A Level · AQA · Economics

4 hours · 21 questions

Exam Questions

5. Perfect & Imperfectly Competitive Markets & Monopolies

Market Structures / The Objectives of Firms / Perfect Competition / Monopolistic Competition / Oligopoly / Oligopoly: Price & Non-Price Competition / Monopoly & Monopoly Power / Price Discrimination / Competition & Competitive Market Processes / Contestable & Non-contestable Markets / Market Structure, Efficiency & Resource Allocation / Consumer & Producer Surplus

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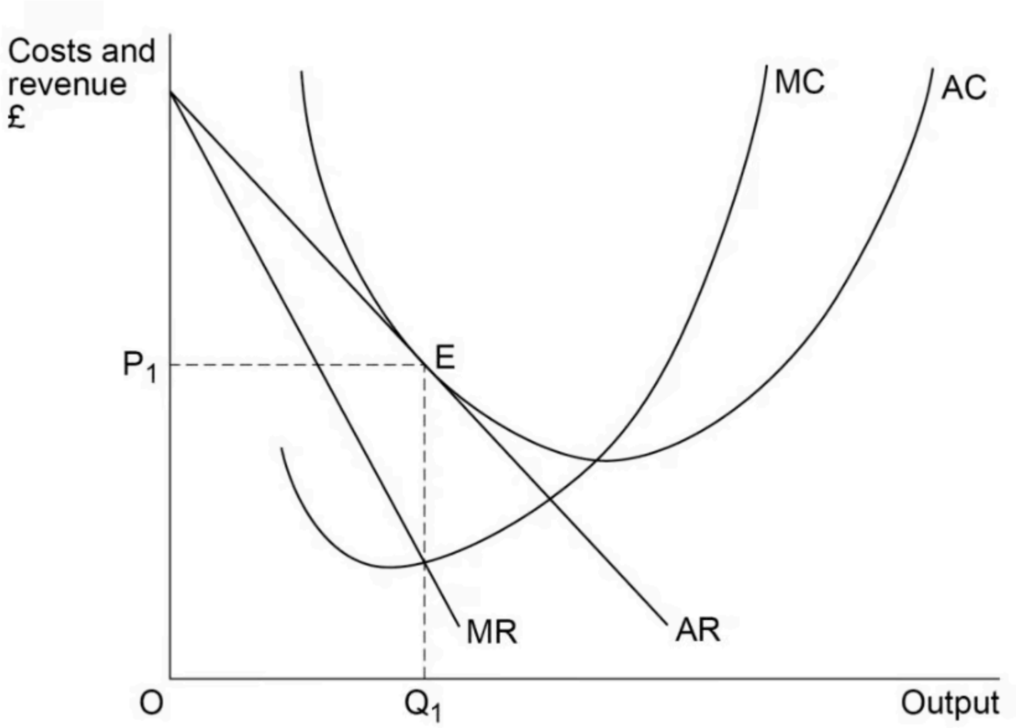
Total Marks **/214**

1 **Figure 2** shows the equilibrium position, point E, of a profit-maximising firm in a monopolistically competitive industry.

Figure 2



All other things being equal, which one of the following applies to the firm's equilibrium at point E? The firm is

A. in short-run equilibrium, but not in long-run equilibrium.

B. making normal profit because AC = AR.

C. making supernormal profit because MC = MR.

D. productively efficient but not allocatively efficient.

(1 mark)

2 A monopolistically competitive firm's demand curve is

A. also the market demand curve.

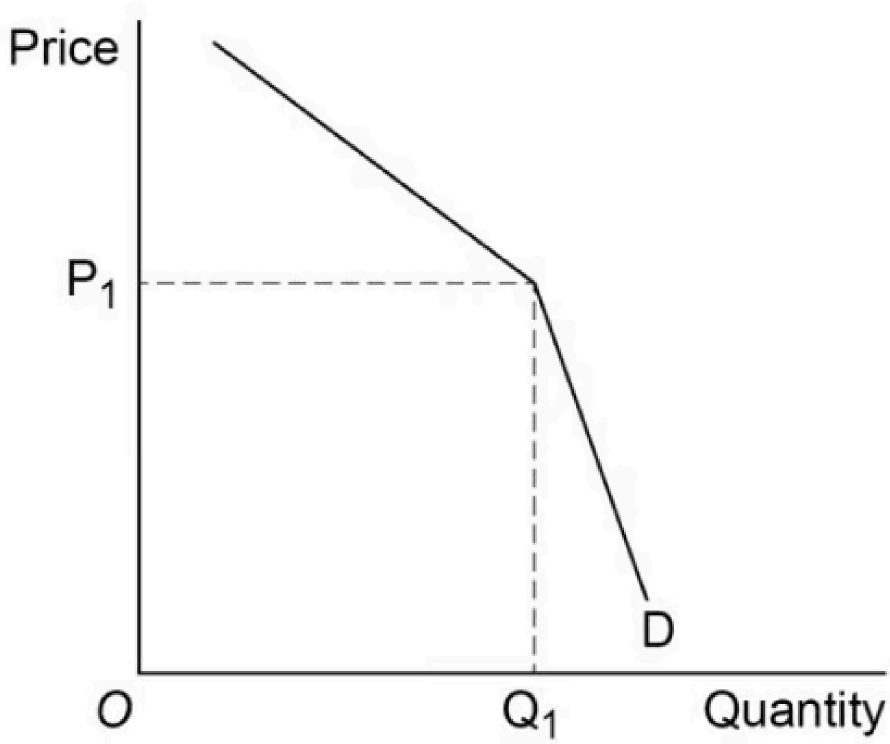
B. inelastic throughout its length.

C. the firm's average revenue curve.

D. the same as its marginal revenue curve.

(1 mark)

3 The diagram below shows the kinked demand curve (D) for a firm operating in a competitive oligopolistic market.



The kinked demand curve model provides an explanation of why the

A. firm colludes with competitors to set the price of $0P_1$.

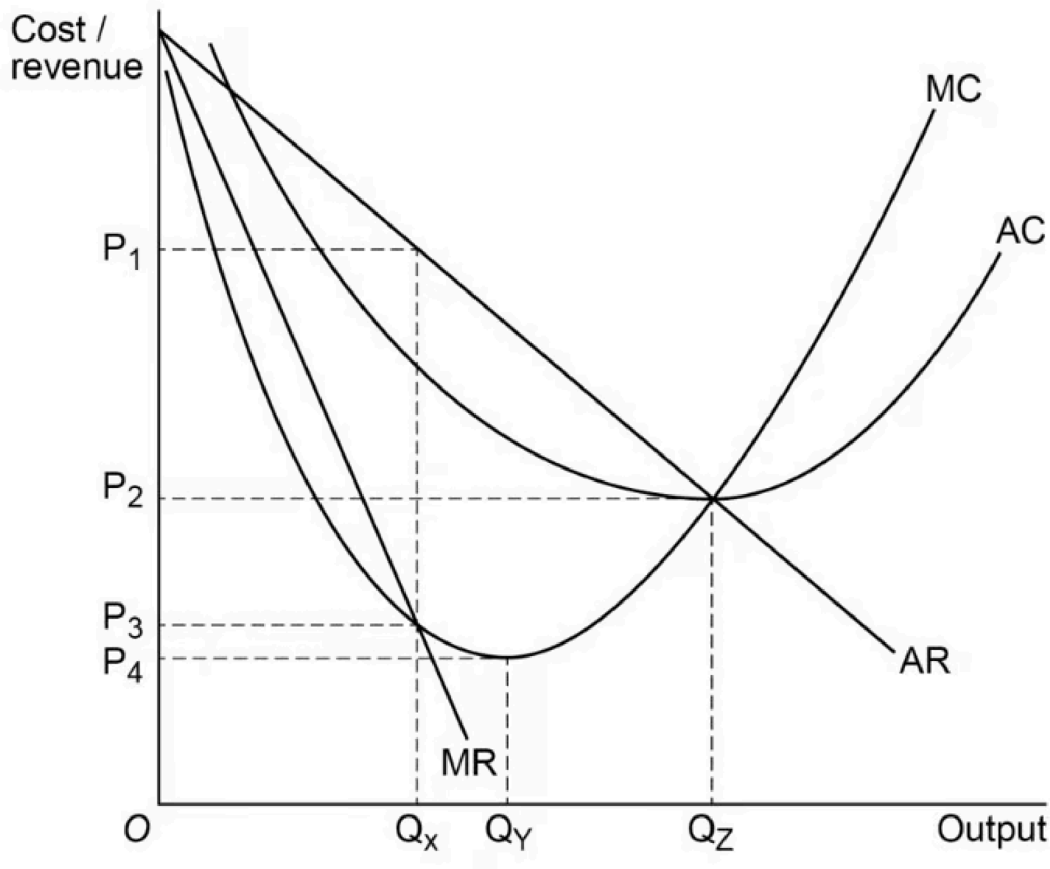
B. firm's demand curve becomes more elastic as it lowers its price.

C. firm's price changes depend on competitors pricing behaviour.

D. firm won't change its price from $0P_1$ even if competitors change their prices.

(1 mark)

4 The diagram below shows the average revenue and marginal revenue (AR and MR) curves, and the average cost and marginal cost (AC and MC) curves, for the only firm in an industry.



If the market is highly contestable, in the long run, the firm is most likely to set its price at

A. $0P_1$

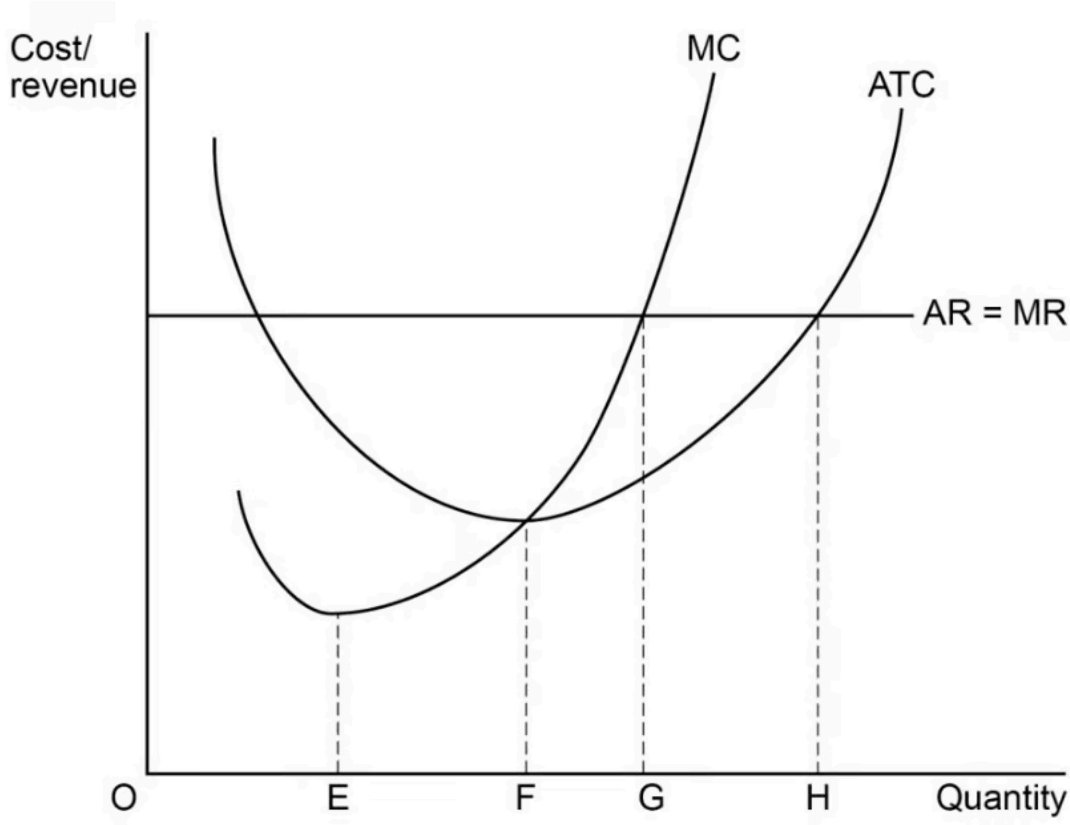
B. $0P_2$

C. $0P_3$

D. $0P_4$

(1 mark)

5 The diagram below shows a firm operating in perfect competition in the short run.



Which quantity, **OE**, **OF**, **OG** or **OH**, indicates the output where profits are maximised?

A. OE

B. OF

C. OG

D. OH

(1 mark)

6 Which one of the following is most likely to measure the degree of competition in an oligopolistic industry?

A. The price elasticity of supply in the industry

B. The profitability of the 10 largest firms in the industry

C. The three firm concentration ratio

D. The value of the Gini coefficient

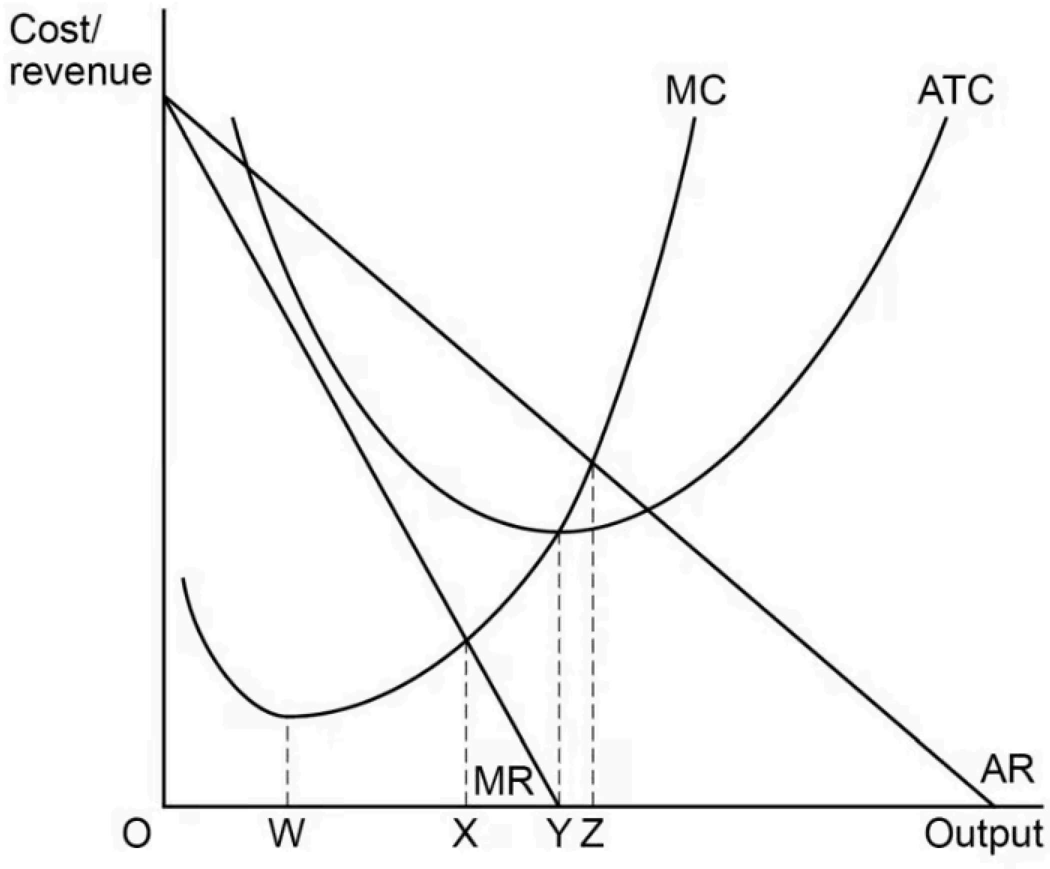
(1 mark)

7 Refer Insert

After considering **Extract E**, and the original evidence in **Extracts A**, **B**, **C**, and **D**, would you recommend to the members of OPEC that they continue to restrict the supply of oil to try to raise the world market price of oil? Justify your recommendation.

(25 marks)

8 The diagram below shows the cost and revenue curves for a monopoly.



At which one of the following levels of output would the firm be productively efficient?

A. OW

B. OX

C. OY

D. OZ

(1 mark)

9 Critics of the world's five most valuable multinational technology firms (Google, Amazon, Apple, Facebook and Microsoft) argue that there ought to be greater government intervention to protect consumers' interests. Several European governments are considering imposing new taxes on the revenues of such firms, rather than their profits

Explain how the imposition of a tax on a good or service affects both consumer surplus and producer surplus

(15 marks)

10 In December 2018, the Competition and Markets Authority (CMA) announced a range of policies to prevent firms charging existing customers more than new customers. Firms supplying financial services, mobile phones and broadband are no longer allowed to discriminate against loyal customers renewing their contracts

Assess the view that price discrimination is always damaging

(25 marks)

11 **Extract E** describes the British railway sector as a 'natural monopoly', which was split up into 'no less than 100 pieces' when it was privatised.

With the help of a diagram, **explain** why breaking up a natural monopoly in rail may affect long-run average costs

Extract E: Privatisation of British Rail

'More competition, greater efficiency and a wider choice of services', proclaimed the 1992 Government white paper that advocated the privatisation of British Rail. Two decades on, passenger journeys have more than doubled from 735 million in 1994–5, to 1.7bn in 2016–17

But how much of this is due to the benefits of privatisation, rather than factors such as increasing urban congestion and a rising population? The UK's trains and tracks are more intensively used than in any other European market except the Netherlands. Investment is up, at around four times (in real terms) the £1.6bn a year it averaged in the late 1980s. The data on service quality are mixed. The UK performs well in terms of punctuality and reliability, but many journeys are uncomfortable. At peak hours 23% of London commuters have to stand. Instead of pushing British Rail into the private sector as a natural monopoly, the Government split it up and sold it in no less than 100 pieces between 1995 and 1997

Privatisation was supposed to unleash efficiencies that would justify the returns private operators demand for their services. However, a recent study shows that the cost of running the UK's railways is 40% higher than in the rest of Europe. "The train you catch is owned by a bank, leased to a private company, which has a franchise from the Department for Transport to run it on track owned by Network Rail, all regulated by another office, and paid for by taxpayers or passengers," says Prof John Stittle. Since 1996, government subsidies have almost doubled in real terms. Ticket prices are now 25% higher in real terms than in 1995 and 30% higher than in France, Sweden and Switzerland

(9 marks)

12 Several loss-making retailers including Homebase, House of Fraser and Poundworld have had to decide whether to shut down operations or carry on while making losses. In contrast, the music-streaming firm Spotify was valued at $27 billion in 2018, despite never having made a profit in any year since it was founded. Spotify has been more focused on expanding market share

Explain the factors a profit-maximising firm will take into account when deciding whether to shut down or to carry on operating, both in the short run and in the long run

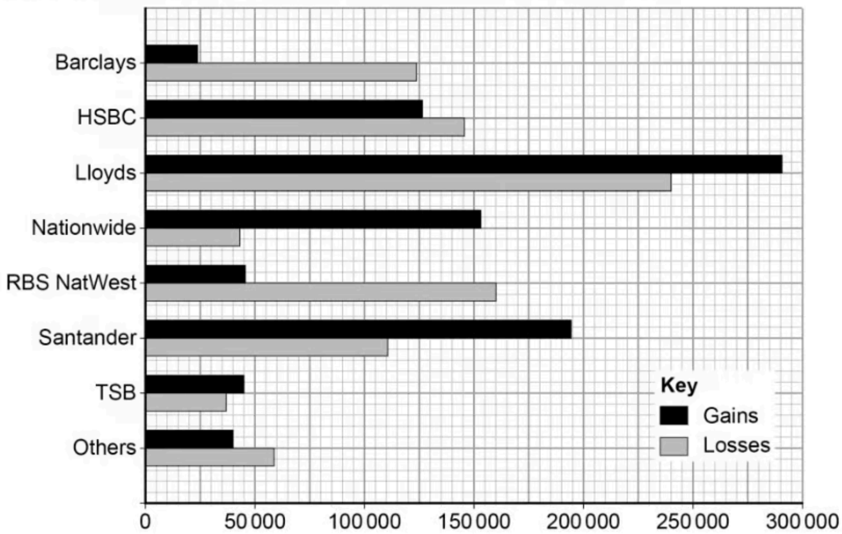
(15 marks)

13 Several loss-making retailers including Homebase, House of Fraser and Poundworld have had to decide whether to shut down operations or carry on while making losses. In contrast, the music-streaming firm Spotify was valued at $27 billion in 2018, despite never having made a profit in any year since it was founded. Spotify has been more focused on expanding market share

Discuss the validity of the traditional economic assumption that the main objective of firms is to maximise profits

(25 marks)

14 **Extract A: Customers switching personal bank accounts in 2016**



Source: BACS

Explain how the data in **Extract A** show that the market power of the Big Four banks is weakening against competition from smaller rivals

(4 marks)

15 Extract C states that 'There is ample opportunity for new players to enter the sector.'

With the help of a diagram, **explain** how the lowering of barriers to entry in the banking market might lead to lower prices and a situation in which banks make normal profit

Extract C: The rise of challenger banks As the first new high street bank in 150 years, Metro Bank promises to operate distinctively: longer opening times than its rivals, instant debit cards for new account holders and eye-catching initiatives such as in-store dog water bowls. There are plans to grow its branch network from 48 to 110 by 2020. This bucks the UK trend for closing bank branches, more than 8000 of which have disappeared from high streets in the past 25 years. Metro Bank's Chief Executive Officer said of the big banks: "They act like oligopolies are supposed to: they under-invest; under-serve and they take you for granted."

Many of the major banks suffer from inefficient, outdated IT infrastructure which limits their ability to reduce prices. They may also suffer from diseconomies of scale, given the size of their workforce and the breadth of their operations. There is ample opportunity for new players to enter the sector

Metro Bank may take years to grab meaningful market share in the UK. Its straightforward business model involves opening new branches, collecting deposits and lending these funds to borrowers. This is safer than the riskier funding methods deployed by the some of the banks that failed during the financial crisis, but is unlikely to generate rapid growth. Even so, its customer focus puts pressure on dominant banks to improve their service

Source: News reports, August 2017

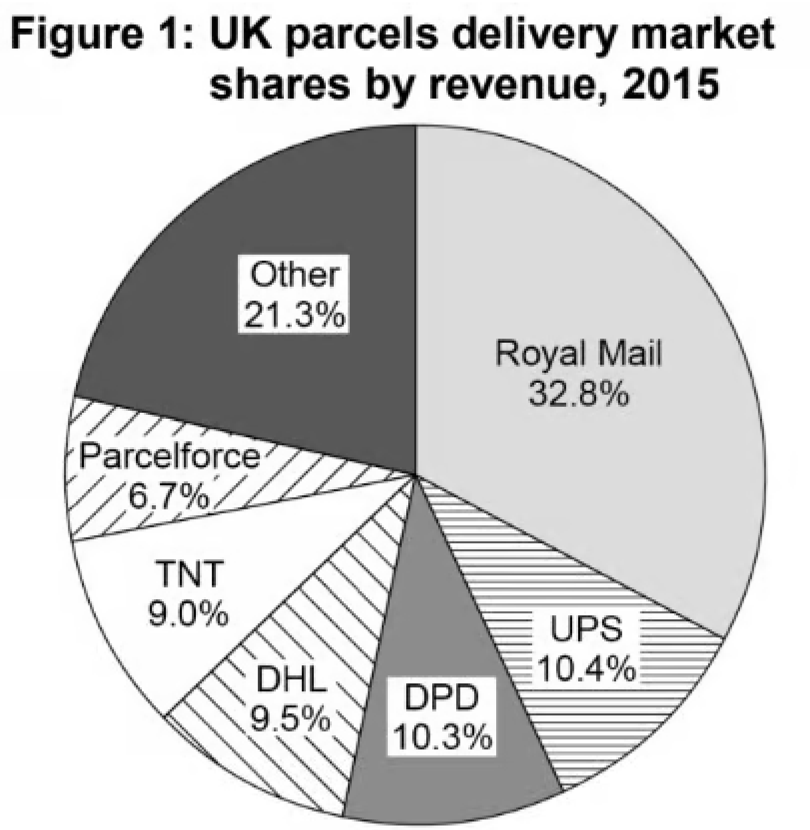
(9 marks)

16 In the United States, corporate profits since 2010 have averaged 9% of GDP, compared to 5% in the 1990s. This is causing concern that the US economy is increasingly dominated by companies with monopoly power

Evaluate the view that a firm making low profits must be inefficiently managed

(25 marks)

17



Using the data in **Extract A (Figure 1)**, calculate the three-firm concentration ratio in the UK parcels delivery market. Give your answer, as a percentage, to **one** decimal place

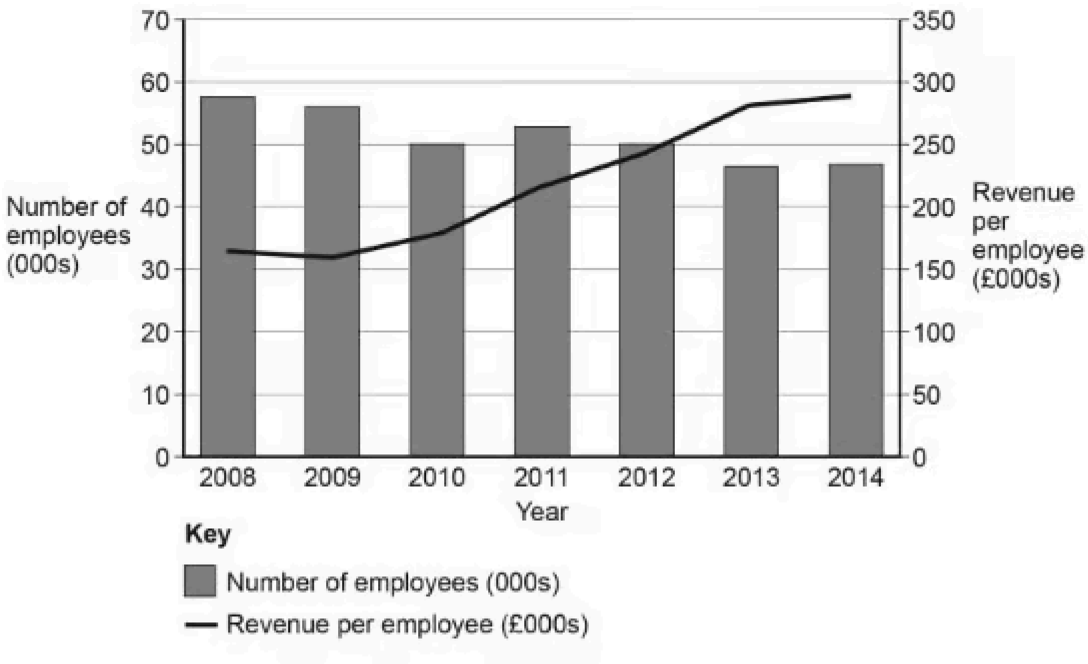
....

....

(2 marks)

18

Figure 2: Employees and revenue per employee in the UK parcels delivery market



Source: Apex Insight Industry Report, 2015

Explain how the data in **Extract A (Figure 2)** show that the UK parcels delivery market is displaying dynamic efficiency

....

....

....

....

(4 marks)

19 **Extract B (lines 12–14)** states that 'The Universal Postal Service obligations require Royal Mail to deliver letters and parcels to all parts of the country six days a week'.

With the help of a monopoly diagram, **explain** how the Universal Postal Service obligations are likely to affect Royal Mail's costs **and** profits.

Extract B: The privatisation of Royal Mail Royal Mail has started a new chapter after the government ended 499 years of public ownership by selling off its remaining stake. Although critics have suggested that the government undervalued the company, total proceeds of the sale amount to £3.3 bn. The newly privatised company will have to cope with structural decline in the number of letters sent in the UK (Royal Mail has a near monopoly in this market), as well as fierce competition in the parcels delivery market, which is rapidly growing because of the growth of online shopping.

A review of Royal Mail is under way by the regulator Ofcom, triggered by concerns that the withdrawal of Whistl, a smaller rival in the door-to-door letters delivery market, means the postal operator has no competitive pressure to improve services and become more efficient. Ofcom is considering whether the price Royal Mail charges competing courier companies, such as Whistl or Amazon, to access its own delivery network are fair. It is also examining whether Royal Mail's Universal Postal Service obligations are reasonable. The Universal Postal Service obligations require Royal Mail to deliver letters and parcels to all parts of the country six days a week, unlike its competitors. Some consumer organisations have claimed that increased competition in the parcel market has led to a worsening service for rural and remote consumers, including problems such as non-deliveries and lengthy journeys to collect undelivered items.

Competitive pressures on Royal Mail's profits may require the firm to cut costs. Pay negotiations with workforce representatives are set to begin but the powerful Communication Workers Union is likely to fight any redundancies. Analysts say that this could make it harder for management to find cash for investments to boost competitiveness.

Source: News reports, October 2015

(9 marks)

20 Roughly £18bn is forecast to be spent in the UK on advertising in 2017. Much of this will be spent by monopolistically competitive firms or oligopolies seeking to differentiate the products they sell to consumers

Explain how price and output are determined for a firm in a monopolistically competitive market, in both the short run and the long run

(15 marks)

21 Roughly £18bn is forecast to be spent in the UK on advertising in 2017. Much of this will be spent by monopolistically competitive firms or oligopolies seeking to differentiate the products they sell to consumers

Evaluate the view that government regulation of monopolistically competitive markets is unnecessary, and that polices to encourage competition and prevent the abuse of monopoly power should focus entirely on oligopolies and monopolies

(25 marks)