



Economics Questions By Topic:

Efficiency (3.4.1)

A-Level Edexcel Theme 3

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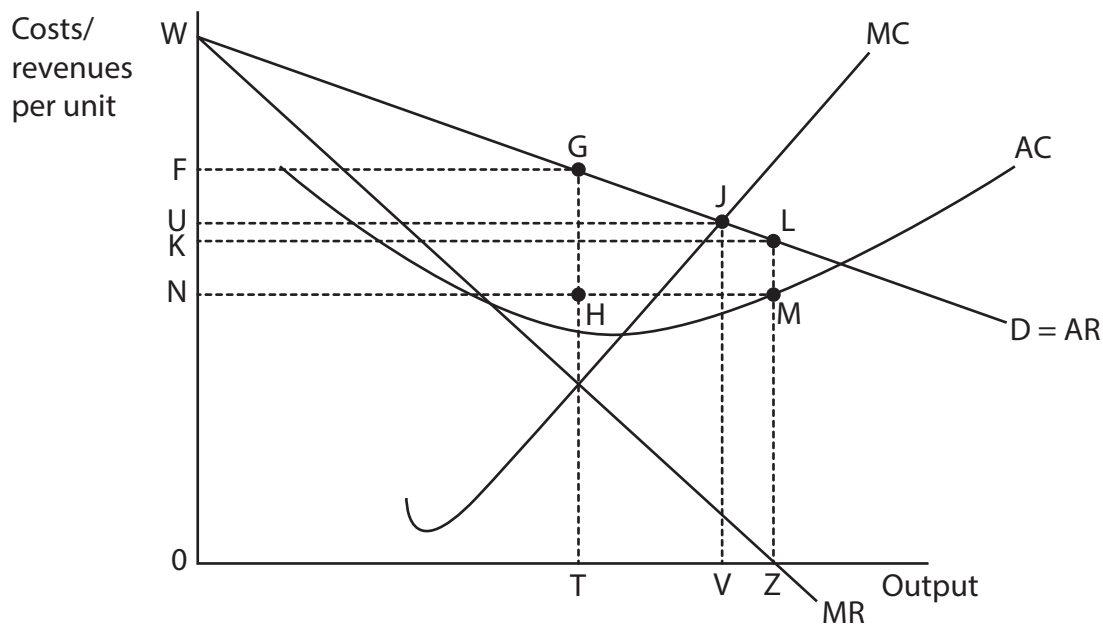
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SECTION A

Write your answers in the spaces provided.

1 The diagram shows the costs and revenues for a firm with monopoly power.



Which of the following statements is true?

(1)

- A At output T the firm is revenue maximising
- B At output V the firm is allocatively efficient
- C At output Z the firm is productively efficient
- D At profit maximising output the supernormal profits are KLMN
- E At output Z the price is zero

Answer

Explanation

(3)

Handwriting practice area consisting of 15 horizontal dotted lines.

(Total for Question 1 = 4 marks)

2 X-inefficiency is most likely to exist in markets where

(1)

- A new firms have recently entered the market
- B there are long-term patents in place
- C there is a high level of contestability
- D the conditions for price discrimination are not met
- E concentration ratios are low

Answer

Explanation

(3)

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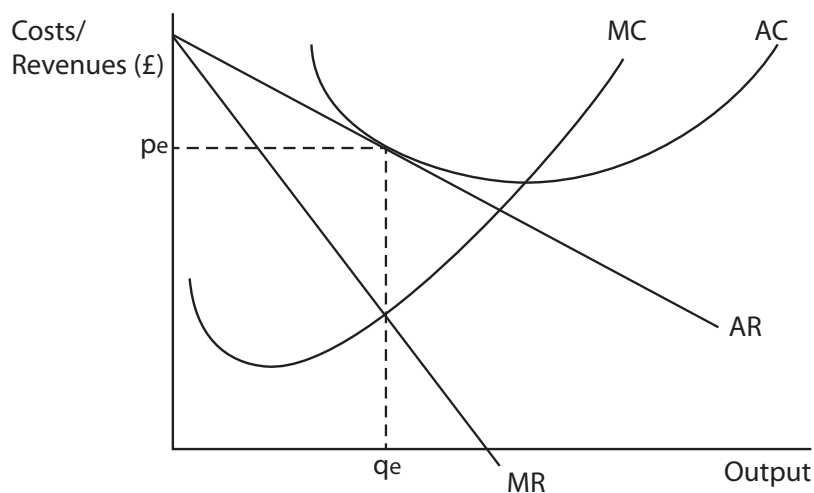
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(Total for Question 2 = 4 marks)

3 A small profit maximising café faces the following cost and revenue curves. It is noted that the café is never full.



Which one of the following is most likely to apply to this café?

(1)

- A It is productively inefficient in the long run
- B It is making supernormal profits
- C There is evidence of collusion
- D It operates in a perfectly competitive market
- E It is allocatively efficient in the long run

Answer

Explanation

(3)

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(Total for Question 3 = 4 marks)

4 Sally's farm grows and sells potatoes and she aims to maximise profit. She believes that the market price of potatoes will not be affected by changes in her farm's output. She will

(1)

- A sell as much as she can produce in the long run
- B become a monopolist, because she can supply the whole market
- C produce at the level of output where marginal cost equals price in the short run
- D produce at the level of output where average cost equals price in the short run
- E produce at the level of output where average fixed costs equals marginal revenue

Answer

Explanation (3)

(Total for Question 4 = 4 marks)

- 5** A firm selling snack food at a music festival is operating in market conditions of monopolistic competition. It is likely to be **(1)**
- A** allocatively efficient in the short run and productively efficient in the long run
 - B** allocatively efficient in the long run and productively efficient in the long run
 - C** both allocatively and productively efficient in the long run
 - D** neither allocatively nor productively efficient in the long run
 - E** both allocatively and productively efficient in the short run

Answer

Explanation **(3)**

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(Total for Question 5 = 4 marks)

6 A profit-maximising firm will produce at the productively and allocatively efficient level of output in which of the following market conditions?

(1)

- A Perfect competition in the long run
- B Monopoly
- C Perfect competition in the short run
- D Monopolistic competition in the long run
- E Oligopoly.

Answer

Explanation

(3)

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(Total for Question 6 = 4 marks)

7 A firm in long run equilibrium under monopolistic competition will be

(1)

- A allocatively but not productively efficient
- B productively but not allocatively efficient
- C productively and allocatively inefficient
- D making supernormal profits
- E allocatively and productively efficient.

Answer

Explanation

(3)

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END OF SECTION A (Total for Question 7 = 4 marks)

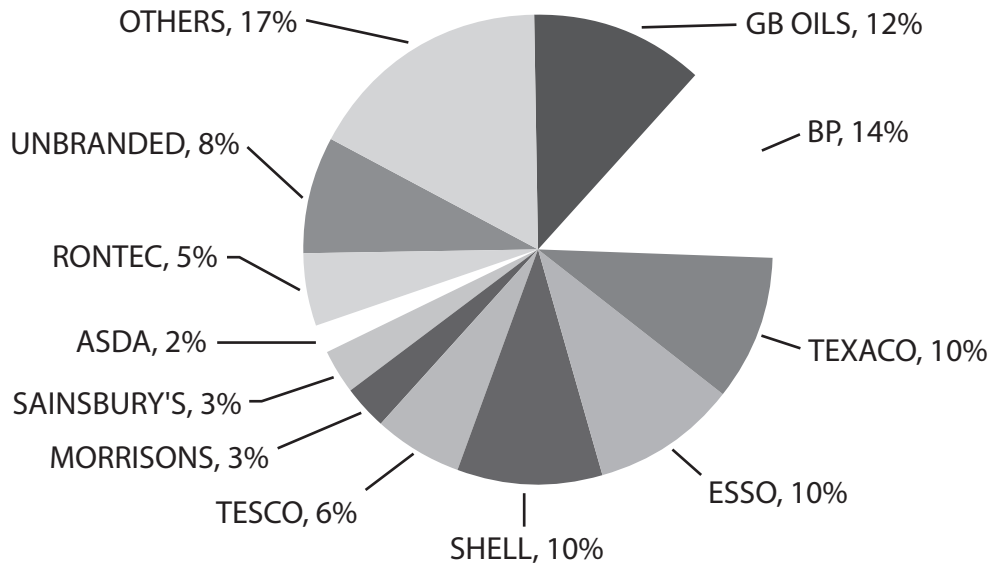
SECTION B

Read all extracts/figures before answering.

Write your answers in the spaces provided.

8 Motor Fuel Prices

Figure 1 UK petrol retail market share



(Source: http://i.dailymail.co.uk/i/pix/2013/01/15/article-016f425cb000005dc-950_634x373.jpg, accessed 1 April 2016)

Extract 1 Predatory pricing of petrol

Supermarket price wars are putting Britain's small petrol stations out of business at a rate of one a day. Sainsbury's, Tesco, Asda and Morrisons have embarked on a war to attract hard-hit consumers, and the price of fuel has been central to their campaign. Morrisons is offering loyalty points on its new fuel card while Asda has launched a price comparison app for mobile phones to convince shoppers it has the cheapest fuel. Both Sainsbury's and Tesco have offered money-off vouchers for petrol customers. 5

The Retail Motor Industry Federation (RMI), a trade association representing the interests of 6 000 small petrol stations, is hoping that the inquiry by the Competition and Markets Authority (CMA) will support its members, who believe that unfair and predatory pricing by the supermarkets and some major oil companies is making it impossible for them to compete. There are now about 8 000 small petrol retailers compared with 21 000 two decades ago and 40 000 in 1966. It predicts that in five years there will be very few independent petrol retailers left. 10

The CMA inquiry comes at a time when the supermarkets have proved particularly effective at building up a huge stake in the petrol market. In 2015, supermarkets accounted for 50% of total fuel sales from just 1 316 sites compared with 37.4 % in 2010. The CMA said the fuel market for Britain's 33 million motorists is worth around £32 billion a year, and accounts for 5p in every £1 of household expenditure. 15

Households are keen to save even one or two pence a litre, particularly those families whose livelihoods depend on the use of a car. 20

The RMI has been gathering evidence from its members to support the argument that the supermarkets have been involved in unfair pricing. Small garages typically make only 5p in profit on a litre of petrol, while major supermarkets were using tactics described as 'loss leading'. It is also blaming the major oil companies for unfair dual pricing. That means they sell to their own garages at one price and then to an independent retailer down the road at a higher price. There is evidence of 'price co-ordination' – otherwise known as price-fixing. 25

When the price of crude oil goes up, the prices motorists pay go up almost immediately – but when the oil price falls, retail fuel prices don't reflect that fall as markedly. 30

Andy Peake, Asda's Petrol trading director, said: "We welcome the CMA's decision to look into petrol and diesel prices. At Asda we are committed to doing everything we can to bring motorists the lowest possible fuel prices. Our preference would be that everyone is charged a national price for fuel, that way drivers would be treated as equals regardless of where they live." 35

(Sources: adapted from <http://www.dailymail.co.uk/news/article-2198634/Energy-giants-face-petrol-price-probe-Market-risk-manipulation-warns-watchdog.html> and <http://www.thisismoney.co.uk/money/cars/article-2200297/Small-petrol-retailers-devastated-aggressive-supermarket-pricing.html>)

Extract 2 Petrol retailers turn to coffee to drive sales

Caroline Harris, marketing director at Costa Enterprises, says: "There is a considerable amount of profit to be made by selling a product that has become an indispensable part of many people's daily routine. Petrol retailers can capitalise on this growing demand by offering their passing trade quality branded coffee 'on the go'. What's more, Costa has been voted the nation's favourite for the third year running making the beverage range and offer from Costa a 'must stock'." 5

She says research from Allegra shows the two key factors that determine consumers' choice in coffee are convenience and quality. Consumers increasingly expect to be able to grab a cup of coffee on the go wherever they are, which is good news for petrol station forecourts, as it almost guarantees a captive audience for coffee. 10
"The research shows that 'quality' has grown in importance for consumers and should therefore be an absolute must in attracting and retaining customers. Customers are more likely to revisit and recommend a consistently good product, which will in turn drive sales for the forecourt operator."

Meanwhile, in specific research on buying behaviour, Costa found that 'buying a coffee' is the main reason for 29% of visitors to a forecourt, and a third of these people, importantly, ended up buying unplanned items as a result. Furthermore, 85% of forecourt customers stated that they are now looking to purchase 'quality' coffee that they can 'grab and go' when out and about. 15

Says Harris: "It also identified that Costa Express brings drivers into the forecourt. 57% of the people asked said that Costa Express increases the likelihood of them visiting a forecourt, with over a third saying they would go out of their way to visit a site with Costa Express and 91% choosing Costa Express because 'the coffee always tastes great'." 20

Starbucks coffee is also available on many petrol station forecourts. Euro Garages is now extending its partnership with the use of Starbucks 'On The Go' machines. With 57 sites already boasting these machines, customers who are busy and on the move can now purchase their Starbucks beverages to take away. "Plans are in place to rollout the Starbucks On The Go machines throughout the 120 forecourt locations," explains Salim Hasan, head of operations at Euro Garages. "The Starbucks On The Go offer now completes the forecourt consumers' coffee experience and they can now choose whether they want to sit and enjoy their beverage in the comfort of a store, use the drive-through facility or simply pick up a drink while in the forecourt." 25 30

(Source: adapted from http://www.forecourtrader.co.uk/news/fullstory.php/aid/7515/Brands_mean_growth.html 02 September, 2013)

8 Discuss the likely impact on economic efficiency of the suggestion that “everyone is charged a national price for fuel” (Extract 1, line 35).

(8)

A series of horizontal dotted lines for writing the answer.

Handwriting practice area with 25 horizontal dotted lines.

(Total for Question 8 = 8 marks)

9 The UK Banking Sector

Extract 1 RBS fined £28 million for sharing price data

Royal Bank of Scotland (RBS) was fined £28.6 million in March 2010 for breaking competition law in the first big case brought against a financial services company, and one of the largest against a company for anti-competitive behaviour. RBS admitted that staff involved in making loans to big law and accounting firms had illegally given pricing data to corresponding staff at Barclays. Barclays had used the information provided by RBS to determine the pricing on its own loans before it reported the lawbreaking to the authorities in 2008. RBS had provided Barclays with broad information about the loan market, as well as specific details of the proposed pricing structure for two new loan facilities. These disclosures took place at a number of social, client and industry events and through telephone conversations between October 2007 and March 2008. 5 10

The breach in competition laws occurred before RBS was bailed out by the government, and it is now 70% owned by taxpayers. RBS said yesterday that it was a “deeply regrettable and isolated case”.

No action is to be taken against Barclays, as a reward for having acted as an informant within the industry, voluntarily disclosing its part in the affair to the competition authorities. 15

(Source: © The Financial Times Limited 2010, adapted from ‘RBS fined £28 million for price sharing data’, by Michael Peel and Sharlene Goff)

Extract 2 Fresh bonus fears as bank profits rise

The UK's five biggest banks – HSBC, Barclays, Lloyds Banking Group, Royal Bank of Scotland and Standard Chartered – have revealed that they made combined profits of £8.4bn in the first half of 2010. This performance is likely to be taken as proof that UK banks have recovered from the credit crisis and benefited from staffing reductions. However, there are concerns that these higher profits will lead to executives claiming greatly increased pay packages. The banks' share prices have jumped this year – RBS is up more than 70%, Lloyds is up nearly 37% – which could trigger the end-of-year bonuses to senior banking staff. Barclays is expected to disclose a bonus-to-salary ratio in line with the 38% paid last year – the highest of the UK banks.

5

Under pressure from the Bank of England and the Financial Services Authority, banks last year cut dividends and reduced bonuses as a proportion of revenue. The Chancellor said “we will not tolerate banks piling the pressure on the small to medium-sized business sector. The banks have an economic obligation to assist that sector. Every small and medium-sized company that I have visited in recent weeks has had some problem with their bank – either they have found it difficult to renew their overdraft or the bank demanded additional collateral, often someone's house. The danger is, particularly next year when there is a huge amount of refinancing required, that small and medium-sized businesses will suffer from a lack of access to short term loans.”

10

15

(Source: © copyright Telegraph Media Group Limited, 31st July 2010)

Extract 3 Other views on bank bonuses

The Deputy Prime Minister, Nick Clegg, said last week that the Government will “not stand idly by” if bonuses are too high. This needs to be more than just words. Ministers need to prevent the payouts being made, or at the very least ensure that awards are made entirely in shares (which will have the effect of increasing the capital reserves of banks), rather than cash. And those banks that still insist on resisting ministerial pressure must face a further tax as punishment.

5

(Source: © *Independent*, www.independent.co.uk/opinion/leading-articles/leading-article-time-for-ministers-to-call-the-banks-bluff-2165552.html, 21st December 2010)

9 Assess the likely impact on economic efficiency in the UK banking industry of increased regulation of UK banks.

(12)

A series of horizontal dotted lines for writing the answer to question 9.

Handwriting practice area with 25 horizontal dotted lines.

(Total for Question 9 = 12 marks)

10 Chocolate Manufacturing and Retailing

Extract 1 Profits rise at Thorntons

Mike Davies, Thorntons' chief executive of the UK's remaining large chocolate manufacturer, reported 25% higher profit, despite a small fall in total sales. As well as from its own shops, Thorntons sells chocolates through its website and to other retailers, such as supermarkets. Sales to other retailers rose by 6.5% to £34.6 million in the 26 weeks to 9 January 2010. In boxed chocolate, Thorntons' sales have grown 82% in the past two years, compared with a 7% decline recorded by Cadbury.

5

The company hopes that a new range of products will help it to become profitable in the second half of the year, which includes the summer months. Thorntons usually records a loss in the second half of the year, because customers eat less chocolate in warmer weather.

10

Source: http://business.timesonline.co.uk/tol/business/industry_sectors/retailing/article7031407.ece
The Times February 18, 2010 'Thorntons plays hard ball on the high street as profits rise' Marcus Leroux

Extract 2 Kraft takes over Cadbury to become world's biggest confectioner

Kraft's offer to buy Cadbury was accepted by Cadbury's board on 19 January 2010. Kraft, the US food giant, will pay £11.7 billion for Cadbury in cash and shares, some 50% more than the firm's value before the bidding started in September.

Kraft's acquisition may be a good deal for both companies. Kraft has little presence in Britain's confectionery market, where Cadbury is strong, but it has thriving businesses in mainland Europe and Russia where Cadbury has made minimal progress. Cadbury is strong in India and various Commonwealth countries, and has a booming chewing-gum business, particularly in Europe and Latin America, an area where Kraft has little expertise. Between them they can make up lost ground in China, where Mars holds the upper hand. The deal is also set to yield cost savings of £414m a year for the combined firm, operating at a larger scale in emerging markets. This is a good deal for most Cadbury's workers. However, the fact that so much of the deal is financed by debt is a negative: borrowing that looks cheap today could double in price tomorrow. That would eat up the cost savings on marketing and administration already factored into the purchase price, and perhaps force undesirable cuts to operations. Cadbury is already efficient: under its current management it has reduced costs significantly, for example, by off-shoring more of its operations. 5 10 15

Three-quarters of mergers result in a fall in short run profits. In such a sensitive consumer sector, the risks of a culture clash and brand destruction are high. That is what happened to Terry's, a smaller York-based chocolate company bought by Kraft in 1993. Terry's has lost visibility in Britain since production was relocated to central Europe in 2005. The same problem could await Cadbury. 20

There are understandable fears that foreign owners will be more likely than domestic ones to axe British jobs or use British profits to pay off their global debts. But all successful big firms, British and foreign alike, respond to the demands and opportunities of the global marketplace these days, and, as Cadbury's current managers have shown, their behaviour is rarely determined by their nationality. 25

The management practices of multinational companies tend to be better than the average in any country they operate in. In theory, then, Kraft's takeover of a British firm should bring better management to Britain. One problem: Cadbury is itself a multinational, and in no need of lessons from Kraft. 30

Source: adapted from <http://bit.ly/89Azni>

'Cadbury goes American. Is this healthy for British manufacturing?' *The Economist* Jan 19th 2010 and <http://bit.ly/aaFiRe> Jan 21st 2010 'Manufacturing blues: Another one bites the dust' Jan 21st 2010

Extract 3 Kraft to close Cadbury plant it offered to keep open

Kraft Foods has gone back on its promise to keep open a Cadbury factory in Somerdale near Bristol, just weeks after the British chocolate maker accepted its £11.7 billion offer. The plant, which employs 400 staff, will be closed in 2011. The Unite union said: "This sends the worst possible message to the 6,000 other Cadbury workers in the UK and Ireland. It tells them that Kraft cares little for their workers." 5

Source: <http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/7199322/Kraft-to-close-Cadbury-plant-it-offered-to-keep-open.html> Amy Wilson and Jonathan Russell 09 Feb 2010

10 With reference to the information provided, evaluate whether Kraft's takeover of Cadbury is likely to increase economic efficiency.

(16)

A series of horizontal dotted lines for writing the answer.

A large rectangular area with rounded corners, containing numerous horizontal dotted lines for writing.

Handwriting practice area with 20 horizontal dotted lines.

(Total for Question 10 = 16 marks)

END OF SECTION B