

Economics Revision Worksheet

A2 Economics

Government Intervention

Worksheets by: Apsara Sumanasiri

Student Name :

Date:

TheRevisionGuide® (www.TheRevisionGuide.com) is a free online resource for Economics and Business Studies.

Don't forget to visit our website as part of your revision.

WORKSHEET

Revision Topic : Government Intervention

Question 1

British Telecom's pricing is regulated by OFTEL according to the formula 'RPI – X'. This means that :

- A** BT may raise the average price of its services by no more than the rate of inflation excluding the effect of mortgage interest repayments.
- B** BT may change its prices by an amount 'X' set by the regulator.
- C** BT's average price will always rise in real terms.
- D** BT's average price will always rise in nominal terms.
- E** BT's average price change can differ from the rate of inflation only by an amount X set by the regulator.

Question 2

In 1997 OfTel changed the price control formula for British Telecom (BT) from 'RPI minus 7.5 per cent' to 'RPI minus 4.5 per cent'. This implied that:

- A** BT would be less profitable in 1998.
- B** prices in 1998 would be higher than in 1997
- C** there would now be more pressure on the company to make efficiency improvements.
- D** the regulator believed that there was less scope for BT to make efficiency improvements.
- E** the regulator believed that any efficiency improvements made by BT would not result in lower costs.

Question 3

An advantage of using the RPI minus X method of regulating a privatized monopoly is that it allows the firm to :

- A** raise prices by less than mortgage interest payments.
- B** keep supernormal profit achieved by additional efficiency improvements.
- C** raise the prices of goods the firm does not export.
- D** make only normal profit.
- E** do no more than break-even.

Question 4

The 1998 Competition Act gives the Office of Fair Trading the power to fine firms up to 10% of annual turnover if they abuse a dominant market position. Which of the following actions by

the directors of a company would be against the public interest and therefore be likely to attract such a fine?

- A** The pursuit of socially responsible objectives.
- B** The adoption of allocatively efficient pricing policies.
- C** Causing unemployment by closing a factory as a cost-cutting measure.
- D** Focusing on increasing sales in the European market.
- E** Forming price fixing agreements with other firms.

Question 5

In October 2002 Ofwat planned a review of the existing price limits set on water companies. These price limits are in the form of RPI + K, where K is the permissible price increase above the rate of inflation. Which of the following might be used by Ofwat to justify an increase in the size of K for particular water company?

- A** increased costs of meeting EU water purity standards.
- B** evidence that there is overstaffing in the water industry.
- C** data suggesting that water companies in other countries are less profitable than UK firms.
- D** expected increases in the RPI.
- E** falling costs of constructing reservoirs.

Question 6

The following figures show national market shares for the UK bus industry:

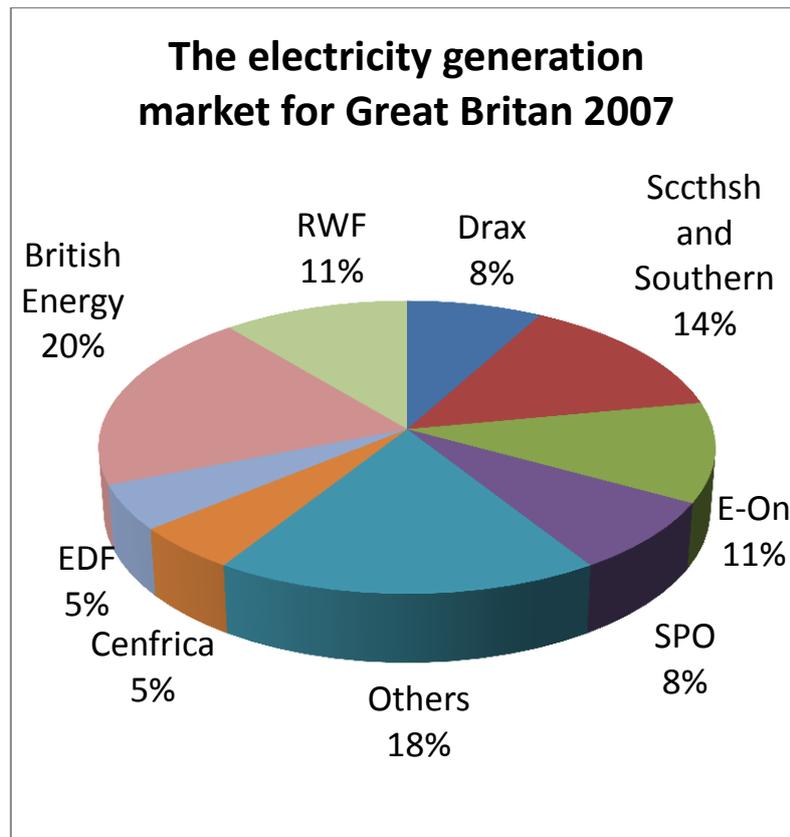
Company	1994 %	1997 %
First Group	12.8	21.6
Stagecoach	13.4	16.0
Arriva	3.5	14.8
Others	70.3	47.6

Source: <http://www.competition-commission.org.uk>

From the data it can be deduced that:

- A** in 1994, a merger between First Group and Arriva would have been eligible for referral by the Office of Fair Trading.
- B** in 1997 the bus industry had a three-firm concentration ratio of 47.6%.
- C** over the period shown, the bus industry became more perfectly competitive.
- D** over the period shown, the bus industry became more concentrated.
- E** over the period shown, First Group's sales revenue increase by 8.8%.

Question 7



Source: The Times, 9th March 2007

The chart shows the percentage shares of the electricity generation market for Great Britain in 2007. Which of the following can be inferred from the data?

- A** A legal monopoly exists in the market.
- B** The three-firm concentration ratio is above 50%.
- C** A merger between British Energy and Drax would be eligible for referral to the Competition Commission.
- D** It is a perfectly competitive market because electricity is a homogenous product.
- E** The market has a low concentration ratio.

Question 8

Household water bills are regulated by Ofwat according to the formula ' $RP1 + K$ '. In 2007, the RPI was 3.9% and K set at 3.1%. This meant average household water bills.

- A** Decrease in nominal terms by 0.8%.
- B** Increased in both nominal and real terms.
- C** Increased by no more than the rate of inflation, excluding mortgage interest repayments.
- D** Increased in nominal terms by 3.1%.
- E** Decreased in real terms by 3.9%.

Question 9

In 2001 the European Commission levied fines of €855 million on 13 pharmaceutical companies for forming a cartel to control the vitamins market. The purpose of such fines is to:

- A** Encourage the development of unwritten and unspoken agreements between pharmaceutical companies.
- B** Reduce the costs of vitamin producers.
- C** Ensure greater economies of scale in the vitamin industry.
- D** Increase the profitability of vitamin producers.
- E** Protect the consumer surplus of purchasers of vitamins.

Question 10

In 2000, the energy regulator (Ofgen) announced a new price control for the National Grid Company, the UK's main supplier of electricity. The control was set at RPI minus 1.5%, to run for five years from 2002. One reason for the RPI minus X system of control is that it:

- A** Allows the National Grid Companies to keep all annual profits, less a percentage 'X', set by the regulator.
- B** Caps all profits to a percentage 'X' set by the regulator.
- C** Allows the National Grid Company to keep any profits from efficiency improvements beyond those expected by the regulator.
- D** Enables the National Grid Company to make supernormal profits on its exported electricity whilst maintaining price increases equal to the rate of inflation at home.
- E** Determines prices for the National Grid Company using a formula which excludes the cost of mortgage interest repayments.

Question 11

In 2002, the Competition Commission recommended that the proposed acquisition by Vivendi Water UK plc of another water supplier, Southern Water Services Ltd, be allowed. The recommendation was conditional on Vivendi selling off its holding in another water supplier, South Staffs Group. The basis of such a recommendation would be whether the proposed acquisition was:

- A** Likely to yield acceptable returns to shareholders.
- B** Politically acceptable to the government.
- C** Likely to cause problems for the UK's trading partners.
- D** In the interest of Vivendi Water plc.
- E** In the public interest.

Question 12

The data below show the estimated market shares of UK Health and Beauty retailers in 2002:

Company	Market Share 2002 (%)
Boots	26.2
Tesco	14.3
Asda	7.6
J Sainsbury	7.0
Superdrug	7.0
Safeways	4.8
Other companies	33.1

Which of the following is true for this market?

- A** The market is perfectly competitive.
- B** There would be no competition issues involved in a take-over bid by Boots for Asda.
- C** Product differentiation is unlikely in this market because of the low level of market concentration.
- D** A bid for Boots by Tesco would be eligible for referral to the Competition Commission.
- E** There is a seven firm concentration ratio of 100%.

Question 13

The 1998 Competition Act introduced new powers for the Office of Fair Trading to fine firms abusing a dominant market position up to 10% of their annual turnover. In which of the following is such abuse most likely?

- A** Industries where there are low levels of market concentration.
- B** Markets that are highly contestable.
- C** Perfectly competitive industries.
- D** Firms in monopolistic competition.
- E** Firms where there is a tradition of sharing future price information with competitors.

Question 14

In March 2003 the Economist reported that the Rail Regulator, Tom Winsor, was in conflict with the Treasury about whose responsibility it is to set the level of investment for Network Rail. One reason for stopping Network Rail from making such decisions itself would be that the company:

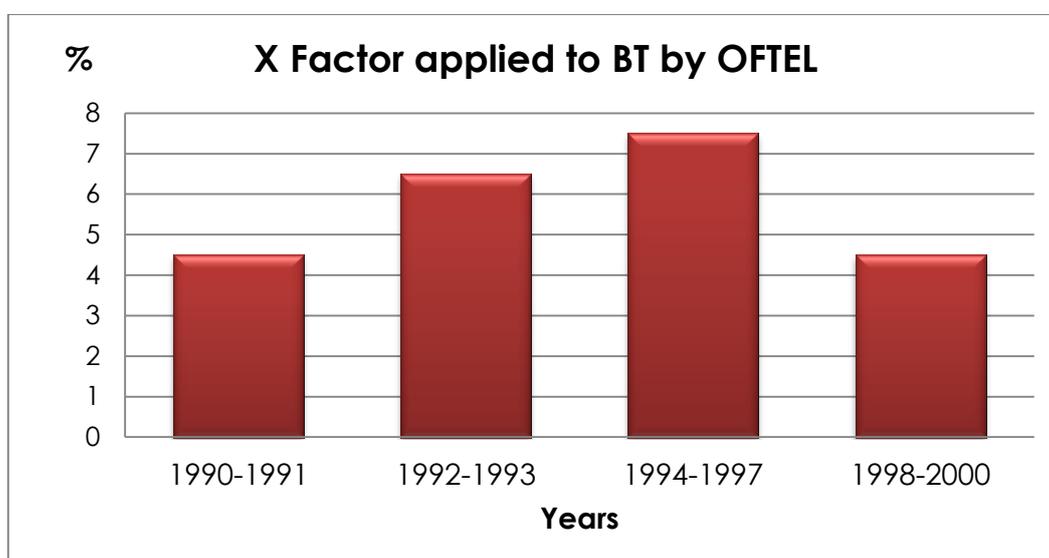
- A** Faces too many competitors in the provision of rail track to be able to make a rational investment decision.
- B** Enjoys a monopoly in the provision of rail track.
- C** Operates in a contestable market for the provision of rail track.
- D** Has no incentive to invest in new rail track.
- E** Has a better idea than regulators of the public interest issues at stake in the provision of rail track.

Question 15

Under the Enterprise Act 2002, the Office of Fair Trading has the power to refer any merger involving more than 25% market share to the Competition Commission for investigation. The investigation is likely to recommend that the merger is not allowed to take place if it is likely to result in:

- A** A share price thought to be too high by many potential shareholders.
- B** A substantial reduction of competition within any market or markets in the UK for goods and services.
- C** Increased consumer benefits such as lower prices and greater choice of product.
- D** A reduced market concentration ratio in the relevant industry.
- E** Greater contestability in the relevant industry.

Question 16



The graph shows the values of X applied by the industry regulator OFTEL when price capping telecommunications company BT, according to the RPI minus X formula.

Which of the following can be inferred from the graph?

- A** Throughout the period shown BT has been allowed by the regulator to make real price increases.
- B** Throughout the period OFTEL believed there was room for BT to make efficiency improvements.

- C** Throughout the period shown BT's profits have been taxed at annual rates greater than 4%.
- D** After the 1990-1991 capping period BT was allowed by the regulator to raise its prices by more than 4% in nominal terms.
- E** After the 1994-1997 capping period OFTEL allowed BT to raise its prices by more than 4%.

Question 17

Which of the following measures is used by UK regulatory agencies to protect consumer interests in the utility industries?

- A** Profit capping.
- B** Employment capping.
- C** Price capping.
- D** Investment capping.
- E** Output capping.

Question 18

In May 2005 the Competition Commission fined Manchester United Football Club and JJB Sports for fixing the price of football shirts. On what grounds might the Competition Commission have acted?

- A** The government wished to tax the excess profits made by these two companies.
- B** JJB and Manchester United were planning an aggressive marketing campaign.
- C** JJB and Manchester United were buying their shirts from unethical sources. .
- D** The Commission wanted JJB and Manchester United to achieve productive efficiency.
- E** JJB and Manchester United were engaged in restrictive practices.

Question 19

Rail fare Rises for 2006

Train company	Average price Rise of season Ticket (%)	Average price rise of cheap day return ticket (%)
Central Trains	3.9	4.4
Midland Mainline	3.9	6.0
Silverlink	3.9	6.1
Virgin West Coast	3.9	5.9
RPI (% change)	2.9	2.9

Source: www.strategicrailauthority.org.uk

The table shows rail fare increases for selected train operating companies in 2006. Season tickets are subject to price controls by the rail regulator according to the RPI + K formula,

where K is + 1%. However, cheap day return tickets are not subject to price controls. It can be inferred from the table that :

- A** The value of K is greater than the rate of inflation.
- B** Removing price controls will protect the consumer surplus.
- C** The real price of season tickets have decreased.
- D** Cheap day return tickets are more expensive than season tickets.
- E** The permissible price increase of season tickets is above the rate of inflation.

Question 20

The government appointed investment bank Goldman Sachs to sell off the Tote, a state owned gambling company, in April 2008. The Tote owns 540 betting shops valued at £320 million. The most likely reason to sell off the Tote is to:

- A** Encourage more gambling.
- B** Reduce contestability within the industry.
- C** Avoid an investigation from the Office of Fair Trading.
- D** Achieve benefits from privatization.
- E** Open up the industry to 'hit and run' competition.

Question 21

HMV, which owns Waterstone's bookstores, was given permission by the Competition Commission to take over Ottakar's bookstores in May 2006.

The £63 million takeover gives HMV 23.6 per cent of the UK book sales market.

The most likely reason the Competition Commission allowed the takeover is that :

- A** Significant competition will remain in the market.
- B** Fewer economies of scale would be achieved by HMV.
- C** It is in the interests of both firms.
- D** Collusion between book stores, supermarkets and online retailers will increase.
- E** Consumer surplus will fall.

Question 22

An investigation into store cards by the competition Commission in 2006 found that the retailers were charging their customers an annual interest rate of around 30%, far higher than the rate required to cover costs. The Commission proposed a series of methods to reduce interest rate charges on store cards. A likely intention of these measures were to make the retail store card market.

- A** less contestable
- B** more allocatively efficient
- C** more concentrated
- D** more profitable
- E** less regulated.

Question 23

Ofcom, the telecommunications regulator, ended more than twenty years of price controls for telephone calls and line rentals on British Telecom in August 2006. The most likely reason for Ofcom's decision is that :

- A** British Telecom is no longer required to raise prices by less than mortgage interest payment.
- B** Profit capping is ineffective in protecting consumer interests.
- C** British Telecom's prices have increased above the rate of inflation over recent years.
- D** Significant competition now exists in the industry.
- E** The rate of technological change in the industry is set to increase.

Question 24

In 2008, the Office of Fair Trading offered up to £100,000 reward for information on illegal restrictive practices. The most likely reason for this is to :

- A** Encourage firms to share market information.
- B** Promote competition.
- C** Encourage merger activity.
- D** Protect the producer surplus.
- E** Encourage firms to increase dividends to shareholders.

Question 25

In September 2007, the European Competition Commission instructed Microsoft, the computer software giant, to make freely available some of its patented technical information to rival companies such as Sun Microsystems. The most likely effect on the computer software market of this decision is to.

- A** Increase concentration.
- B** Increase contestability.
- C** Strengthen computer patents.
- D** Increase entry barriers.
- E** Increase Microsoft's profits.

Question 26

The big four UK banks, Royal Bank of Scotland, Lloyds TSB, HSBC and Barclays, currently control approximately 85% of the market for small business bank accounts. In March 2002 the Competition Commission found that the banks were overcharging their small business customers and proposed a series of measures to reduce the price of using a business bank account. A likely intention of these price reductions was to make this banking market :

- A** More allocatively efficient.
- B** Less regulated.

- C** Ineligible for future referrals to the Competition Commission.
- D** Achieve higher supernormal profits.
- E** Less competitive.