

Economics Revision Worksheet

A2 Economics

Contestable Markets

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WORKSHEET

Revision Topic : Contestable Markets

Question 1

The strong loyalty consumers have for branded trainers such as 'Adidas' and 'Nike' tends to make this industry :

- A** perfectly competitive.
- B** horizontally integrated.
- C** contestable.
- D** vertically integrated.
- E** one with high sunk costs.

Question 2

In which of the following is the emergence of cartels most likely ?

- A** Perfect competition.
- B** Monopolistic competition.
- C** An industry with a high concentration ratio.
- D** Perfectly contestable markets.
- E** Industries where there are few economies of scale.

Question 3

Many consumers buy chocolate confectionery on impulse. Effective branding to make products instantly recognizable is therefore essential. This suggests that chocolate confectionery markets are likely to be characterized by:

- A** low levels of contestability
- B** low levels of market concentration
- C** low levels of advertising
- D** high levels of 'hit and run' entry into the market
- E** high levels of failure of established products.

Question 4

The market for automatic washing machine soap powder is currently dominated by Unilever and Procter & Gamble. Which of the following would make this market less contestable?

- A** An unsuccessful promotional campaign on the back of existing soap powder boxes.
- B** Lower levels of expenditure on research and development by the existing firms.
- C** Lower exit barriers to potential new entrants.

- D** A cutback in advertising expenditure by Unilever.
- E** Greater product loyalty by customers as the result of the endorsement of existing brands by washing machine manufactures.

Question 5

Estate agencies in the UK property market are often seen to operate under conditions of monopolistic competition. Which of the following will be true for an individual estate agency in long run equilibrium?

Efficiency	Type of Product
A Allocatively efficient	Differentiated
B Allocatively inefficient	Homogenous
C Productively efficient	Differentiated
D Productively inefficient	Homogenous
E Productively inefficient	Differentiated

Question 6

In July 2007 Intel, the American manufacturer of computer chips, faced a record fine of up to £1.7 billion, from the European Competition Commission for predatory pricing against its main rival Advanced Micro Devices. The most likely reason for Intel conducting predatory pricing was to:

- A** Increase market contestability.
- B** Decrease market concentration.
- C** Decrease competition.
- D** Decrease entry and exit barriers.
- E** Increase consumer surplus in both the short run and long run.

Question 7

Manufacturers of chewing gum spend large sums of money promoting their brands. This tends to make the chewing gum market:

- A** More allocatively efficient.
- B** More competitive.
- C** Less prone to dominance by large companies.
- D** Less contestable.
- E** Less concentrated.

Question 8

Which of the following conditions is most likely to explain the existence of many painting and decorating firms in the building industry?

- A** High sunk costs.
- B** High contestability.
- C** Significant scope for internal economies of scale.
- D** The existence of paint product patents.
- E** Limit pricing by leading painting and decorating firms.

Question 9

The government sold the state-owned design and servicing division of British Nuclear Fuels Limited to Toshiba for £3 billion in 2006. The most likely reason for the sale was to:

- A** reduce contestability within the industry.
- B** achieve x inefficiency.
- C** open up the industry to 'hit and run' competition.
- D** achieve benefits from privatization.
- E** avoid an investigation from the Competition Commission.

Question 10

In 2005 Sony launched the 'Play Station Portable' to compete with Nintendo's 'Game Boy' in the handheld computer games market. Which of the following is most likely to make it difficult for other firms to enter this market?

- A** High levels of contestability.
- B** The absence of customer loyalty for handheld computer games.
- C** High sunk costs
- D** Strong government laws on anti-competitive practices.
- E** High profit margins on each handheld computer game sold.

Question 11

In June 2004, the EU Competition Commissioner, Mario Monti, blocked a proposed £2.7 billion merger between two giant global music companies, Sony and Bertelsmann Music Group. By preventing this merger, the EU Competition Commissioner intended to :

- A** maintain competition between the major music companies.
- B** avoid unnecessary waste in advertising and sales promotion budgets of the proposed new company.
- C** decrease the rate of technological change in the EU market.
- D** strengthen the collective position of the dominant music companies in the EU market.
- E** increase the ability of music companies to cooperate in price fixing agreements.

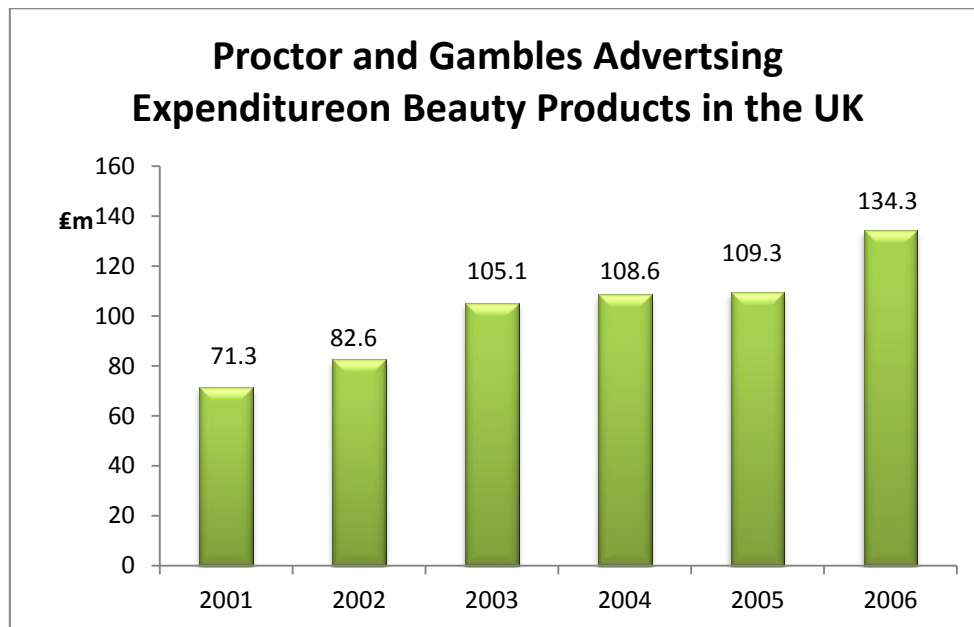
Question 13

Telephone charges in the UK have fallen by 35% in real terms since 1996. Which of the following is the most likely explanation of this?

- A** High barriers to entry in the telecommunications industry.
- B** Falling levels of contestability in the industry.

- C** Rising average costs in the provision of telecommunication services.
- D** Price capping by the industry regulator.
- E** Low rates of UK inflation since 1996.

Question 12



The chart shows Proctor & Gamble's advertising expenditure on its beauty products (such as Max Factor, Olay and Pantene) in the UK between 2001 and 2006. This trend in advertising expenditure is likely to :

- A** reduce market concentration.
- B** increase hit and run competition in the beauty industry.
- C** reduce contestability
- D** decrease sunk costs for beauty products.
- E** reduce entry barriers.

Question 14

Advertising expenditure by four supermarkets in UK 2006 and 2007.

Company	2006 £ million	2007 £ million
Tesco	67.5	71.0
Sainsbury	50.6	53.5
Asda	39.5	44.9
Morrison	28.8	46.5
Total	186.4	215.9

Source: Nielsen Media research (reported in *The Times*, 24 December 2007)

The table shows total advertising expenditure conducted by the four largest supermarket companies in the UK for 2006 and 2007. The change in advertising expenditure over the period is most likely to :

- A** increase sales at a faster rate for Sainsbury than Morrison.
- B** make the supermarket sector prone to 'hit and run' competition.
- C** decrease contestability in the supermarket sector.
- D** lead to higher total level of sunk costs for Asda compared to Tesco.
- E** decrease concentration in the supermarket sector.

Question 15

The bonuses to customers available through supermarket loyalty cards, such as those offered by Tesco and Sainsbury's are likely to make the industry.

- A** less integrated.
- B** less contestable.
- C** less concentrated.
- D** less profitable.
- E** more contestable.

Question 16

In 2007, Sony launched the PlayStation 3 games console in Britain at a price of £425. This exceeded the launch price of its major competitors, Microsoft's Xbox 360 at £265 and Nintendo's Wii at £180. The most likely explanation for these price differences is that:

- A** PlayStation 3 has a higher price elasticity of demand than the other games consoles.
- B** great price competition exists in the games console market.
- C** PlayStation 3 has lower unit production costs than the Xbox 360 and Wii.
- D** Microsoft and Nintendo have adopted profit maximizing pricing policies for their games consoles whereas Sony has a sales maximization pricing policy.
- E** significant product differentiation exists between the games consoles.

Question 17

A loss-making motor vehicle manufacturing firm is most likely to continue in production in the short run if :

- A** Average revenue exceeds average fixed cost.
- B** government subsidies are withdrawn.
- C** average revenue exceeds marginal revenue.
- D** staff threaten industrial disruption.
- E** average revenue exceeds average variable cost.

Question 18

UK consumers were charged £269 and US consumers the equivalent of £200 for the Apple iPhone in October 2007. The most likely reason why Apple was able to charge different prices is because :

- A** high costs are involved in combining a mobile phone, iPod music player and internet surfer into one product.
- B** it costs less for Apple to distribute the iPhone to the UK market than the US
- C** different price Elasticities of demand exist for the iPhone between UK and US consumers.
- D** there is significant leakage between the two markets.
- E** Value Added Tax is higher in the US than the UK.

Question 19

Figure 1

Household price of gas 2005

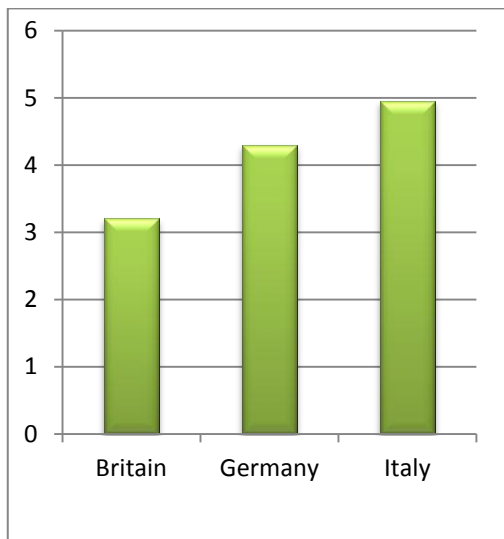
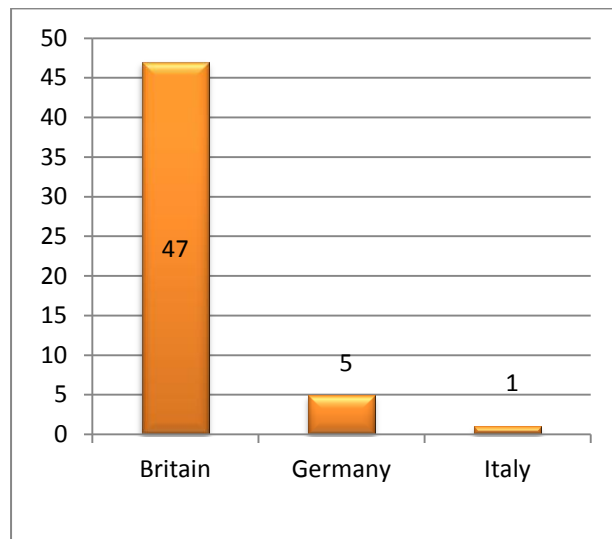


Figure 2

households switching gas suppliers %2005



Source: 'Power giants face UK-style breakup', David Gow and Mark Milner, *The Guardian*, 11th January 2007

Figure 1 shows the price of gas and Figure 2 shows the percentage of households switching gas suppliers in selected countries. Which of the following can be inferred from the data?

- A** Industrial concentration is lower in the Italian gas market than the British gas market.
- B** Consumer surplus is greater in the German gas market than the British gas market.
- C** The higher the price of gas the more likely it is that consumers will switch gas suppliers.
- D** Producer surplus is greater in the British gas market than the German and Italian gas markets.
- E** The British gas market is more competitive than the German and Italian gas markets