# Economics Questions By Topic:

# Government Intervention (3.6)

# A-Level Edexcel Theme 3

0207 060 4494
www.expert-tuition.co.uk
online.expert-tuition.co.uk
enquiries@expert-tuition.co.uk
The Foundry, 77 Fulham Palace Road, W6 8JA

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## SECTION A

**Write your answers in the spaces provided.**

1 In 2014 the UK Government announced that there would be a change in the price cap on regulated rail fare increases. The price cap changed from RPI + 1% to RPI + zero. Assuming RPI changes are positive, regulated rail fares will

**(1)**

**A** rise by 1% in nominal terms

**B** rise by 1% in real terms

**C** remain unchanged in nominal terms

**D** remain unchanged in real terms

**E** fall by an amount equal to the changes in RPI

Answer ☐

Explanation

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**(Total for Question 1 = 4 marks)**

**2** In 2013 the UK competition authorities forced LloydsTSB Bank to de-merge by forming two separate companies. 631 retail bank branches were rebranded as TSB, and 1 300 branches as Lloyds Bank.

Which one of the following is the most likely reason for this decision by the competition authorities?

**(1)**

**A** There are diseconomies of scale in the retail bank sector

**B** The level of contestability was high in the retail bank sector

**C** There was increased consumer surplus gained through horizontal integration

**D** There was a decrease in price gained through vertical integration

**E** LloydsTSB had a high market share in the retail banking industry

Answer ☐

Explanation

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**(Total for Question 2 = 4 marks)**

**3** Network Rail is a firm responsible for maintaining the UK rail infrastructure. It faces a fine of £75 million, imposed by the Office of Rail Regulation (ORR), for failing to meet its punctuality target. Only 87% of long distance trains arrived on time in 2012–2013, missing the 92% performance target set by the ORR.

**(1)**

The intended purpose of such performance targets is to increase the

**A** quality of service where lack of competition might lead to poor results

**B** contestability of the market where entry barriers are high

**C** x-inefficiency in the industry

**D** producer surplus of the firm where shareholders will benefit

**E** government's revenue in the context of a fiscal deficit

Answer ☐

Explanation

**(3)**

**(Total for Question 3 = 4 marks)**

**4** Barr and Britvic are two of the three largest soft drink firms in the UK. In February 2013, the proposed takeover by Barr of Britvic was referred to the Competition Commission for investigation. There were likely to have been concerns that the takeover would lead to

**(1)**

**A** economies of scale

**B** an increase in consumer surplus

**C** a decrease in contestability

**D** a reduction in external economies of scale

**E** a signal for more firms to enter the industry

Answer

Explanation

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**(Total for Question 4 = 4 marks)**

**5** In March 2013, the government agreed to a £288 million Private Finance Initiative (PFI) hospital contract, to replace the Alder Hey Children's Hospital in Liverpool.

What is the most likely reason that a PFI hospital contract was used?

**(1)**

**A** This method would not lead to an immediate increase in government borrowing

**B** Private borrowers can borrow at a cheaper rate than the government can

**C** PFI contracts increase x-inefficiency

**D** It is easy to get out of a PFI contract once agreed

**E** The government has no experience of large-scale building projects

Answer

Explanation

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**(Total for Question 5 = 4 marks)**

**6** Severn Trent Water is a local monopoly supplier of water in the Midlands. In 2008 it was fined by Ofwat, the water regulator, and required to reduce its planned charges. The most likely effect of this decision would be to

**(1)**

**A** increase producer surplus

**B** substantially lessen competition

**C** increase monopsony power

**D** satisfy the shareholders

**E** increase consumer surplus

Answer ☐

Explanation

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**(Total for Question 6 = 4 marks)**

**7** In a review in March 2011 Ofgem, the energy regulator, reported that it had concerns over the vertically integrated energy markets. The figure below shows the UK market share of the largest vertically integrated energy firms:

| | Percentage of UK market (volume of sales) |
|---|---|
| EDF Energy | 24% |
| E.ON | 12% |
| RWE npower | 10% |
| SSE | 10% |
| ScottishPower | 9% |
| Centrica | 6% |

(Source: © Crown Copyright)

The most likely reason for Ofgem's concerns is:

**(1)**

**A** There is a low level of producer surplus

**B** Vertical integration tends to decrease the concentration ratio

**C** Centrica is too small to achieve economies of scale

**D** Vertical integration can create a barrier to entry

**E** EDF Energy is a legal monopoly

Answer

Explanation

**(3)**

(Total for Question 7 = 4 marks)

**8** In January 2010 the Office of Fair Trading (OFT) referred the UK's local bus services to the Competition Commission over concerns about pricing. It had received complaints about the "predatory behaviour" of existing firms, designed to exclude new entrants from the market. Which characteristic was likely to have been observed?

**(1)**

**A** Prices equal to marginal cost

**B** High prices in the short run

**C** Prices set above average costs in the short and long run

**D** Revenue maximisation pricing

**E** Prices set below average variable costs in the short run

Answer ☐

Explanation

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**(Total for Question 8 = 4 marks)**

**9** In 2009 a 30-year private finance contract for widening and maintaining the M25 motorway was agreed. The contract was valued at £6.2 billion, with penalties if the consortium of companies did not achieve completion on time.

The main reason that the government used a private finance contract was likely to be because it:

**(1)**

**A** wanted to manage the project within the public sector

**B** cannot use performance targets in the public sector

**C** has limited experience of road building

**D** wanted to increase producer surplus

**E** wanted to commence a major project without raising the finance at the initial stage

Answer ☐

Explanation

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**(Total for Question 9 = 4 marks)**

**10** In August 2009 the Competition Commission published a Groceries Supply Code of Practice. Large supermarket chains were paying very low prices to some suppliers. Which type of market power does this suggest the large supermarket chains have?

**(1)**

**A** Monopsony

**B** Monopolistic competitive

**C** Perfectly competitive

**D** Natural monopoly

**E** Competitive monopoly

Answer ☐

Explanation

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**(Total for Question 10 = 4 marks)**

**11** On 1 November 2009 a new law in the UK gave financial regulators the power to impose fines on banks if they deliver poor service to customers. This method of government intervention in markets is a form of:

**(1)**

**A** price capping

**B** monitoring of prices

**C** public private partnership

**D** competitive tendering

**E** performance targeting.

Answer ☐

Explanation

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**(Total for Question 11 = 4 marks)**

**12** In March 2009 the UK Competition Commission required British Airports Authority to sell off three of its seven airports, starting with Gatwick and then Stansted.

The most likely reason for the Commission's decision was the

**(1)**

**A** increased competition from foreign airports

**B** monopoly power of British Airports Authority

**C** high level of contestability in the airport industry

**D** limit pricing used by the airports

**E** falling average costs resulting from horizontal integration.

Answer ☐

Explanation

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**(Total for Question 12 = 4 marks)**

**13** On 26 November 2009 the water regulator Ofwat announced that water bills must be cut by an average of £3 a year per household over the next five years and that there must be an extra £1 billion investment by water companies. The most likely reason for these decisions was

**(1)**

**A** to increase producer surplus

**B** to increase the returns to investors in water companies

**C** to reduce contestability in the water industry

**D** to force unprofitable firms out of business

**E** to increase efficiency in the water industry.

Answer

Explanation

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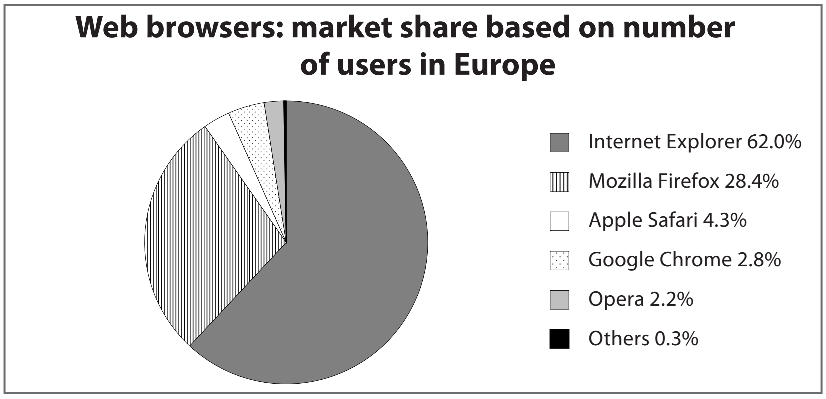
**(Total for Question 13 = 4 marks)**

**14**




Source: http://www.atinternet-institute.com/en-us/browsers-barometer/browser-barometer-september-2009/index-1-2-3-180.html

The chart shows the usage-based market share of internet web browsers in Europe. In 2008 the Microsoft computer software company was fined €1.68 billion by the European Competition Commission for pre-installing its browser, Internet Explorer, on computers running the Windows operating system. In December 2009, Microsoft agreed to allow consumers to choose their web browser on setup.

The most likely impact on the market for internet web browsers is

**(1)**

**A** an increase in the five-firm concentration ratio in the web browser market

**B** an increase in profitability for Microsoft

**C** an increase in advertising revenues for Internet Explorer web space

**D** a worsening of the quality of the browser products offered in the market

**E** a decrease in market share for Internet Explorer.

Answer ☐

Explanation

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**(Total for Question 14 = 4 marks)**

**15** A report by the University of East Anglia into the Private Finance Initiative and the Norfolk and Norwich University Hospital in June 2009 argued that the hospital was costing £20 million a year more than if it were run in the public sector.

Source: http://www.uea.ac.uk/polopoly_fs/1.116276!Three%20page%20briefing%20-%20NNUH%20report%20-%20June%202009.pdf.

Which of the following is a reason why the government has encouraged Public Private Partnerships?

**(1)**

**A** It is easy to accurately forecast the future costs of projects

**B** The government has a fiscal surplus

**C** To increase x-inefficiency in the public sector

**D** Performance targets have never been set in the public sector

**E** To make use of private sector finance to fund major projects.

Answer ☐

Explanation

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**(Total for Question 15 = 4 marks)**

**16** Intel is the world's largest microchip manufacturer, supplying over 75% of the market. In May 2009 it was fined $1.44bn by the European Commission. It claimed that Intel gave secret payments to computer makers to use only Intel chips and paid a major retailer to stock only computers with its microchips. The most likely justification for this fine is that:

**(1)**

**A** it ensured Intel would make a loss

**B** the market for microchips is contestable

**C** it would increase Intel's producer surplus

**D** Intel was abusing its market power

**E** the market for microchips has a low concentration ratio.

Answer

Explanation

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**(Total for Question 16 = 4 marks)**

**17**

| Year (July) | Making a call (€ per minute) | Receiving a call (€ per minute) |
|---|---|---|
| 2009 | 0.46 | 0.22 |
| 2010 | 0.43 | 0.19 |
| 2011 | 0.34 | 0.11 |

Source: *The Guardian*, 'EC wants price caps to prevent mobile phone bill shock', 24 September 2008

The table shows the maximum prices for making and receiving mobile phone calls permitted by the European Competition Commission. The most likely reason for these price caps is that the Commission believes that in this industry:

**(1)**

**A** contestability is too high

**B** excessive profits are being made

**C** consumer surplus is too high

**D** it is unnecessary to intervene since sufficient price competition exists between mobile phone companies

**E** investment needs to be encouraged.

Answer ☐

Explanation

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**(Total for Question 17 = 4 marks)**

**18** In the United States, limits have been placed on profits of recently privatised utilities, relative to the value of their capital assets. What may be considered the biggest disadvantage of this method of regulation?

**(1)**

**A** Firms will undervalue their capital assets

**B** Quality may decline as the regulator forces costs down

**C** The firm can make unlimited supernormal profits

**D** Firms have little incentive to become more productively efficient

**E** Firms are encouraged to make excess profits which they pay out as dividends to shareholders.

Answer ☐

Explanation

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**(Total for Question 18 = 4 marks)**

**END OF SECTION A**

## SECTION B

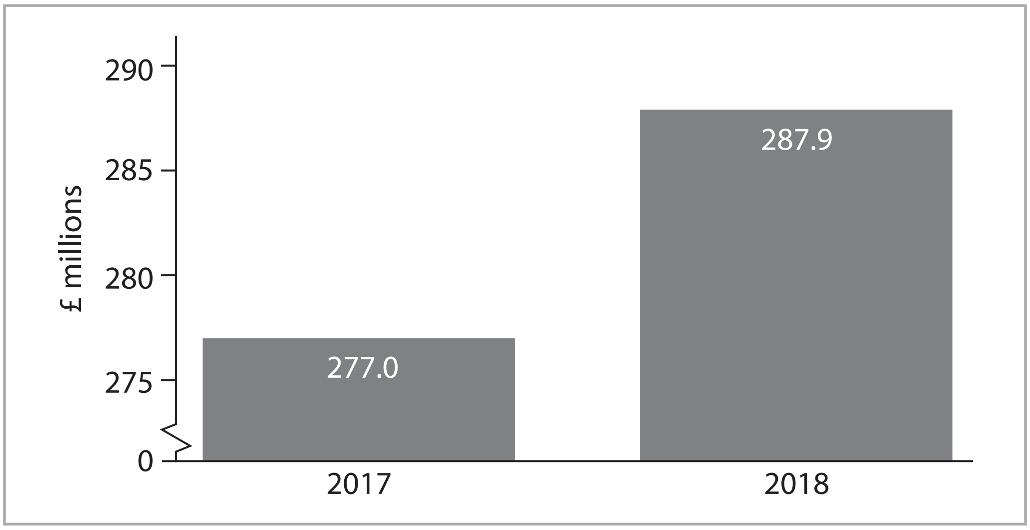
**Read all extracts/figures before answering.**

**Write your answers in the spaces provided.**

**Question 19**

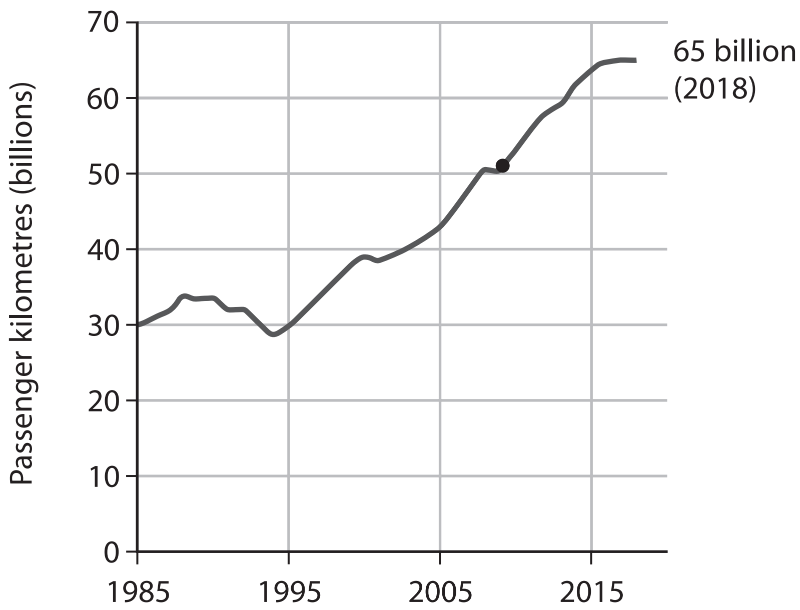
**The UK Rail Industry**

**Figure 1: UK government subsidy to Northern, a train operating company in Northern England**




(Source adapted from: https://www.theyworkforyou.com/wrans/?id=2018-10-18.181280.h)

**Figure 2: Rail passenger kilometres travelled per year in the UK, billions**




(Source adapted from: fullfact.org)

**Figure 3: Price of a single off-peak train journey, Edinburgh to Leeds Saturday 22nd December 2018 19:00 hours**

| Adult | Young Persons (16–25) Railcard |
|---|---|
| £105.30 | £69.50 |

(Source: https://www.lner.co.uk/buy-tickets/booking-engine)

**Extract A**

**The case for nationalisation**

Privatisation has not made the rail industry cheaper to operate, despite the promise from one government source that it would see private companies bringing: "more competition, greater efficiency and a wider choice of services".

One reason, suggest the critics, is fragmentation. Instead of pushing British Rail into the private sector as a single supplier the government chose to break it into three components of track, train operators and rolling stock i.e. the trains and carriages. This has encouraged each part of the rail industry to prioritise its own profits rather than collaborating to improve the system.

Privatisation, meanwhile, never really worked. The rail network of 2 500 stations and 32 000 km of tracks was renationalised in 2001. This has encouraged the government's transport secretary, a supporter of private sector involvement, to argue that the state Network Rail monopoly should be removed so that companies can bid to build new rail lines to upgrade the railway.

The privately-owned train operators are now the subject of fierce criticism, due to overcrowding and cancelled services. Private companies are supposed to compete to win a bid to be the train operator for a region for a short number of years. However in recent years the number of private companies bidding or renewing their contract as rail operators has fallen. In May 2018 the government rescued the East Coast line by renationalising it. The line had been run by the private rail operator Virgin Rail, which was suffering lower passenger numbers and revenue than forecast.

Some argue that there is a simple solution: reunite track and train in the only feasible manner, nationalisation.

(Source adapted from: https://www.ft.com/content/d82848ca-f7ba-11e7-88f7-5465a6ce1a00)

**Extract B**

**Southern Rail boss paid £495 000**

The Chief Executive of Southern Rail, the private-sector train operator that has become associated with delays, losses, cancellations and strikes, was paid £495 000 last year. This increased calls for nationalisation and a maximum wage for executives at companies with government contracts. In contrast the average base pay for a train driver in the UK is £47 705, although they can earn up to £63 000.

Nearly a third of Southern Rail trains were late in 2016 as it tried to deal with a labour dispute that involved extensive strike action. The rail trade unions are opposed to planned changes to the role of train guards, which they claim will put passenger safety at risk.

(Source adapted from: Rob Davies, The Guardian 10 April 2017
https://www.theguardian.com/business/2017/apr/10/southern-rail-boss-double-pay-rise)

**19** Assess whether complete nationalisation of the rail industry might protect employees.

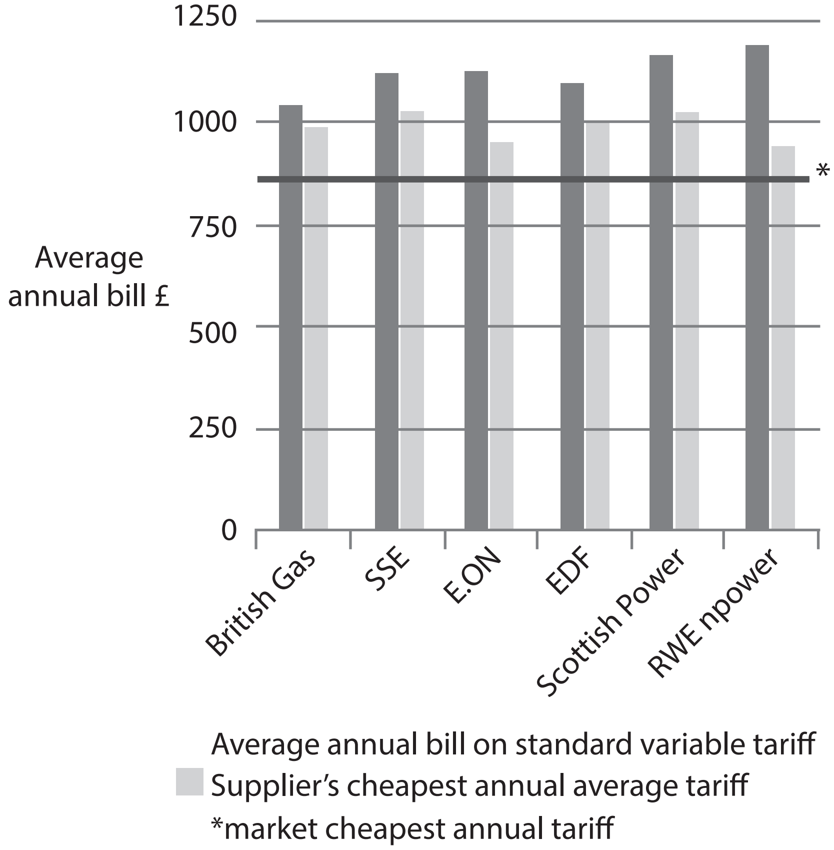
**(10)**

**(Total for Question 19 = 10 marks)**

**Question 20**

**Energy and telecommunication markets in the UK**

**Figure 1: Average annual household bill from the Big Six UK energy suppliers, 2017**




(Source: https://www.lovemoney.com/news/67298/standard-variable-tariff-compared-cheapest-deal-provider-savings)

**Extract A**

**Energy price cap to fix 'broken' market in UK**

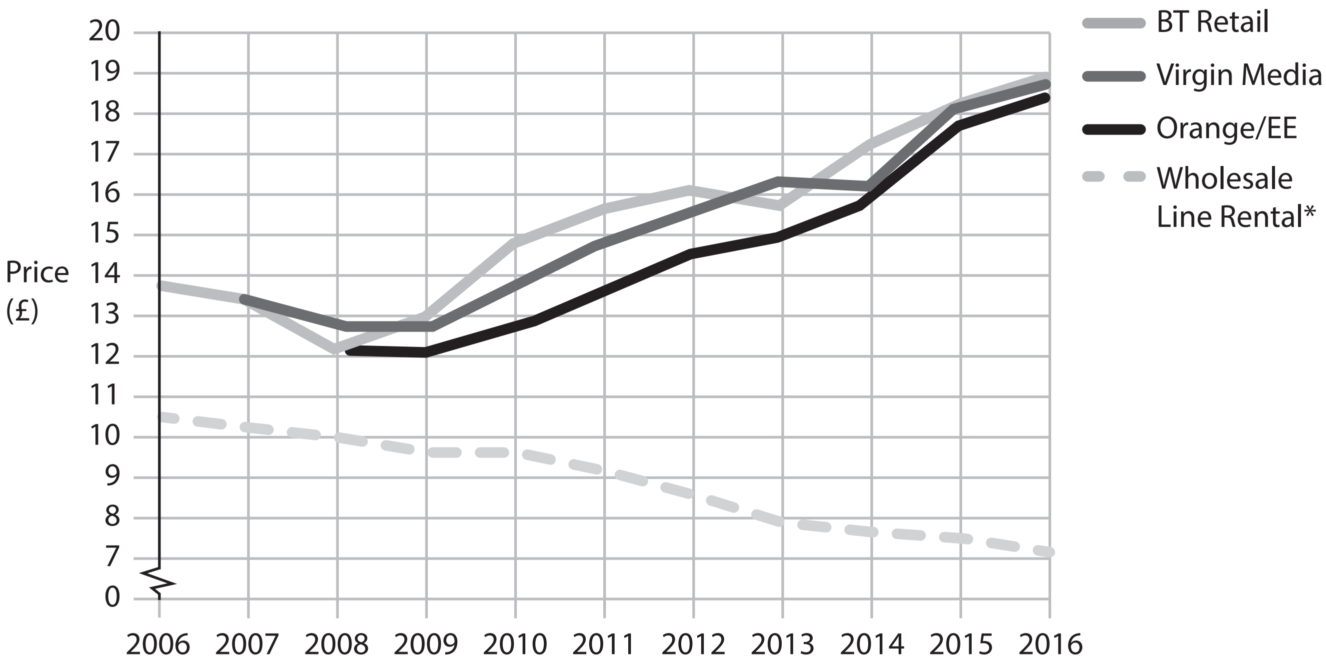
The Prime Minister recently said that the regulator Ofgem (Office of Gas and Electricity Markets) should limit electricity and gas suppliers' most expensive tariffs.

Under the planned new legislation, the energy bills of 11 million households will be capped for as long as five years. The government claimed this cap could save households up to £100 a year. This legislation would force Ofgem to change the licence conditions for energy suppliers so that they are required to cap electricity and gas prices. The measure will apply to anyone on a standard variable tariff, the expensive plans that customers are moved to when cheaper, fixed-price deals end. Ofgem will need to consult energy companies on how the cap is calculated, the government said. The Prime Minister repeated her claim that she had to act because the 'market is broken', a charge the big energy companies reject. "I have been clear that our broken energy market has to change – it has to offer fairer prices for millions of loyal customers who have been paying hundreds of pounds too much," she said.

However, Michael Lewis, chief executive of E.ON said "the government must guard against any unintended consequences that undermine customer service and push up prices as a whole. A price cap will not be good for customers. It will reduce competition and innovation". Smaller suppliers such as First Utility said the Big Six had only themselves to blame for the cap, because they had kept millions of people on standard variable tariffs.

(Source: adapted from 'UK puts energy efficiency at heart of climate change strategy', Adam Vaughan, Copyright Guardian News & Media Ltd 2017 https://www.theguardian.com/money/2017/oct/12/may-energy-price-cap-ofgem-electricity-gas-tariffs)

**Figure 2: The monthly rental cost of a telephone landline**




*Wholesale line rental – the rental price BT Openreach charges telephone service providers

(Source: https://www.ofcom.org.uk/about-ofcom/latest/features-and-news/landline-prices-review)

**Extract B**

**BT profit rises**

BT Group, which includes BT Openreach and BT Retail, reported a rise in profit as revenue increased following the integration of the consumer mobile business, EE. BT finalised the takeover of EE in August 2016, and the integration has resulted in BT controlling 35% of the mobile consumer market. The profit of the UK-based telecommunication group in its second quarter 2017 rose to £566 million.

BT Group chief executive Gavin Patterson said: "We will operate a multi-brand strategy with UK customers being able to choose a mix of BT, EE or Plusnet services, depending on which suits them best. The acquisition enables us to offer great value bundles of services and customers are set to be the winners as we compete for their business".

(Source: adapted from www.marketwatch.com (Oct 27 – 2016) and http://home.bt.com/news/bt-life/bt-to-retain-ee-brand-as-acquisition-confirmed-11364037422234)

**Extract C**

**BT to slash landline charges for 1 million customers**

Rental charges for landline-only customers – households with a telephone-only contract but no BT broadband – will fall from £18.99 to £11.99 per month after the regulator attacked existing deals as 'poor value for money'. This rental reduction will save a million landline-only customers £84 a year.

The regulator Ofcom (Office of Communications) said it stepped in because these bills for landline-only customers – nearly two-thirds of whom are over 65 – have "soared" in recent years. This is despite BT and other landline providers benefiting from significant cuts in the wholesale line rental cost of providing the service by BT Openreach. Many landline-only customers are elderly, and have been with BT for decades. Ofcom has focused on BT because it accounts for two-thirds of the UK's 1.5m landline-only customers.

A spokesperson for Ofcom said "This position [of dominance] has allowed BT to increase prices without much risk of losing customers, and other providers have followed BT's pricing lead. We expect BT's price cut to mean other providers will follow suit". Ofcom said that over three-quarters of BT's landline-only customers have never switched provider, which has left them a prime target for price rises. The regulator said that all major landline providers have increased their line rental charges by between 23% and 47% in recent years, while their own costs for providing the service have fallen about 27%. Ofcom said it is also looking at measures to help people shop around for better deals with more confidence.

(Source: adapted from 'BT to slash landline charges for 1m customers', Mark Sweney, Copyright Guardian News & Media Ltd 2017 https://www.theguardian.com/business/2017/oct/26/bt-to-slash-landline-charges-for-1m-customers)

**20** Discuss methods of government intervention to protect consumers within the utilities markets, such as energy and telecommunications.

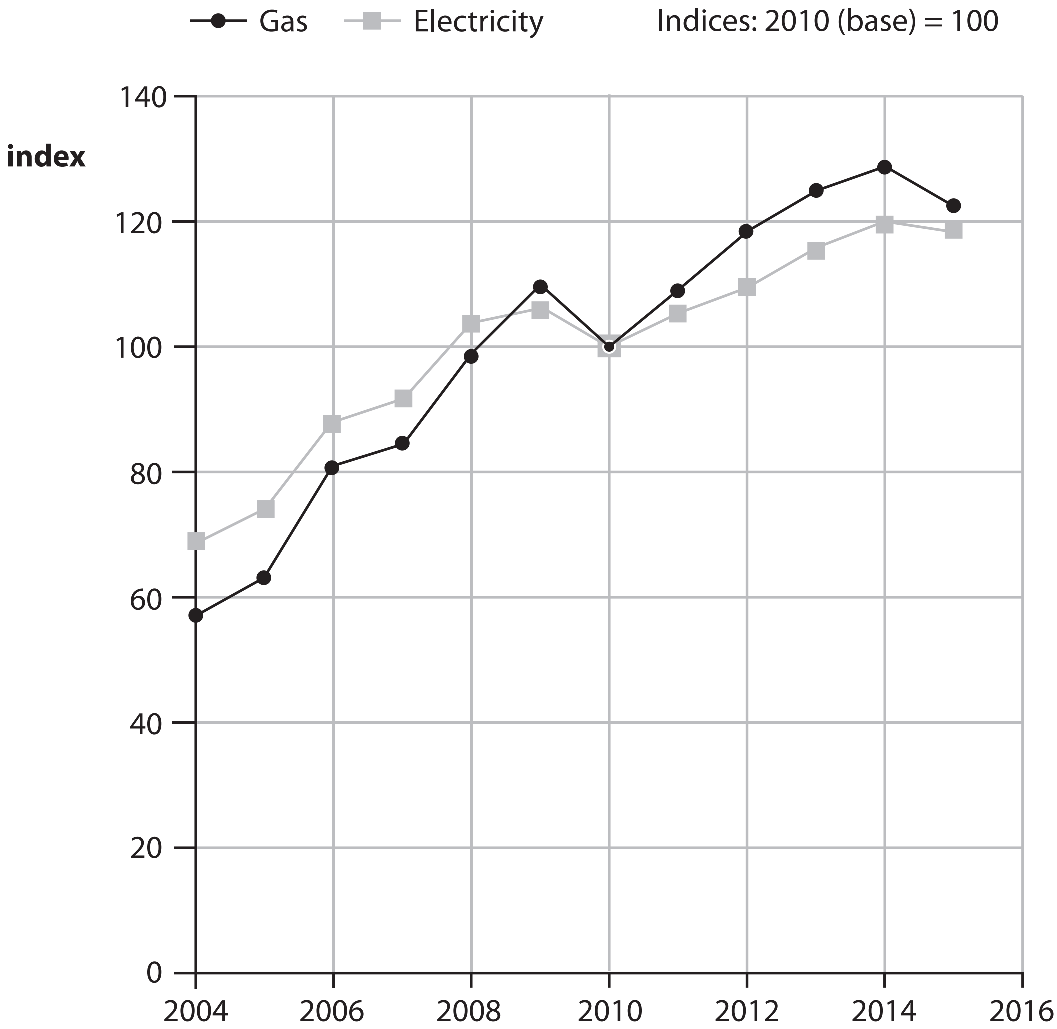
**(15)**

**(Total for Question 20 = 15 marks)**

**Question 21**

**The UK energy market**

**Figure 1: UK retail electricity and gas real price indices, 2004–2015**




(Source: https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf)

**Figure 2: UK retail electricity and gas supply: market share by company, 2016**

| **Company** | **Electricity %** | **Gas %** |
|---|---|---|
| British Gas | 23 | 36 |
| EON | 16 | 13 |
| SSE | 16 | 13 |
| EDF | 12 | 8 |
| Scottish Power | 11 | 9 |
| RWE (nPower) | 10 | 9 |
| Other companies | 12 | 12 |
| **Total** | **100** | **100** |

(Sources: https://www.ofgem.gov.uk/chart/electricity-supply-market-shares-company-domestic-gb and https://www.ofgem.gov.uk/data-portal/retail-market-indicators)

**Extract A**

**Competition and Markets Authority (CMA) report into the UK energy market**

An investigation into the UK energy market by the CMA concluded that customers have been paying £1.4 billion a year more than they would in a fully competitive market. It found that 70% of domestic customers of the six largest energy firms were on an expensive standard rate. These customers could each save over £300 a year by switching to a cheaper deal but appear reluctant to do so.

However, the CMA investigation found no evidence of anti-competitive practices by firms. There has even been an increase in new entrant energy suppliers over recent years and their combined market share has reached 12% in both gas and electricity supply.

To protect consumers, the CMA has introduced various measures to open up and increase competition in the UK energy market. These include:

- the creation of a database designed to help consumers switch energy suppliers – rival suppliers can directly contact these customers
- the conversion of all homes to smart energy meters making it easier for customers to measure energy consumption and switch supplier
- new rules to protect the four million vulnerable customers using prepaid meters – this includes a temporary price cap until smart meters have been installed.

(Source: adapted from 'Competition and Markets Authority Final report into Energy Market Investigation' https://www.gov.uk/government/news/cma-publishes-final-energy-report-in-full)

**Extract B**

**Proposals to regulate profits in the UK energy market**

Currently energy retail companies make an average profit of 7% of total revenue. The Chairman of the Competition and Markets Authority (CMA) suggested that these profits are as much as five times higher than they should be, given the companies' limited role in marketing, metering and billing customers. He recommended a profit cap of 1.25% of total revenue.

However, Scottish Power criticised proposals for regulating profits saying that it would reduce investment in the energy industry and undermine long-term energy provision. The firm claimed that such a low rate of return is below the profit margin made by supermarkets.

All six large energy firms are vertically integrated – producing as well as distributing gas and electricity. This can provide efficiency benefits but also harm competition.

(Source: adapted from 'Profit cap doesn't fit with new investment, energy boss warns', by Robin Pagnamenta, *The Times*, 19th September 2016)

**Extract C**

**Skills shortages in the UK energy sector**

The energy sector is facing a skills shortage of engineers and technicians. Some 29% of employers in the gas and electricity industries report unfilled job vacancies compared with an average of 18% across all industries.

A lack of information and advice on career prospects for young people is partly to blame - many graduates have a negative image of the work involved. There is also a lack of students taking science, technology, engineering and maths-based subjects at school and university. Less than one-fifth of the energy sector's workforce are women.

The energy sector is characterised by an ageing workforce - data from the UK Labour Force Survey reveal that around two-thirds of workers are aged over 50. These cannot easily be replaced as a long time period is required for training and developing workers' skills in a highly regulated industry.

Urgent action is required by businesses and the government to reduce labour immobility to benefit the energy sector. This action could include policies to increase investment in training programmes, recruit skilled workers from overseas, change the industry image and deal with its ageing workforce.

(Source: adapted from 'Sector insights: skills and performance challenges in the energy sector', by the UK Commission for Employment and Skills, March 2015; https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/416998/15.03.25._Energy_SLMI_-_evidence_report.pdf)

(a) With reference to Extract A, discuss the likely effectiveness of 'measures to open up and increase competition' in the UK energy market.

**(12)**

(b) With reference to Extract B, assess how the regulation of energy suppliers' profits is likely to affect consumers **and** suppliers in the energy market.

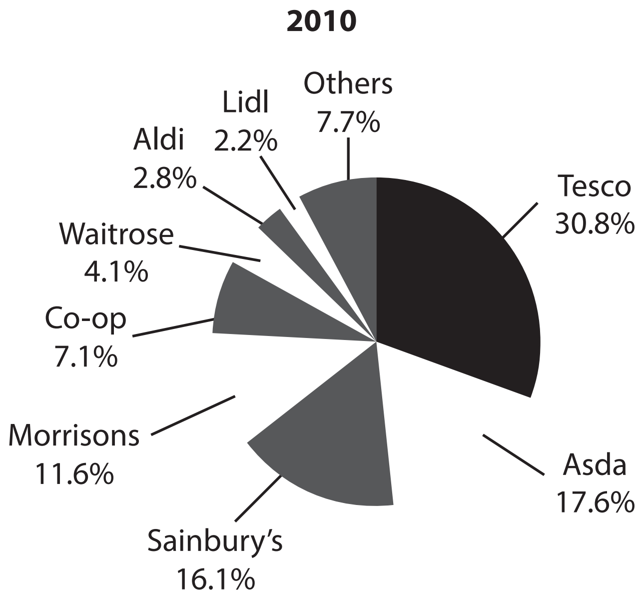
**(10)**

**(Total for Question 21 = 22 marks)**

**Question 22**

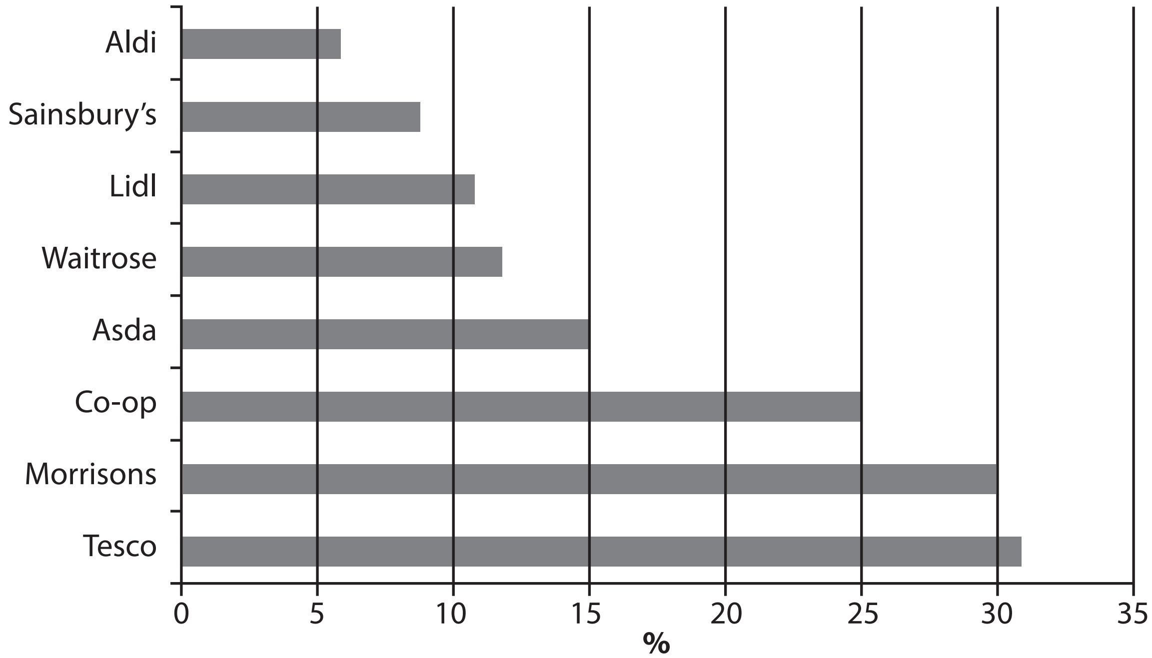
**Supermarket price war, food waste and possible mergers**

**Figure 1: Market shares by total revenue in the UK supermarket sector, 2010 and 2015**




(Source: Kantar worldpanel, http://www.kantarworldpanel.com/en/grocery-market-share/great-britain/snapshot/11.10.15/)

**Figure 2: Proportion of food suppliers reporting that the following supermarkets fail to meet the Groceries Code of Conduct, 2015.**




(Source: YouGov poll of more than 1100 food suppliers to supermarkets. Reported in The Times, 23 June 2015)

**Extract A**

**Supermarket price war puts pressure on their food suppliers**

The number of food suppliers (to supermarkets) struggling to remain in business has increased by more than 50% over the past year as supermarkets engage in an intense price war. It has never been tougher for the UK's food suppliers according to a study by accountants Begbies Traynor. It blames aggressive price-cutting by the supermarkets and delays in payments to food suppliers as the main causes of the difficulties. Further problems include food suppliers being forced to pay excessive amounts for packaging specified by supermarkets and funding in-store promotions. Almost 90% of struggling food suppliers are small and medium-sized businesses.

The price war has contributed to food prices paid by consumers falling by 1.7% over the past two years.

The market shares of the big four supermarkets – Tesco, Asda, Sainsbury's and Morrisons – are under pressure as shopping habits change. Many consumers are switching from one main weekly shop to shopping more frequently at local discount stores such as Aldi and Lidl or purchasing goods online from other grocery retailers.

The big four supermarkets have responded by putting more pressure on their suppliers despite an investigation by the Groceries Code Adjudicator (GCA). The GCA has the power to fine supermarkets up to 1% of their annual sales revenue if they break the Groceries Code of Conduct. A YouGov study found considerable differences between the supermarkets in meeting the Code with Aldi performing well but Tesco badly. Despite the Groceries Code, many food suppliers are reluctant to complain for fear of losing contracts with the supermarkets.

(Source: adapted from 'Supermarket price war takes toll on UK food suppliers'. Rupert Jones, The Guardian, 20th July 2015)

## Extract B

### Food waste in the supply chain

A report from the British Retail Consortium reveals that supermarkets are directly responsible for around 0.2 million tonnes of food waste every year. This is due to the expiry of use-by-dates and poor handling of stock.

However, 4.1 million tonnes of food waste occurs annually in the food supply chain before it even reaches the supermarkets, indicating the existence of information gaps. The supermarkets are cooperating with food suppliers and farmers to try to reduce this waste. This involves improving forecasts for supply and demand of food and increasing the reliability of transportation and storage.

Consumers, the final stage of the supply chain, waste a further 7 million tonnes of food each year. This suggests irrational behaviour. Supermarkets are also working with consumers to reduce the waste by providing advice on how to store and use leftover food. The development of packaging designs to keep food fresher for longer is one of the innovations under way to reduce waste.

(Source: adapted from 'Supermarkets tally up food waste bill'. Will Nicholls, in Businessgreen, 19th January 2015. http://www.businessgreen.com/bg/news/2390792/supermarkets-tally-up-food-waste-bill)

## Extract C

### Proposed merger activity in the supermarket sector

Analysts at Société Générale, an investment bank, have recommended a merger between Sainsbury's and Morrisons. They claim it would lead to increased economies of scale and market power for the combined business. Such a merger between the third and fourth largest supermarkets in Britain would have been unrealistic a few years ago due to concerns of its impact in reducing competition. However, the chances of getting permission from the Competition and Markets Authority have increased following the growth of Aldi and Lidl. Giant mergers have been approved in other sectors such as Lloyds-HBOS (banking) and British Telecom-EE (telecommunications).

The suggested merger would have its challenges. There is considerable overlap between the locations of the stores and the enlarged company would require the rationalisation and co-ordination of hundreds of thousands of employees. A new expensive IT system is likely to be required and the underlying difficult market trends would remain in the food retailing industry.

(Source: adapted from 'Tesco-bury and AS-Morrisons. Could Britain's supermarkets be about to merge?' Graham Ruddick, in The Telegraph, 16th December, 2015. http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11699724/Tesco-burys-and-AS-Morrisons.-Could-Britains-supermarkets-be-about-to-merge.html)

**22** Examine measures the government might use to restrict the monopsony power of supermarkets.

**(8)**

**(Total for Question 22 = 8 marks)**

**Question 23**

**Hand car wash (HCW) firms in the UK**

**Extract A**

**What is the true human cost of your £5 hand car wash (HCW)?**

The UK's hand car washes (HCWs) are extremely price competitive, but they have also been linked to modern slavery. Are they ever fair for workers?

There is little agreement about how many HCWs there are in the UK. Estimates range from 10 000 to 20 000. This lack of accurate information about the industry makes government regulation very difficult. Automated car washes, with their fierce rotating bristles, used to be the first option for drivers in a hurry. Now there is more choice. While the economy slows and incomes fail to keep up with inflation, demand for HCWs has grown. Many people see paying £5 for a car washed by someone else, rather than cleaning it at home, as a small expense which yields a high utility. But what is the true cost of a £5 car wash – and what should we be paying?

The growth of HCWs is partly the result of changes in the structure of industry in the UK. Many petrol stations have closed as drivers fill up at supermarkets. Garages and their forecourts have closed as cars become more reliable and locked into service agreements. The available sites for HCWs have therefore increased significantly and rents have fallen.

HCW entrepreneurs have identified available land and have benefitted from changes in the labour market, partly as a result of EU migration. UK drivers are now able to obtain cheap and effective hand car washing. For many migrants, car washes are a first job. "They accept car washing for a short period while they improve their language skills and move into other industries," says Ian Clark, a professor of work and employment at Nottingham Business School. "But there are also car-wash workers without networks who are in a dead end, working there for long periods."

Many drivers are only interested in getting the cheapest wash. If the price is very low, it probably means that workers are receiving less than the minimum wage and working in poor conditions. Crude calculations illustrate the problem. A £5 HCW employing five workers for 10 hours a day would need to wash 79 cars a day to just cover the wage costs. This assumes the workers are paid the minimum wage. This is one car every seven and a half minutes. Even if the profit can be higher on valet services, the price of which can be as little as £12 for a full inside-and-out clean, it's hard to see how a car wash price as low as £5 pays a living wage. This ignores all other costs which HCWs incur such as business rates and rent.

Evidence from car-wash workers is limited but Clark and others have been able to build a picture of some of the tougher conditions on drenched forecourts. "Like nail bars and small garment manufacturers, car washes are what we call 'hard-to-reach places,'" Clark explains. As part of the research, Clark and his team spoke to workers from 45 HCWs in the Midlands.

Clark and his team met and observed workers who lacked waterproof boots or trousers, or hi-vis jackets and gloves. "They're spraying around hydrochloric acid solution for alloy wheels, breathing in the vapour and fumes," Clark says. Some workers were paid a little over half the minimum wage.

(Source adapted from: https://www.theguardian.com/world/2018/jul/16/true-human-cost-5-pound-hand-car-wash-modern-slavery)

**Extract B**

**Government intervention in the HCW industry**

There are three main areas of government intervention that might impact on labour intensive firms such as HCWs:

First, there is the planning issue which focuses on the impact on the environment, for example, the disposal and recycling of waste water and chemicals. There could be planning regulations to prevent the use of tarmac rather than concrete on forecourts. Tarmac allows waste water and chemicals to seep into the sub soil. It could also be a requirement to have a sludge trap to stop the waste entering waterways.

Second, there is the health and safety issue for workers. Prolonged exposure to chemicals and lack of protective clothing puts the health of workers at risk. Performance targets could involve minimum levels of protective clothing and rest breaks for the workers.

Third, there is the issue of tax. The informal nature of the business type makes tax evasion easier.

Not all UK HCWs violate regulations. There are legitimate, regulated HCW firms as well as examples of good practice by independent outlets. One national supermarket, Tesco, has banned all independent hand car washes from its car parks. It is now in a partnership agreement with national car wash operator Waves. It uses a WashMark certificate of quality and compliance which was introduced by the industry to improve working conditions. Other major supermarkets are considering similar changes. One adviser believes £9 is a reasonable minimum price for a basic wash. Some pressure groups have developed a mobile phone app where evidence of unreasonable conditions can be reported by drivers.

Involving drivers in the issue, and making them demand fairer car washes, creates an incentive for good businesses to improve practices and come forward to get a WashMark certificate.

(Source adapted from: https://www.parliament.uk/documents/commons-committees/environmental-audit/Hand-Car-Wash-evidence.pdf research into HCWs by Professor Ian Clark, Nottingham Business School May 2018)

**23** Evaluate the microeconomic and macroeconomic effects of increased government intervention in an industry. Refer to HCWs or another industry of your choice.

**(25)**

**(Total for Question 23 = 25 marks)**

## 24 Apple and Samsung

### Extract 1 Jury awards over $1billion in patent victory to Apple

Apple has won a powerful victory in its US patent battle with Samsung, after a jury found that the South Korean electronics firm breached design patents. The jury awarded $1.05 billion in damages to Apple because they found that Samsung had copied features such as 'rubberbanding' scrolling, its sleek glass front, its touchscreen features such as 'tap to zoom' and 'bounce back' scrolling, its edge-to-edge glass front, rounded corners and app icons.

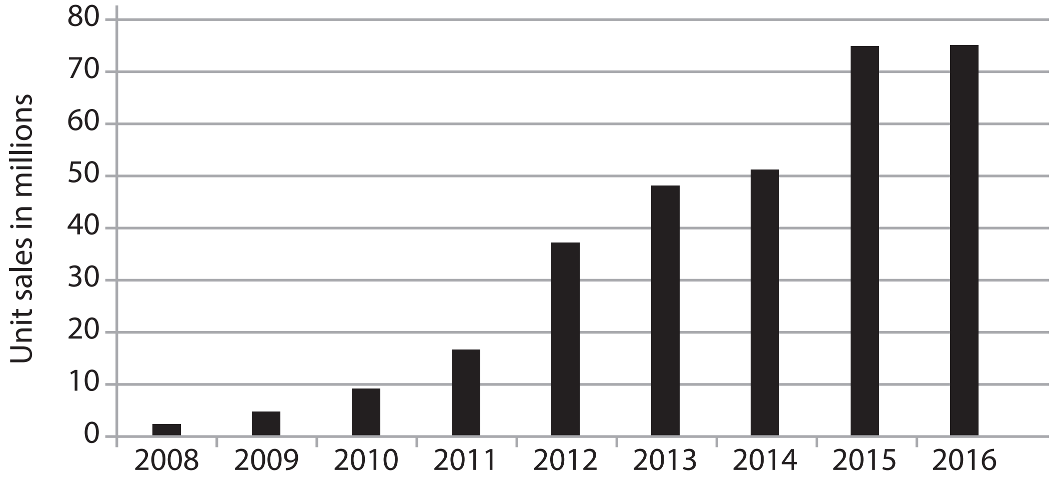
The verdict that consumers could be confused between the two companies' products will send shockwaves through the smartphone industry, with implications for other handset makers that use Google's Android operating system. Analysts point out that the US ruling will have a global effect, because smartphone makers will be unwilling to create different products for different markets, to continue to innovate, to offer choices and to lower prices for the consumer.

(Source: © The Financial Times Ltd, 25 August 2012)

### Figure 1 A Samsung Galaxy and an Apple iPhone

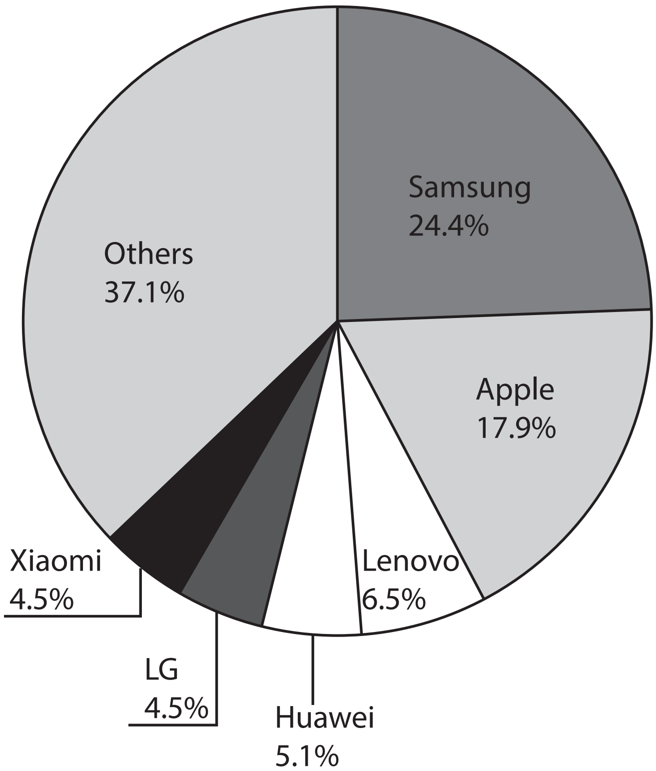
(© Pieter Beens/Shutterstock)

**Figure 2 iPhones sold in the first quarter of each year, globally (millions)**




(Source: http://ichef-1.bbci.co.uk/news/624/cpsprodpb/C553/
production/_87951505_iphonesales.png)

**Figure 3 Global market share of smartphones, 2015**




(Source: http://cdn2.dazeinfo.com/wp-content/uploads/2015/04/
worldwide-smartphone-shipments-share-Q1-2015.png)

**Extract 2 Apple: the only way is down?**

If Apple's revenue was compared to a country's GDP, it would be only slightly smaller than that of Denmark. Impressive though this may be, Apple's record-breaking profits are under threat if Chinese growth slows down. To date, Apple has sold more iPhones in China than in the US. This quarter's recent profits – $18 billion for the first quarter of 2015 – reflect Apple's ability to maintain profit margins even while selling phones in China at reduced prices in order to enter that market. The iPhone and iPad are superb devices, but they are not so radically different from those made by rivals. It is economies of scale that preserve Apple's position, while others struggle to innovate, design and produce in such numbers.

Competitors envy those profit margins, and talk about 'democratising' technology, which means bringing prices down to make equally beautiful devices attainable for all. It is, for now at least, a very optimistic view. That's largely because the iPhone combines the 'cool' factor with superior design and, unless Apple's image is ruined, it will continue to be more attractive to millions of consumers than any other phone. No other manufacturer, whether South Korea's Samsung or China's Xiaomi, has managed to break into the high-cost, high-margin market in the same way as Apple. The same is true with the iPad, and the same is likely to go for the Apple Watch.

What, however, happens next? No company has ever sustained such world-beating performance for years on end, and when it comes to technology new trends come and go from various companies all the time. Statistics suggest Apple's sales and profits are likely to be affected by the global slowdown in growth, most particularly that of China, and turbulence in world markets.

But there are two key things to consider: first, there is a new technology landscape that makes monopolies more likely than ever. We are all likely to use one search engine online. We are similarly loyal to operating systems and devices with which we are familiar. Apple has built its success on repeatedly delighting consumers and reinforcing their loyalty. The bond between Apple and consumers looks stronger than ever, and the company's financial performance simply reflects that. This problem makes it difficult for regulators to determine appropriate competition policy.

Second, is a point that doesn't get made often enough: Apple's iPhone is the device that drives its profits, and the iPhone 6 may be the best iPhone ever made but it is an evolution of the original 2007 device. Its new Watch is an exciting prospect, but the phone itself remains the driver of profits. As more and more competitors catch up, Apple's ability to maintain its lead is likely to rely on ever more marginal improvements. At which point marketing is all that's left – and how many consumers will value marketing over the pound in their pocket? A new technological breakthrough may be needed to maintain Apple's dominance in the future.

(Source: adapted from Matt Warman, 28 Jan 2015, *The Telegraph,* http://www.telegraph.co.uk/technology/apple/11373701/Apple-the-only-way-is-down.html)

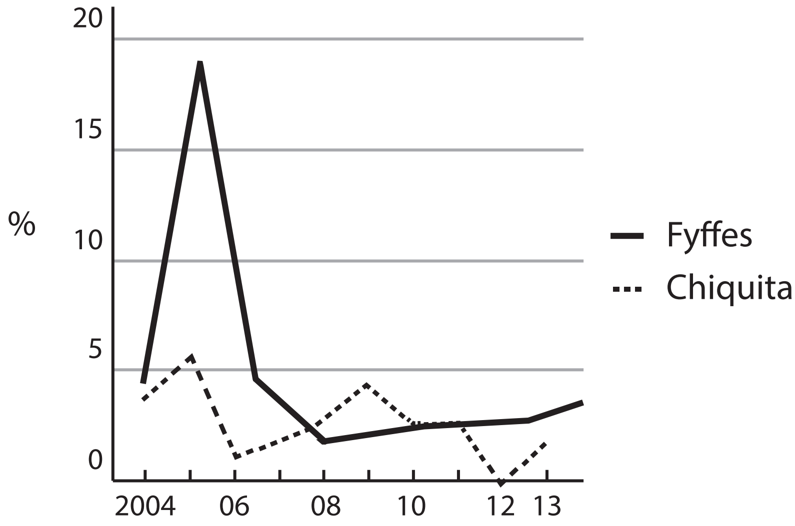
**24** Evaluate the difficulties 'for regulators to determine appropriate competition policy' (Extract 2, line 29) in markets for consumer technology products such as smartphones.

**(16)**

**(Total for Question 24 = 16 marks)**

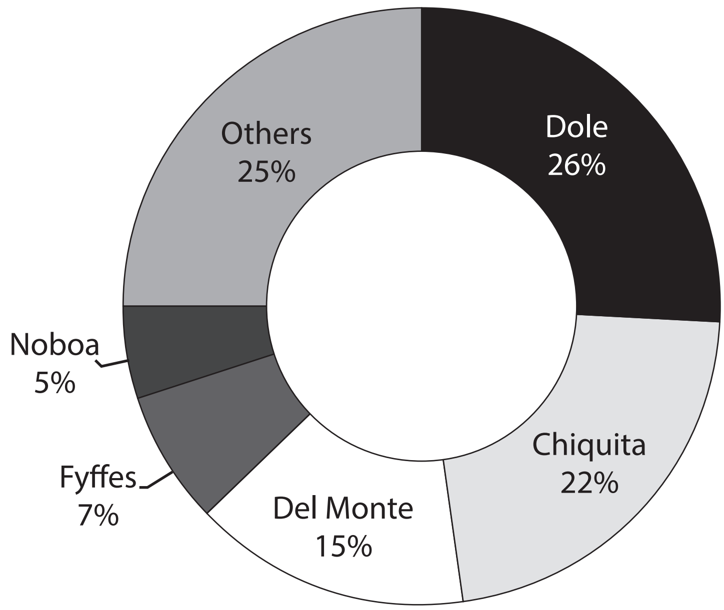
**25 Bananas**

**Figure 1 Fruit importers' profit margins, %**




(Source: http://www.ft.com/cms/s/0/8537646e-a85b-11e3-8ce1-00144feab7de.html#axzz3SqiJkq3q)

**Figure 2 Global market share of banana distributors (excluding supermarkets)**




(Source: http://www.businessweek.com/articles/2014-03-10/
with-chiquita-fyffes-merger-dole-will-no-longer-be-top-banana)

**Extract 1 Supermarket pricing makes merger of Chiquita and Fyffes necessary**

Bananas have become the biggest fruit on the planet in terms of production volume, as consumers eat ever more of them. Global banana production has doubled since 1990 to 100 million tonnes a year. A deal to create the world's largest banana distributing company was arguably made necessary by the low fresh fruit prices to be found on the shelves of any supermarket. By planning a $1 billion merger, Chiquita of the US and Dublin-based Fyffes are attempting to address a retail price squeeze that is reducing their already low profit margins. Their profit margins have been shrinking: Chiquita's from 3.5% in 2004 to 0% in 2012, and Fyffes' from just under 5% to 3.5% over the same period, say their annual reports.

A banana price war between large supermarkets, which often sell the fruit as a loss leader, has hit profit margins for distributors. Large retailers are also using their purchasing power to force producers and distributors to absorb cost increases, which have been made worse by poor weather and crop diseases. Supermarkets are also increasingly sourcing their bananas directly from producers, damaging distributors' revenues, said Alistair Smith, a campaigner for social and environmental issues relating to the supply of bananas. In the UK, such direct sourcing accounted for more than half of the bananas traded. Smith said "The current low prices are not sustainable for the industry. They are damaging the industry and the people who work in it. The industry has been suffering from overcapacity for the past few years, so a merger of the two major players should resolve some of the volatility in the market."

Announcing the proposed merger, Ed Lonergan, Chiquita's Chief Executive, said: "We have always identified Fyffes as a fantastic partner. The tie up makes particular sense now as the banana market is the most competitive I have ever seen – there are so many players bringing bananas into every port in the world."

A merger is likely to give the combined company more negotiating power with suppliers, although the Fairtrade Foundation warns that the merger would only squeeze banana growers further. The merged company would have combined sales of $4.6 billion. It would distribute about 160 million cases a year in total, compared with 117 million at Del Monte and 110 million at Dole.

Chiquita is the larger company, with annual revenues in excess of $3 billion compared with $1.5 billion at Fyffes. The merged company would have the scale to negotiate better deals with retailers. Chiquita and Fyffes hope to achieve $40 million a year in pre-tax cost savings while gaining share in the melon, pineapple and packaged salads markets. Savings will come from logistics, for example putting more bananas on to fewer boats.

The high profile of these brands makes it likely that regulators will scrutinise the proposed merger as the new company would have almost 30% of the European market.

(Source: adapted from http://www.ft.com/cms/s/0/c8463dac-a86f-11e3-b50f-00144feab7de.html#axzz3BffD7L9c March 10, 2014 and http://www.ft.com/cms/s/0/43b73338-a825-11e3-a946-00144feab7de.html#axzz3BffD7L9c and 'Bananas: the right split' in the Lex column 14 March 2014)

**25** Discuss the problems that the competition authorities might experience in attempting to regulate the merger of firms distributing bananas.

**(12)**

**(Total for Question 25 = 12 marks)**

**26 Price fixing in the baby milk powder market**

**Extract 1 Soaring baby milk prices provoke price fixing claim**

Firms producing baby milk powder, known as formula milk, are making huge profits on exports to China. In 2012, the total share of the top five foreign formula milk brands reached 60% of the Chinese market. A climate of panic among parents in China over the safety of domestically produced formula milk was pushing prices ever higher. The competition authorities in China have accused foreign firms of participating in a conspiracy to fix the price of formula milk. They are being investigated for alleged price-fixing and anti-competitive behaviour.

Wyeth Nutrition, which Nestlé bought in its $11.9 billion takeover of Pfizer’s baby food business, is accused along with other formula milk producers of “violating anti-monopoly laws via high prices and limited market competition” by the Chinese regulatory authority, the National Development and Reform Commission (NDRC). Wyeth Nutrition has been actively co-operating with NDRC’s review of the industry, a spokeswoman from Nestlé said.

Parents, fearful that the local formula milk products may be counterfeit or otherwise tainted, go to extreme lengths to buy imported formula milk. This follows the scandal in 2008 when melamine, in domestically produced formula milk, killed six babies and caused sickness in 300 000 others. A tin of foreign-made formula milk that sells for £10 in Britain retails for as much as £30 in China. A flourishing black market has led to tins of milk powder being smuggled in from Europe and sold online. Prices have risen by 30% since 2008. “People are willing to pay that amount for a product from a brand they trust to have better safety, particularly when it involves children and babies,” said James Roy, a senior analyst. He said that consumers are unhappy and that the government is responding by exerting pressure. He thought it unlikely that the companies were engaging in real price fixing.

(Source: *The Times,* 3 July 2013)

**Extract 2  Fines on foreign formula milk producers**

China has temporarily banned some imports of formula milk. In August 2013, China's price regulator imposed fines equivalent to £71 million on five foreign formula milk producers following an investigation into price fixing.

Analysts said the investigation into formula milk pricing was part of a broader Chinese plan to boost consumption of local formula milk products. But they said the fines were unlikely to damage the reputation of the affected companies. If anything, foreign formula milk producers might increase their market share because of the price cuts resulting from the investigation.

"It will have an impact on domestic brands over the long term as the prices of high-end premium brands come down. Customers will tend to buy the foreign brands as the price gap between domestic and foreign brands narrows," said Jacqueline Ko, an analyst at Maybank Kim Eng Research.

Fonterra, one of the companies fined, said it would give additional training to sales staff and review its distributor contracts in the wake of its fine. "We believe the investigation leaves us with a much clearer understanding of expectations around implementing pricing policies," said Kelvin Wickham, a senior executive of Fonterra.

"There have been some small [price-fixing] cases previously, but nothing of this scale," said one lawyer who defended a company involved in the investigation. "There is real political momentum behind this. Inflation and product safety are at the top of the government's agenda." As China's economic growth rate threatens to slow below the official target of 7.5%, the Chinese government is concerned about growing public anger over the price and quality of essential goods and services such as formula milk.

(Source: http://uk.reuters.com/article/2013/08/07/uk-china-milkpowder-idUKBRE97602U20130807 and China fines milk formula makers in pricing probe http://www.ft.com/cms/s/0/d40bda56-ff06-11e2-97dc-00144feabdc0.html?siteedition=uk#axzz2g1t7sgtP)

**Extract 3  Chinese government to give $4.9bn to domestic formula milk producers**

Chinese formula milk producers, including Inner Mongolia Yili Industrial Group and China Mengniu Dairy, are set to get 30-billion yuan ($4.9 billion) in official funds to support mergers. The plan is to reduce the number of domestic formula milk producers in the highly fragmented market over the next five years from 200 to 50. This will create stronger sector leaders to increase the ability of companies to compete with international rivals who dominate the premium end of China's $12.4bn formula milk market.

Chinese formula milk firms would gain the support in the form of government subsidies, funds from China Development Bank and favourable tax policies, the China Business Journal said. The total amount would be about 30-billion yuan, it said.

(Source: http://www.bdlive.co.za/world/asia/2013/09/23/state-to-give-chinese-milk-powder-makers-4.9bn, September 23 2013, 09:05)

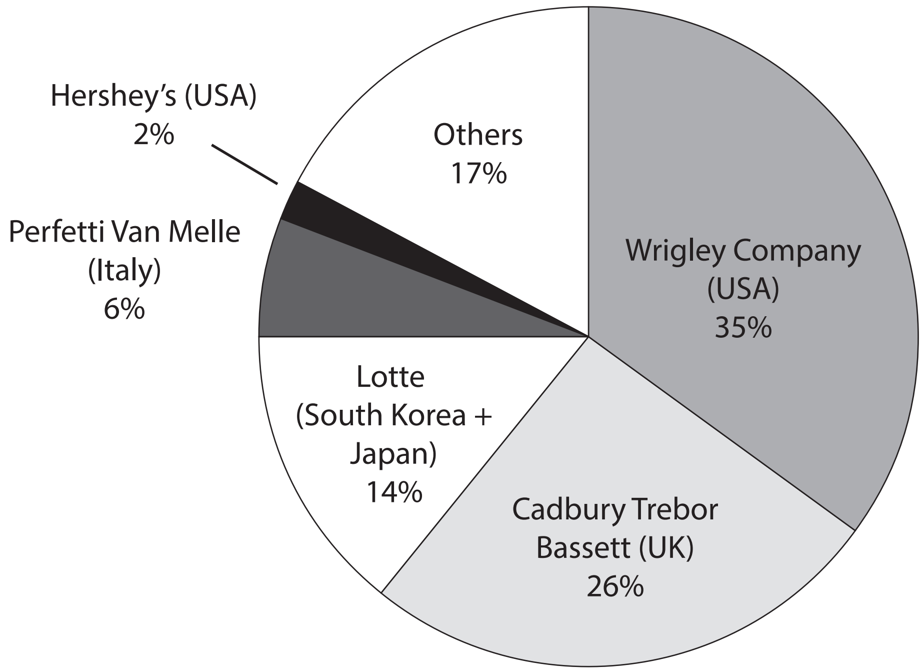
**26** Evaluate the likely impact of the '£71 million' fines (Extract 2, line 2) on the price and availability of high quality formula milk.

**(16)**

**(Total for Question 26 = 16 marks)**

**27** The chewing gum market

**Figure 1 Global market shares for chewing gum manufacturers**




**Extract 1 British designers create non-stick chewing gum that dissolves**

Chewing gum is a problem worldwide and has even been banned in some countries. Normal chewing gum is made from synthetic latex, which is resistant to the weather and is strongly adhesive. A piece of gum costs around 3 pence to make, but it costs an estimated 10 pence to scrape it off the pavement using freezing machines, corrosive chemicals or even high-pressure steam hoses. The UK Government currently spends £150 million each year removing chewing gum from the streets using chemicals.

Recently a non-stick chewing gum that dissolves within just 24 hours has gone on sale in the US. The gum, developed in Britain, contains a special polymer which makes it far less sticky. 'Rev7' has the same taste and texture as normal chewing gum, but is water soluble and can be easily removed from clothes using soap and water. This ability to retain water also results in a longer lasting flavour which improves the experience for consumers. It is also more effective when used as a nicotine gum, designed to help smokers give up cigarettes, because it releases the nicotine in a more controlled way. Tests show that most of the gum can be removed by conventional street cleaning. Any gum washed into the drains will degrade into minerals, biodegradable products and inert materials.

Designer Terry Cosgrove, a scientist at Bristol University, said: "The motivation to invent the product came from seeing chewing gum on the streets in this country and in America. It's everywhere. The materials developed can be used for lots of other uses such as anti-graffiti paint and bacterial protection. But because chewing gum is such an enormous problem at the moment we decided to target this as our main area. This is like a dream come true for me, seeing academic research result in a real commercial product." He reportedly offered the product design to Wrigley's, the current market leader in chewing gum, but no agreement was made.

Instead, Revolymer was set up in Wales in 2005 based on technology developed by Cosgrove at the University of Bristol. Revolymer was awarded patents relating to the Rev7 polymer technology, and the firm was aided by a grant of £1 million given in 2006 by the Welsh Assembly Government and the South West Regional Development Association to support the development of removable chewing gum. "There are also several other exciting ventures in the pipeline" said Cosgrove.

(Sources: adapted from www.telegraph.co.uk 5 October 2010 and www.revolymer.com/history March 2013)

**Extract 2 Rev7 is withdrawn from US market**

Revolymer is to stop directly selling its 'Rev7' confectionery gum in the US at the start of 2013. The US gum market as a whole is shrinking and there is a challenge to Revolymer's patent for nicotine gum products by other gum manufacturers. The firm said the shut-down of sales of Rev7 in the US is set to incur a one-off cost of £360 000 but the annual cost base of its US operation is £500 000 which it said would not be incurred in the future.

Its Rev7 gum has recently been launched in Ireland in partnership with the Topaz service station network as an initial test market for the rest of Europe.

Revolymer is seeking more commercial partnerships for its nicotine gum. The first product resulting from such a partnership was launched in Canada in 2012. In a statement, Revolymer said: "Management continues to believe that Revolymer's strategy of licensing its technology to commercialisation partners, rather than seeking to market its own products, will generate significant shareholder value."

(Source: adapted from www.insidermedia.com 20 December 2012)

**27** Discuss **two** benefits of awarding patents to new products developed by scientists.

**(8)**

**(Total for Question 27 = 8 marks)**

## 28 Egg farming, egg distribution, food manufacturing and supermarkets

### Extract 1 A letter from a chicken farmer

Our problems started four years ago when the big egg packaging and distribution firms merged, purchasing nearly 70% of the eggs produced. I lost £40 000 last year and I could see the profits of Noble Foods [the UK's biggest egg distributor] increasing. There was no competition anymore and prices paid to egg farmers stayed low, while everything else, like the cost of chicken feed, was going up. New EU regulations preventing the housing of hens in conventional 'battery' cages have meant installing new cages, costing over £14 per hen. Many egg farmers like me are unable to absorb the costs of buying the new cages and some egg farmers have left the industry. 750 000 hens have been slaughtered across the UK.

### Extract 2 The egg distribution business - profile of Noble Foods Limited

Noble Foods, the UK's largest egg packaging and distribution business, operates 160 vehicles from seven sites, 365 days a year, employing over 150 full-time drivers in temperature controlled vehicles. Eggs are collected from over 325 individual farm producers located throughout the UK and transferred to a packing centre, where they are sorted and boxed for delivery to customers. Pre-tax profits at Noble Foods increased by £1.4 million in 2011.

(Source: © 2011 Noble Foods Ltd)

### Extract 3 Increased costs of eggs for food manufacture

Eggs – both in liquid and powdered form – are used in a variety of food products from biscuits and cakes to pasta and mayonnaise. The reduced supply of eggs, caused by the new EU regulations, is damaging the profits of some food manufacturers. Several of them are closing down their production lines because they cannot afford the soaring cost of eggs from distribution firms. However, they cannot raise their prices because supermarkets refuse to pass on any increase to consumers.

**Extract 4 British farmers forced to pay the cost of supermarket price wars**

Farmers say they are being forced out of business by the unfair buying practices of supermarkets. Discounts such as "buy one get one free" are not a generous gift from the supermarket. There is public ignorance of how supermarkets buy produce and the system that allows them to offer lower prices while increasing their profits. Tesco's profits were above £3.5bn for the first time last year and Sainsbury's rose by nearly 13%. These results are achieved largely by getting suppliers to reduce their prices or not pass farmers' cost increases through to the supermarkets. Most sectors of British farming, from eggs to fruit, vegetables and pork, have had reduced prices paid for their produce in the past year, despite record increases in costs.

(Sources 1, 3 and 4: adapted from © The Guardian 2 July 2011, © The Observer and © Parliamentary copyright 2011)

**Figure 1 Egg types in the EU**

| Types of eggs produced in EU | Minimum cage requirements per hen | Market share in UK, 2012 forecast |
|---|---|---|
| Hens in conventional cages, 'battery' | 550cm$^2$ | Banned January 2012 under new EU regulations |
| 'Caged' hens in EU-compliant cages | 750cm$^2$ and a minimum height of 45cm with nest area, perching space and a scratching area | 49% |
| Barn eggs | 1110cm$^2$ free to move in large indoor area | 4% |
| Free range eggs | As barn, with daytime access to open air pen, 4m$^2$ | 44% |
| Organic free range eggs | As free range, plus organic food (no artificial growth enhancers) | 3% |

**Figure 2 UK egg market information 2011**

| | |
|---|---|
| Egg production | 9 691 million eggs |
| Egg consumption | 11 512 million eggs (32 million per day) |
| **Consumers of eggs in the UK** | |
| Retail (supermarkets etc.) | 47% |
| Food Manufacturers | 25% |
| Foodservice (hotels, restaurants) | 28% |

(Sources for Figure 1 and Figure 2: permission to reproduce granted by the British Egg Information Service, www.britegg.co.uk and © European Union, http://eur-lex.europa.eu/)

**28** Discuss the effects of increased EU regulations on egg consumers. Refer to Figure 2 in your answer.

**(12)**

**(Total for Question 28 = 12 marks)**

**29 The UK household energy market**

**Extract 1 Price cuts by the 'Big Six' energy companies**

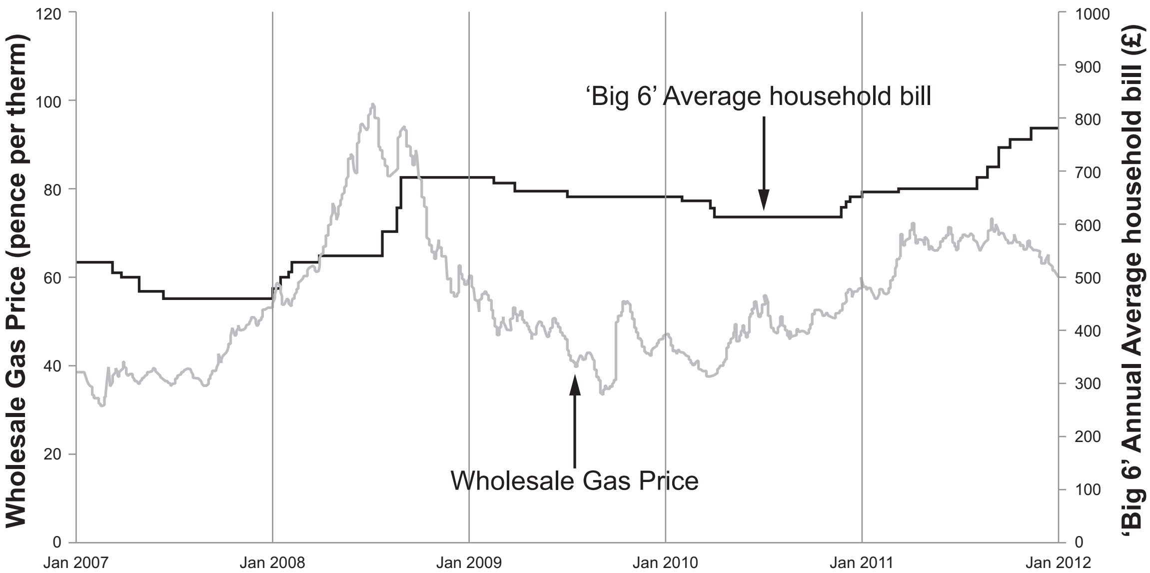
99% of all gas and electricity bought by households in the UK is supplied by the 'Big Six' energy firms, British Gas, Scottish and Southern Energy (SSE), Scottish Power, E.ON, EDF Energy and npower. The combined profits of the 'Big Six' reached £15 billion in 2011, up £2 billion on the previous year, with an average profit per customer of £80 a year.

British Gas, which supplies both gas or electricity to half of UK households, cut its electricity prices by 5% in February 2012 but kept gas prices unchanged. This was quickly followed by SSE cutting 4.5% from its gas prices. British Gas had been expected to cut prices after another of the 'Big Six' energy providers, EDF Energy, announced it would be reducing gas prices by 5% with effect from 7 February 2012.

However, the cuts were smaller than expected. The average standard tariff for a customer buying both gas and electricity from the same supplier will remain on average £1 250 a year (doubled since 2005). The price cuts will only reduce bills by between £24 and £28 per year for the average household. 5.5 million households will remain in fuel poverty, meaning that they are spending at least 10% of their income on power.

(Source for Figure 1 and Extract 1: adapted from © The Guardian News and Media Limited, 2012)

**Figure 1 A comparison of wholesale and retail price of gas**



**Extract 2 Energy regulator tells firms to cut their prices or face tough controls**

A price cap, RPI-X, on energy bills could be introduced for the first time since 2002, according to the regulator Ofgem. There are rising concerns that customers are being exploited by the 'Big Six' energy firms. The energy firms will have to simplify their pricing structures (tariffs) this year. If this fails the whole industry will face a Competition Commission inquiry which could force a break-up of its dominant players. Ofgem said: "Parliament has given us the task of trying to create an effective market where competition is the downward pressure on prices. We think that's the way to go, although we haven't ruled out regulation, particularly for more vulnerable customers, if our reforms don't work." Energy campaigners are calling for a windfall tax on excessive energy profits and for the money to be used to help in the fight against fuel poverty by making homes more energy efficient.

Rising global demand for energy and the end of cheap North Sea gas are responsible for most of the increases but consumer groups also believe suppliers are keeping bills artificially high. One of the 'Big Six', the French-owned EDF Energy, reported a near trebling of its annual profits to €3 billion (£2.5 bn), with profits from its British operations rising 8.5%. EDF Energy is currently the subject of two Ofgem investigations into poor customer service and inappropriate selling methods. Ofgem is currently consulting on forcing the 'Big Six' to set uniform standard charges to allow consumers to compare raw costs, or unit prices, more easily. Ofgem is also intending to sweep away the hundreds of different tariffs operated by the companies into just two types – standard and innovative. In 2008 Ofgem ran a nine-month inquiry after all the energy companies raised their prices within a few weeks of each other. No evidence of collusion was found but action was proposed to ensure that smaller independent companies are not kept out of the supply market. The price movements look like tacit collusion but the regulatory authorities lack the power to prove this.

Ofgem's faith in an unregulated free market has been shaken by the failure of the 'Big Six' to embrace its previous reforms of bills and tariffs. Although it says it is "encouraged" by recent attempts by some suppliers to simplify charges, it is closely monitoring their performance and failure to comply will trigger a full Competition Commission inquiry. Companies need to narrow the widening gap between wholesale and household energy prices. "Consumers are right to ask whether the market structure is right and whether regulation of prices is the answer," said Ian Marlee, a senior Ofgem official.

(Source: adapted from Martin Hickman © The Independent, www.independent.co.uk and © http://www.regulation.org.uk/energy.shtml) *(a) Discuss problems faced by regulators when investigating an issue of 'tacit collusion' (Extract 2, line 25).

(12)

*(b) Assess the case for creating an 'effective market where competition is the downward pressure on prices' (Extract 2, lines 6–7), rather than price cap regulation.

(16)

**(Total for Question 29 = 28 marks)**

## 30 Government intervention in markets

**Number of UK Private Finance Initiative (PFI) projects per year**

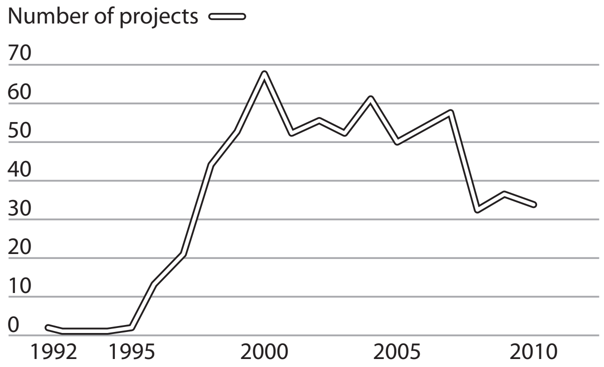



**Figure 1**

**Value of UK Private Finance Initiative (PFI) projects per year**

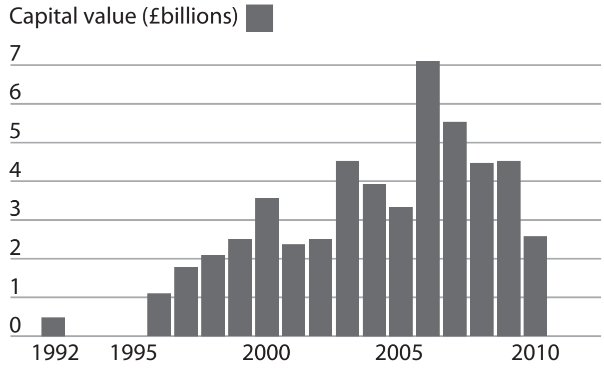



**Figure 2**

### Extract 1 The private finance initiative is divisive

The private finance initiative (PFI) introduced in the UK in 1992 has delivered 700 major items of British infrastructure and services, raising £70 billion of capital for major projects such as new hospitals, schools, prisons and new roads. These services are being provided now, to be paid for by taxpayers in the future. In the PFI model, the private sector takes the risk – that is, it is intended that the PFI firm pays fines or the losses if the project is delivered late or over budget, or fails to perform once up and running. There is some proof that PFI works: for example, the Olympic Delivery Authority completed construction of the venues for the 2012 Games under budget. However, if the costs of the project go above the contracted amount, the private sector pays the difference. For example, McAlpine lost £100 million on the Dudley hospital project in the West Midlands.

Some economists are asking whether PFI is proving value for money. Private sector borrowing costs more than government borrowing. These higher interest rates add to the capital cost of PFI projects. Payment for these PFI projects – including their running and maintenance – will cost taxpayers £240 billion up to 2050. London's Jubilee line underground extension went way over budget and the tax payer had to meet much of the cost because of the collapse of contractor Metronet. FireControl, a PFI to replace England's 46 emergency call centres with nine regional sites, had technical problems. This meant the scheme was cancelled and £342 million of taxpayers' money is committed to paying rent on eight empty sites that will never be used. Once a PFI contract is signed, it is almost impossible to get out of it except at enormous expense.

Other forms of government intervention in markets, for example deregulation in postal services and price capping in the water industry, might be more effective than PFI at promoting competition and economic efficiency.

(Sources: adapted from © The Financial Times Ltd, Nicholas Timmins, 7 August 2011 and © Guardian News and Media Ltd, Jamie Doward, 12 June 2011)

**Extract 2 Healthcare suffers under PFI**

Andrew Lansley, the government's Health Secretary, said he has been contacted by 22 health service trusts which claim their "clinical and financial stability" is being undermined by the costs of their PFI contracts. This includes National Health Service (NHS) trusts in London, such as South London Healthcare, Barking, and others including Oxford Radcliffe, Plymouth and North Bristol trusts. Between them the trusts run more than 60 hospitals which care for 12 million patients.

The total cost of the PFI schemes is often far more than the value of the assets. In one example, a hospital in Bromley, south east London, will cost the NHS £1.2 billion, more than 10 times what it is worth. As a result, Mr Lansley says, the 22 trusts "cannot afford" to pay for their schemes, which in total are worth more than £5.4 billion. The annual payments have risen sharply because PFI costs are linked to inflation. There are increasing demands on the health service while NHS budgets are strictly controlled.

Hospitals are having to make substantial cuts to pay the PFI costs. There is evidence that waiting lists for non-urgent operations have begun to rise as hospitals delay treatment to save money, and patient care has suffered. The NHS is abandoning its £12.7 billion computerised patient record and booking scheme project, the National Programme for IT.

Companies who run PFI schemes earn profit margins of up to 71% on the projects, in what some economists call an uncontestable market, once the contract is agreed. Now there is growing pressure from MPs and ministers to return some of their "supernormal profits" and renegotiate their PFI contracts.

(Source: adapted from © The Telegraph Media Limited Robert Winnett, 21 Sep 2011)

(a) Using examples from the data, explain what is meant by the *private finance initiative (PFI)*, (Extract 1, line 1).

**(4)**

*(b) In the light of the information provided, assess the likely benefits of PFI schemes to consumers.

**(12)**

*(c) Apart from PFI, discuss ways in which government intervention might promote economic efficiency in markets.

**(16)**

**(Total for Question 30 = 32 marks)**

## 31 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.

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.

(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.

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."

(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.

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

(a) With reference to Extract 1, what is meant by *anti-competitive behaviour* (Extract 1 line 3)?

**(4)**

*(b) Assess the likely impact on economic efficiency in the UK banking industry of increased regulation of UK banks.

**(12)**

**(Total for Question 31 = 16 marks)**

## 32 The global yogurt market

### Extract 1 Yoplait, a French yogurt firm, has plenty of potential buyers

Five years ago the French Government was concerned over rumours that Danone, the world's biggest maker of yogurts, would be bought out by the US giant, PepsiCo. The French prime minister put Danone on a list of companies to be kept under French ownership. Now, however, Yoplait – the world's second-biggest yogurt firm – is on the market. PAI Partners, a French private-equity company, is selling 50% of the firm. The rest is held by Sodiaal, France's biggest dairy co-operative. Once again, bidders are interested.

Demand for yogurt is booming across the world. According to a recent study, it is the fastest-growing sector in the dairy industry. The Chinese have been converted to yogurt in part by the addition of small plastic spoons to pots. Even the United States of America is considered an emerging market when it comes to yogurt. The average French person eats 30kg of yogurt per year compared with only 10kg for Americans.

Although Yoplait is lagging behind Danone in almost all countries, the two are equally placed in America where Yoplait has had a business arrangement with General Mills for 30 years to sell their yogurts. This has been a great success, but General Mills and Yoplait are currently in disagreement over terms for the renewal of their agreement. Ken Powell, the chief executive of General Mills, does not appear keen to take control of Yoplait, but this could change if Yoplait were to move to dissolve the relationship.

The most likely buyer is Lactalis, a French firm that could take over Yoplait in partnership with Nestlé. It put in a $1.76 billion bid for the whole company in November 2010. Other possible buyers include Unilever, a big Anglo-Dutch firm, and America's Kraft. A bid by PepsiCo cannot be ruled out. The maker of fizzy drinks and crisps wants to expand the healthier end of its range. Yoplait would be a perfect fit—as Danone would have been a few years ago.

(Source: adapted from *The Economist Newspaper* 20 November 2010)

### Extract 2 Product launch of *Yoplait Greek* yogurt

How do you launch a new product in the $3.7 billion yogurt industry? That's a question that Yoplait recently tackled with the launch of *Yoplait Greek* in March 2010. Greek yogurt is yogurt that has been strained to remove the whey to make it thicker. The market for Greek-style yogurt already has several competitors including *Fage* and *Chobani*. However, *Yoplait Greek* managed to attract 90,000 customers to its website in its first month. This is more than three times the number of visitors to the next largest Greek-style yogurt website. See Figure 1.

*Yoplait Greek* used a combination of online display and search engine marketing to raise awareness of the product and attract consumers to its website. Display advertisements were placed on social networking sites such as *Yahoo* and *Facebook* to generate awareness. *Yoplait Greek* also had top sponsored search ranking on keywords "yogurt" and "Greek yogurt". The offer to download a coupon was featured prominently on every page on the site. Of the consumers who visited YoplaitGreek.com in March, 45% downloaded a coupon.

**Figure 1**
**Number of visits to Greek-style Yogurt websites, January to March 2010**

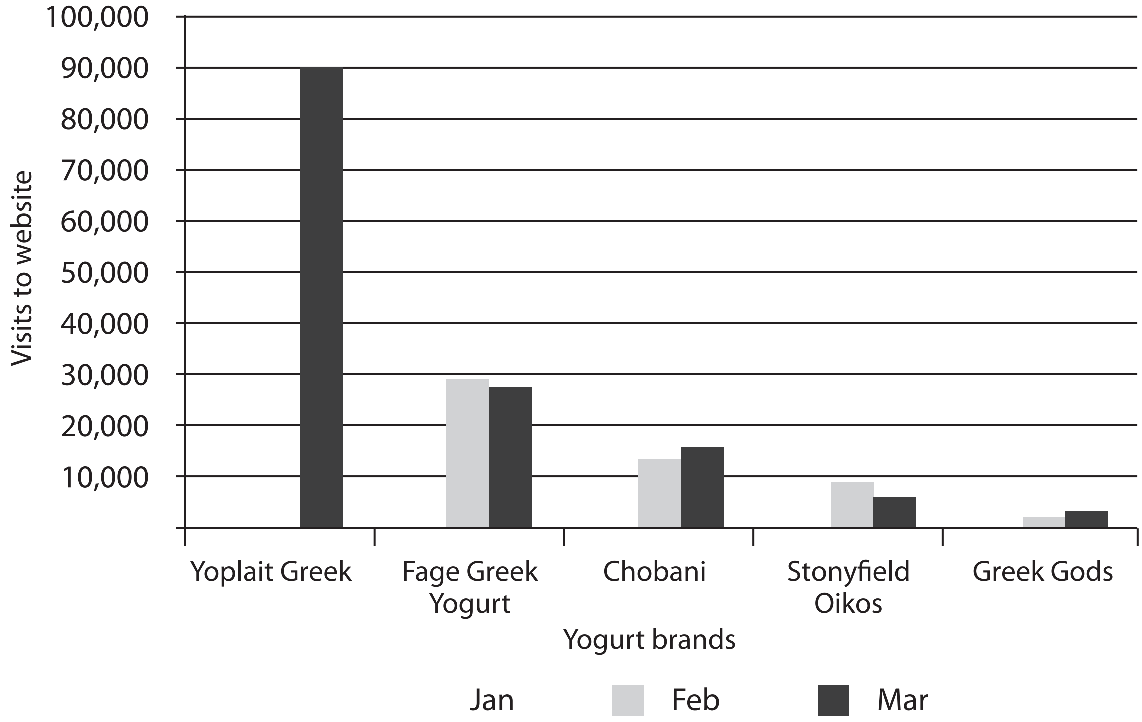
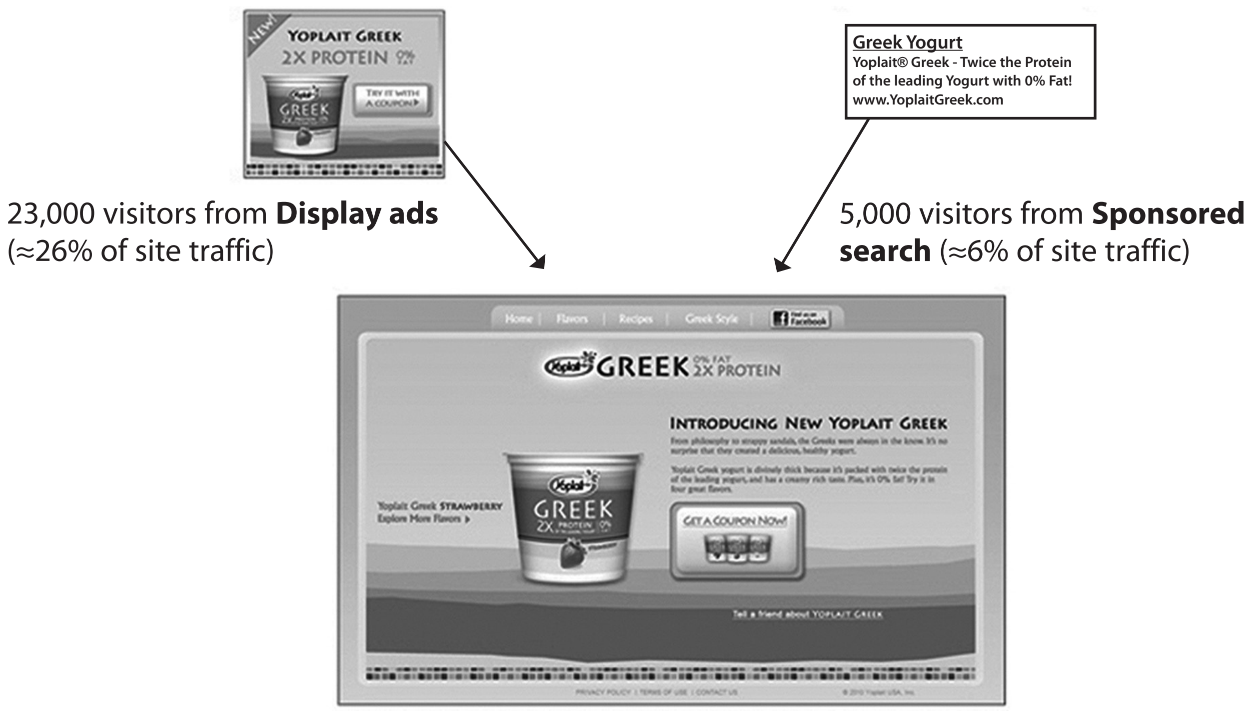



**Figure 2**
**Website visitors to YoplaitGreek.com, March 2010**




**YoplaitGreek.com**
90,000 visitors in March

(Source for Extract 2 & Figures 1 & 2: http://blog.compete.com/2010/05/03/using-the-online-channel-for-cpg-product-launch-yoplait-greek/)

**32** Discuss **two** reasons why the French government may intervene to prevent the acquisition of Yoplait by an overseas firm.

**(8)**

**(Total for Question 32 = 8 marks)**

## 33 Maintaining competition in markets

### Extract 1 Reckitt could face £80m fine over Gaviscon 'market abuse'

The household goods giant Reckitt Benckiser (RB) has been accused by the Office of Fair Trading (OFT) of deliberately exploiting its 'dominant market position' to stop National Health Service (NHS) doctors from supplying generic (unbranded) versions of its Gaviscon indigestion medicine. When a patent ends, rival companies can legally copy the ingredients of the drug using the generic formula.

However, RB withdrew Gaviscon Original from the NHS prescription database with the effect that open competition was delayed until 2007. This meant that when doctors tried to prescribe the original product, they could only find the new Gaviscon Advance on the database. This new drug is patent-protected until 2016. An industry informant claimed that generic copies of Gaviscon Original could have saved the NHS about £40 million since 1999, when the patent ended.

If it is found to have abused its power, the OFT could fine RB – which also makes the painkiller Nurofen and the dishwasher powder Finish – up to 10 per cent of its annual sales, which came in at £7.78bn in 2009. The accusation by the OFT is significant because Gaviscon is a major contributor to RB's revenues.

While Gaviscon Original is still available as an over-the-counter product, Reckitt has previously commented that it was the second largest prescribed brand on the NHS. Reckitt said: 'Reckitt Benckiser believes it competes fairly and within the letter and spirit of the law. RB has stated that up to 80% of its revenues and profits from pharmaceutical sales could be lost after the launch of generic competitors.'

### Other OFT Investigations

The Office of Fair Trading's assault on the medicines market is the latest example of its increasingly aggressive interventions under chief executive John Fingleton. Since arriving at the OFT in 2006, Mr Fingleton has stepped up the regulator's activities, launching a string of investigations into industries ranging from housebuilding to supermarkets to banking. 'The OFT recently announced a review of barriers to entry, exit and expansion in the retail banking market. We are now talking to various companies about how well some financial markets work. Except where there are serious breaches of the law, the OFT's preference is to seek ways for market problems to be resolved by companies themselves rather than by imposing solutions.'

There have been some OFT failures, for instance the attempt to regulate the banks regarding unauthorised overdraft fees failed when the High Court ruled that the charges were beyond the control of the OFT. However, a string of investigations is continuing, into both market abuse cases and more straightforward competition matters. The OFT is seeking, for example, the right to consider the merger of T-Mobile and Orange in the UK, rather than leaving the decision to Europe's competition watchdogs.

Source: The Independent Online February 24 2010 James Thompson http://www.independent.co.uk/news/business/news/reckitt-could-face-16380m-fine-over-gaviscon-market-abuse-1908493.html' and http://www.telegraph.co.uk/finance/businesslatestnews/7535749/Are-City-markets-working-for-business-and-the-economy.html, 30 March 2010

(a) With reference to Extract 1, explain why governments allow patents to be granted.

**(4)**

*(b) With reference to the information provided and your own knowledge, to what extent is the government's competition policy successful in promoting competition between firms?

**(12)**

**(Total for Question 33 = 16 marks)**

## 34 British Airports

### Extract 1 International bidders line up for British Airports Authority (BAA) airport sale

Following a ground-breaking report this week from the Competition Commission, BAA (an airport operator) has been forced to put Gatwick airport up for auction. International infrastructure groups have approached BAA with offers to buy Gatwick, London's second airport, for up to £3 billion. The Spanish company Ferrovial bought BAA for £10.3 billion two years ago.

The competition watchdog says that BAA's ownership of London's three largest airports – Heathrow, Gatwick and Stansted – is against the public interest. It will be the first time the Commission has forced the sale of an asset outside a takeover or merger situation.

The sale process could take two years and could eventually yield a healthy profit for Ferrovial. The sale would end a system of ownership that has existed for more than 40 years. BAA has owned seven of the UK's largest airports, including the London trio, since 1965.

Source: Adapted from 'International Bidders line up for BAA airport sale' by Dominic O'Connell
*The Sunday Times* 17 August 2008.

### Extract 2 Regulation, not competition, will shape airports

It is quite possible that you could be reading this in an airport lounge sitting out a delay to your flight. You will be irritable and likely to vent your frustration against both the airline and the airport operator which, if you are in southeast England, is most likely to be BAA.

That is why, when the Competition Commission decrees this week that BAA's monopoly of airport ownership should be broken up, the news will be met with almost universal joy.

However, the truth is that even if BAA is forced to sell one of its airports in southeast England – either Gatwick or Stansted, it is unlikely to make any difference to the future of aviation in Britain. The world's big airlines want to go to Heathrow, not to Gatwick or Stansted, and it is doubtful whether a change in ownership will alter that.

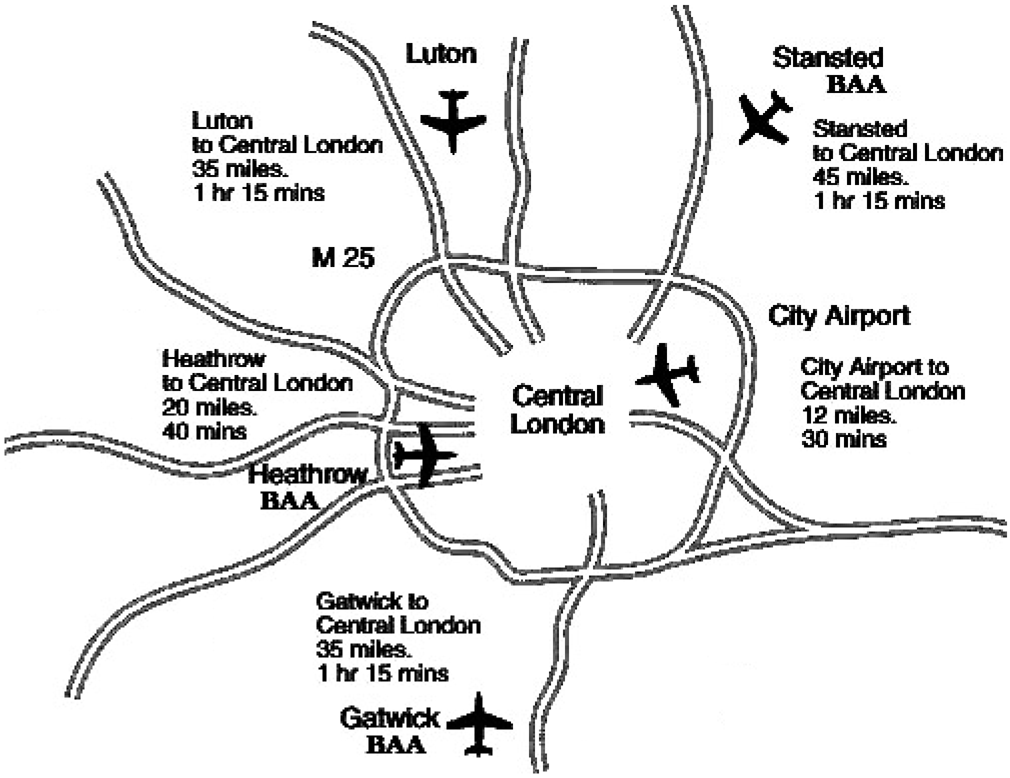
Admittedly it could improve the customer experience and bring in some much-needed competition. However the future of Britain's airports will be determined by regulation and planning rather than by competition.

If a company buys Gatwick it will not alter the fact that BAA is locked in an enormous battle for a second runway at Stansted and a third at Heathrow. The Commission's findings will be welcomed, but they will not address the big picture.

Making airports work financially is about making the best of the asset. That means pressing for more flights and more runways and it is the government that holds the key to that.

Source: Adapted from 'Regulation, not competition, will shape airports' by John Waples
*The Times* 16 August 2008.

**Figure 1: Map of airports around London**




Source: Adapted from http://www.travelguidelondon.co.uk/london-guide/places-and-tourist-sites/london-luton-airport-map-directions-information.html.

**34** Discuss the effectiveness of the Competition Commission in regulating industries such as the airport industry.

**(8)**

**(Total for Question 34 = 8 marks)**

**END OF SECTION B**