

Revision Worksheet Answers

A2 Economics

Answer: Contestable Markets

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WORKSHEET ..Answer..

Revision Topic : Contestable Markets

Question 1

Correct Answer E (1 mark)

Answer Guide :

Understanding of brand loyalty (1 mark). To persuade consumers to buy a new brand would require heavy and irretrievable advertising or other marketing expenditure (1 mark). The market therefore has low contestability with high sunk costs (1 mark).

Question 2

Correct Answer C (1 mark)

Answer Guide :

Definition of concentration ratio (1 mark). Meaning of high concentration (1 mark) explanation this encourages cartels (1 mark). Also award: definition of cartel (1 mark)

Question 3

Correct Answer A (1 mark)

Answer Guide :

Contestable markets are those with low sunk costs or low *exit* barriers (1 mark), explanation that branding would require heavy advertising by new entrant (1 mark), some application to chocolate confectionery (1 mark).
Also award (1 mark) for definition of sunk costs

Question 4

Correct Answer E (1 mark)

Answer Guide :

Definition of contestability in terms of low barriers to exit through low sunk costs, irretrievable expenditure (1 mark). Explanation of loyalty to existing brands requiring

extensive advertising by potential new entrants and therefore raising sunk costs (2 marks). Explanation of increasing barriers e.g. Reducing PED (1 mark).

Question 5

Correct Answer E (1 mark)

Answer Guide :

Definition/characteristic of a firm in monopolistic competition (1 mark) Application of product differentiation to Estate Agents (1 mark) The firm is not productively efficient where $MC=AC$ (1 mark). Also award: Correct diagram of a firm in long-run monopolistic competition (1 mark).

Question 6

Correct Answer C (1 mark)

Answer Guide :

Definition: predatory pricing (firm sets price below average cost) (also accept price below average variable cost) (1 mark) Reason: the intention of Intel is to knock-out rival firm(s) to gain market share / monopoly power / higher profits (1 mark). (Do not accept the term 'decrease competition' on its own as this is the key).

Feature of predatory pricing e.g. a temporary loss is made and firm can raise price back up to make profits once rival firm(s) knocked out (1 mark) Diagram showing predatory pricing (1 mark). Note: No mark for stating predatory pricing is illegal.

Question 7

Correct Answer D (1 mark)

Answer Guide :

Definition of contestability in terms of low barriers to exit through low sunk costs (1 mark). Explanation of advertising expenditure as sunk cost (1 mark) application to chewing-gum (1 mark).

Question 8

Correct Answer B (1 mark)

Answer Guide :

Definition of 'contestable markets' in terms of low sunk costs or low entry and low exit costs/threat of competition is high (1 mark) Application/characteristics of painting and decorating firms - this may include low start-up costs/low technology/accessible skills/hit and run competition. (up to 2 marks). Note: A maximum of 2 explanation marks can be achieved if no application to painting and decorating firms.

Question 9

Correct Answer D (1 mark)

Answer Guide :

Definition of privatization e.g. the sale of state/public sector assets to the private sector (1 mark). Any two benefits of privatization e.g. lower prices for raise revenue for government/increase competition/increase efficiency/consumer benefits (1 + 1 mark).

Question 10

Correct Answer C (1 mark)

Answer Guide :

Definition of sunk costs (unrecoverable costs) (1 mark)

An example of a sunk cost e.g. advertising, specialized machinery (1 mark) Award explanation that there is a reduction in **contestability** (1 mark) Application to the computer games market e.g. the need for computer games to play on the handheld computers (1 mark).

Question 11

Correct Answer A (1 mark)

Answer Guide :

Aims of Competition Commission - increasing competition, and allow public interest arguments (1 mark). The merger threatened to reduce competition (1 mark) in an already highly concentrated market (1 mark). Reference to one advantage or disadvantage to consumers e.g. consumer choice, higher price, service quality etc in context of the music industry (1 mark).

Question 12

Correct Answer C (1 mark)

Answer Guide :

Definition of contestability e.g. the ability of firms to enter and exit a market / a market with low entry and exit barriers / low sunk cost. Also accept definition of a non-contestable market (1 mark). Advertising expenditure is an entry barrier / sunk cost since it creates brand loyalty (1 mark) and puts pressure on new entrants to increase advertising spending (1 mark). Advertising expenditure has increased - leading to an increase in entry barriers / sunk costs to the market (1 mark)

Question 13

Correct Answer D (1 mark)

Answer Guide :

The need for a regulator (to combat market power, create efficiency gains). (1 mark)
Price capping formula of RPI minus X, (1 mark), explanation that this involves falling real prices if, as in this case, X is set at a positive value (1 mark). Also award:
Explaining that 'x' represents expected efficiency improvements (1 mark)

Question 14

Correct Answer C (1 mark)

Answer Guide :

Definition of contestability (or non-contestability): low sunk cost / low entry and exit barriers (1 mark) Application and analysis: Total advertising expenditure by the four supermarkets has increased (1 mark); advertising expenditure is a sunk cost / entry barrier which reduces contestability (1 mark) Also award: advertising expenditure may create more brand loyalty and so act as a barrier to entry for new firms (1 mark)

Question 15

Correct Answer B (1 mark)

Answer Guide :

Definition of contestability (1 mark) Application to loyalty cards - e.g. irrecoverable advertising (2 marks).

Question 16

Correct Answer E (1 mark)

Answer Guide :

Outline of product differentiation applied to games consoles, for example different quality / unique good / different games played on consoles / different graphics / different speed of characters / different functions of consoles / colour / packaging. (1 + 1) A higher price is likely to reflect higher production costs per unit. (1 mark) Product differentiation creates brand loyalty / demand is more price inelastic / higher prices may lead to higher profits. (1 + 1)

Question 17

Correct Answer E (1 mark)

Answer Guide :

Definition or formula of average revenue (revenue per unit of output or $TR \div TQ$) or average variable cost (variable cost per unit of output or $TVC \div TQ$) or variable cost (costs which vary directly with output) (1 mark) Examples of variable costs to motor vehicle manufacture - labour, electricity, vehicle components. (1 mark)

By remaining in production the firm can reduce its losses by contributing to part of its fixed costs or fixed costs only need to be covered in long run as they are sunk into the firm. (1 mark) Also award: Diagram showing firm making loss (1 mark) but covering average variable costs. (1 mark) Numerical example of loss making firm where revenue exceeds variable costs. (1 mark) In the long-run the firm will exit the industry if it cannot cover both fixed and variable costs. (1 mark) Identification of shut-down position when $AR = AVC$ or AR is below AVC .

Question 18

Correct Answer C (1 mark)

Answer Guide :

Definition of price discrimination (a firm charging different prices to different consumers for the same product) (1 mark) Apple is able to charge a higher price in UK since it has lower price elasticity of demand (less elastic / more inelastic demand) than for the US. (1 mark) Diagrammatic analysis depicting different price elasticities of demand, with UK market having a higher price than US market. (1 + 1 mark) Also award: Apple is able to separate the two markets and so there is little leakage or has monopoly power / market power (1 mark) (Only 1 mark available here).

Question 19

Correct Answer E (1 mark)

Answer Guide :

Data reference for example, UK gas market appears more competitive in terms of 'price'. - It has the lowest price of gas for the three countries shown / a higher proportion of consumers have been able to switch gas suppliers. (1 mark) NB award a maximum of 1 mark for data reference.

Award for development of these points, for example this implies significant consumer choice exists for UK gas consumers / more firms are likely to exist in UK gas market / lower concentration ratio / higher consumer surplus in the UK / less brand loyalty in the UK / lower unit costs of production in the UK. (1 + 1 mark)