

## Revision Worksheet Answers

### A2 Economics

# Answer: Government Intervention

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# WORKSHEET ..Answer..

Revision Topic : Government Intervention

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## Question 1

Correct Answer E (1 mark)

### Answer Guide :

Candidates need to explain that the RPI is a measure of inflation (or the cost of living) (1 mark) and that the regulator is empowered to limit price increases according to the formula  $RPI-X$ , where X represents potential efficiency gains (1 mark) leading to a fall in *real* terms (1 mark - also award this mark to any correct numerical example conveying this point).

## Question 2

Correct Answer D (1 mark)

### Answer Guide :

Explanation of RPI in terms of inflation rate (1 mark) explanation of X in terms of efficiency improvements (1 mark). Reference to this specific change (1 mark)

## Question 3

Correct Answer B (1 mark)

### Answer Guide :

Explanation of components of formula: RPI inflation (1 mark), X for efficiency improvements i.e. expected cuts in costs (1 mark) therefore within the cap firms will strive to make additional efficiency gains because they can keep the resulting profits (1 mark). Also award reference to consumer benefits as a result of efficiency gains (1 mark)

## Question 4

Correct Answer E (1 mark)

### Answer Guide :

Recognition of collusion or cartel (1 mark). Identification (1 mark) and explanation (1 mark) of the public interest consequences of this, e.g. in terms of higher prices, reduced output, loss of consumer surplus. Also award diagrammatic illustrations of the welfare loss from price fixing.

## Question 5

Correct Answer A (1 mark)

### Answer Guide :

Explanation of price capping generally in terms of inflation and costs or efficiency improvements (1 mark). Deduction that higher environmental cost will justify higher prices to consumers (2 marks)

## Question 6

Correct Answer D (1 mark)

### Answer Guide :

Definition of concentration ratio (1 mark). Calculation of the three firm concentration ratio for the bus market in the two years (ratio rises from 29.7% to 52.4% or difference equals 22.7%) (2 marks)

## Question 7

Correct Answer C (1 mark)

### Answer Guide :

Application - the merger between British Energy and Drax would lead to 28% market share (candidate must state 28% to gain the mark) (1 mark) Reference to a monopoly/legal monopoly is 25% or more market share - must be explicit (1 mark) Role of Competition Commission is to protect public interest / consumer interest by promoting competition within markets or explanation of an advantage of competition in terms of lower prices and greater consumer choice. (1 mark)

## Question 8

Correct Answer B (1 mark)

### Answer Guide :

RPI is the retail price index / measure of inflation (1 mark) Application - water bill increase in nominal terms by 7% or nominal terms mean a rise in the money price (1 mark) Application - water bill increase in real terms by 3.1% or explanation of real terms (water bill increase at a faster rate than inflation) (1 mark) Explanation of role of regulator (to promote competition or mimic competition / protect consumer interest) or 'K' means water bills allowed to rise at a faster rate than inflation in order for firms to have sufficient funds for improving quality of water / service (1 mark). If candidate explains the meaning of real and nominal price increases

with full use of the data, award full marks. Note: No mark awarded for discussion of 'x' as an efficiency gain.

### **Question 9**

**Correct Answer E (1 mark)**

**Answer Guide :**

Explanation that the fine is to discourage price fixing or the uncompetitive raising of prices or understanding that cartels exist for this purpose **(1 mark)**. Reference to consumer surplus - either a definition or a diagram **(1 mark)** . Explanation that this will preserve consumer surplus **(1 mark)**

### **Question 10**

**Correct Answer C (1 mark)**

**Answer Guide :**

Reference to fact that RPI stands for rate of inflation **(1 mark)**. Explanation that X stands for expected efficiency improvements **(1 mark)** link to being able to keep profits from further efficiency gains **(1 mark)**.

### **Question 11**

**Correct Answer E (1 mark)**

**Answer Guide :**

Explanation and examples of two public interest issues e.g. potential negative effects of resulting monopoly power such as higher prices, lower quality of service etc **(2 marks)**. Tying the issues to the water industry **(1 mark)**. Also award: worries that there would be a reduction in competition **(1 mark)**

### **Question 12**

**Correct Answer D (1 mark)**

**Answer Guide :**

Market share of 25% criterion **(1 mark)** use of data (e.g. 40.5%) to show that such a bid would involve diminution of competition or other link between **(2 marks)** or explanation of market diminution alone **(1 mark)**.

### Question 13

Correct Answer E (1 mark)

**Answer Guide :**

Firms in a dominant market position are likely to be few in number or the industry has a high concentration ratio (1 mark). Sharing future price information is collusion (1 mark). Also accept reference to disadvantage of collusion e.g. prices will rise (1 mark) Also accept explanation or role of OFT (1 mark).

### Question 14

Correct Answer B/D (1 mark)

**Answer Guide :**

Definition or diagram of monopoly (1 mark). Link between monopoly and underinvestment (1 mark). That this market power might not be used in the interests of consumers (1 mark) or some further evaluative comment (1 mark).

### Question 15

Correct Answer B (1 mark)

**Answer Guide :**

Recognition that 25% market share is a monopoly (1 mark).

Impact of reduced competition on the monopoly or consumers in terms of price, quality of service, range of choice and innovation (up to 3 marks). Also award for explanation of work of competition authorities in terms of promoting competition/public interest (up to 2 marks)

### Question 16

Correct Answer B (1 mark)

**Answer Guide :**

Explanation of RPI (1 mark) and X in terms of efficiency improvements imposed by the regulator (1 mark) which could mean consumers gain through lower prices (1 mark). In this case the graph shows positive X factor throughout the period. (1 mark) Also accept numerical application of RPI-X formula to Telecommunications Also accept real price of telephone calls falling (1 mark)

### Question 17

Correct Answer C (1 mark)

**Answer Guide :**

Price capping is undertaken by the formula  $RPI-X$  or  $RPI + K$  or a definition of price capping (1 mark), where RPI is a measure of inflation (1 mark) and 'X' is based on expected efficiency gains or 'K' capital expenditure needs (1 mark). If the candidate identifies a benefit to the consumer (1 mark), e.g., consumers may gain through price changes being controlled by the regulator, e.g. a real price decrease may occur depending on size or '-X' (1 mark). Allow consumer may gain with '+K' since the regulator will ensure sufficient funds for investment and thus improved service. (1 mark). Price capping operates in Natural Monopolies providing essential services (1 mark).

**Question 18**

Correct Answer E (1 mark)

**Answer Guide :**

Definition of collusion (1 mark): firms acting together to reduce consumer welfare.

Explanation of role of competition commission (1 mark): to promote competition in order to protect consumer welfare. Comment on reasons why fines can be imposed by the Commission (1 mark). Application to JJB and Manchester United and explanation of restrictive practices (1 mark).

**Question 19**

Correct Answer E (1 mark)

**Answer Guide :**

RPI is a measure of inflation (1 mark)

The permissible price increase of season tickets is 3.9% whereas the rate of inflation is 2.9% or K is set at +1% above the rate of inflation (1 mark) The purpose of a real increase in price is to allow train operating companies to secure additional revenue / profit for improving service/ investing in services (1 mark). Also award for reference to price controls protecting consumers (1 mark).

**Question 20**

Correct Answer D (1 mark)

**Answer Guide :**

Definition of privatization (sale of state assets to the private sector) (1 mark) Identification of two benefits from privatization (1 + 1) or identification of one benefit explained (1 + 1) (improve government finances / increase efficiency / competition / increase share ownership).

## Question 21

Correct Answer A (1 mark)

### Answer Guide :

The role of competition commission in protecting consumer interests (accept public interest) (1 mark) The takeover still leaves HMV with less than 25% market share which is the legal definition of a monopoly (1 mark) Competition should ensure consumer choice/competitive prices/product quality (1 mark). Also award for recognition of market entry by supermarkets and internet book suppliers (1 mark).

## Question 22

Correct Answer B (1 mark)

### Answer Guide :

Definition of allocative efficiency (price = marginal cost or average revenue = marginal cost) (1 mark). Moving towards allocative efficiency will involve reducing interest rate charges (price) on store cards (1 mark) Note the definition and movement towards allocative efficiency can be shown by diagram (1 + 1 mark). Role of Competition Commission in terms of promoting competition / reducing monopoly pricing of retail store cards (1 mark).

## Question 23

Correct Answer D (1 mark)

### Answer Guide :

The role of the regulator is to protect the consumer interest / public interest by promoting competition or creating conditions which mimic competition (1 mark). The existence of competition will keep prices down in the industry / protect the consumer surplus / reduce the producer surplus (1 mark). The regulator has been successful in removing entry barriers to the telecoms industry / application of appropriate example such as Virgin (1 mark). Also award for recognition of price capping formula as RPI-X (1 mark)

## Question 24

Correct Answer B (1 mark)

### Answer Guide :

Identification and explanation of illegal restrictive practices, for example collusion / price fixing / predatory pricing / limit pricing (1 + 1 mark) Identification of the role of the OFT in

reducing these illegal practices or promoting competition or protecting consumer interests or promoting the public interest **(1 mark)**

Advantage of increased competition e.g. consumer choice / competitive prices / product quality / investment in an industry / public interest **(1 mark)** Also award for reference to whistle blowing which makes it harder for firms to engage in illegal anticompetitive practices **(1 mark)**

## **Question 25**

**Correct Answer A (1 mark)**

### **Answer Guide :**

Role of OFT or Competition Commission investigate anti-competitive practices / protect the consumer or public interest / the powers of the OFT, for example fine firms up to 10% of annual revenue. **(1 mark)** Identification of price fixing / collusion / cartel. **(1 mark)** Price fixing is against interest of consumers since it leads to higher prices / lower consumer surplus. **(1 mark)**

## **Question 26**

**Correct Answer A (1 mark)**

### **Answer Guide :**

Definition of allocative efficiency, price=marginal cost **(1 mark)** Either a diagram showing a firm with both profit max and allocatively efficient prices **(2 marks)**. Or a written explanation: The banks were accused of monopoly pricing, with price above marginal cost **(1 mark)**. A reduction in price should allow the cost of running a business bank account to fall towards the marginal cost of providing it. **(1 mark)**