(2 marks).**

Question 2

Correct Answer A (**1 mark**)

Answer Guide :
Allocative inefficiency since MC does not equal AR (accept answers which state the firm is not allocative efficient since it is not producing where MC = AR or MC = Price). **(1 mark)**

Any characteristic of law entry barriers, for example rent out a building / employ staff on temporary basis / purchase beauty products from wholesaler at low cost / low level of skills / low level of technology. **(1 mark)**

Low entry barriers mean supernormal profits are competed away in the long run so only normal profits made. **(1 mark)** Any characteristic of product differentiation, for example location / décor / type of beauty treatments available / staff uniforms / opening hours. **(1 mark)**

Also award:Correct diagram showing firm in monopolistic competition – long run **(1 mark)**
NB No marks awarded for other characteristic of monopolistically competitive markets.

Question 3

Correct Answer B (**1 mark**)

Answer Guide :
Definition of sunk costs (fixed costs which cannot be recovered by firm on exit from an industry) **(1 mark)** Application – the £8 million advertising expenditure has created brand loyalty / led to lower price elasticity of demand, which will deter new entrants **(1 mark).** NB Merely stating advertising is a sunk cost does not merit a mark. One other example of sunk

costs: high start up costs in terms of factory and machinery / weak second hand market / economies of scale achieved by Coca Cola / difficulty in obtaining market outlets **(1 mark)**

Question 4

Correct Answer A (**1 mark**)

Answer Guide :
Correct explanation of limit pricing: allow one mark for illustration that the firm sets price just below the predicted average costs of production of a new entrant **(1 mark)**; 1 mark for prohibiting entry **(1 mark)** 1 mark for disincentive **(1 mark)** Also accept valid diagram showing limit pricing, if cost differences are illustrated **(1 mark).** Outline of effect of a patent right expiring i.e. opening up of competition **(1 mark)** Application to pharmaceuticals industry **(1 mark)**

Question 5

Correct Answer D (**1 mark**)

Answer Guide :
Definition of monopoly (**1 mark**)

Definition of limit pricing: Setting price below average cost of new entrants (**2 marks**) Setting price low enough to deter new entrants (**1 mark**)
Also award diagram of limit pricing (up to 2 marks)

Also award effects of limit pricing e.g. reduced S-R profits, higher L-R profits and less consumer choice (up to 2 marks)

Question 6

Correct Answer B (**1 mark**)

Answer Guide :
The state owned gas and electricity industries already have monopoly power (**1 mark**)
Application of barriers to entry e.g. greater economies of scale or greater sunk costs (up to 2 marks) (**2 marks**)
Also award: A merger would strengthen their positions by reducing competition further (**1 mark**) Explanation of role of competition commissioner in promoting for markets to work well **(1 mark)**

Question 7

Correct Answer A (**1 mark**)

Answer Guide :
Definition of diseconomies of scale (long-run average costs rise as output increases) **(1 mark)** Diagram depicting diseconomies of scale **(1 mark)** Explanation of management co-ordination problems due to the huge range of products sold by the company. **(1 + 1 mark)**

Question 8

Correct Answer B (**1 mark**)

Answer Guide :
Identification of economies of scale **(1 mark)** Diagram showing falling long-run average cost **(1 mark)** Application and analysis to road haulage: technical economy of scale (volume based or increased dimensions) **(1 mark)** means lower cost per ton of goods transported / savings on wage costs / fuels costs / tax disc / increased capacity (identification of concept **1 mark** + explanation **1 mark**)