**Market Structure Practices**

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1. ACJC H2 Economics 2019 Preliminary Qsn 1

**The UK Rail Industry**

**Table 3: Rail Ticket Prices for Southampton to Manchester (in UK pound sterling (£))**

|  |  |  |
| --- | --- | --- |
| Type of ticket | Direct route | Indirect route |
| Advance | 57.00 | \*n/a |
| Off-peak | 113.50 | 115.10 |
| Anytime | 124.80 | 221.50 |
| First Class Anytime | 276.30 | 305.00 |

\*n/a = not available

When buying a ticket for a rail journey, consumers often face an array of possible prices and types of rail ticket. Consumers could choose the following types of rail tickets:

1. Indirect route will require travellers to switch to another rail to reach the destination and the journey will usually include multiple stops.
2. Advance tickets have to be bought in advance (up to the day before the day of travel) and are sold in limited numbers and subject to availability. These tickets are only valid on the date/train specified.
3. Off-Peak tickets can be bought anytime. However, travellers have to travel during off-peak hours (exclude peak hours in the mornings, late afternoons and late evenings on Mondays- Fridays).
4. Anytime tickets can be bought anytime and allow travellers to travel anytime.
5. First Class tickets offer additional free Wi-Fi, complimentary food and drinks, free newspapers, extra leg room and reclining seats as well as access to first class lounges at certain stations.

*Source: Economic Review February 2019 Vol 36 No.3*

(d) Explain whether the UK rail ticketing strategies could be considered an example of price discrimination. [4]

Answer

Price discrimination is the practice of firm charging a **different price** for the **same product** when the price difference cannot be explained by differences in costs of production.

**Example of price discrimination**

Advance tickets

- Travellers who are buying ‘Advance’ tickets are planning ahead. This group of travellers has the option of buying early (‘Advance’ tickets) or buying just before boarding the rail. They could buy ‘Anytime’ tick if they want to travel anytime or buy ‘Off-peak’ tickets if they are travelling during off-peak hours.

- Given the various options available, travellers have many substitutes to choose from. Thus, their **demand is more price elastic** compare to other groups of traveller à ‘Advance’ travellers are charge a lower price.

- It is also possible to identify the ‘Advance’ travellers as this group of travellers are buying their tickets in advance (up to the day before the day of travel).

- Resale of ‘Advance’ tickets is not possible as the ticket would include the name, time and destination of travel. Thus, it is impossible for travellers to buy ‘Advance’ ticket at lower price and sell it at higher price to another traveller.

- There is no different COP as the ‘Advance’ travellers will be enjoying the same rail service as other group of travellers such as travellers travelling using the ‘Anytime’ tickets.

OR

Anytime tickets

- Travellers who are buying the ‘Anytime’ tickets could be individuals who need to travel at short notice because of sudden emergency or a business meeting called at the last minute. Such last-minute travellers have a more price inelastic demand à ‘Anytime’ travellers will be charged a higher price

- It is also possible to identify the ‘Anytime’ travellers as this group of travellers will not be buying their tickets in advance and likely to buy them at the last minute or any time of the day of their travel.

- Resale of ‘Advance’ tickets is not possible as the ticket would include the name, time and destination of travel.

- There is no different COP as the ‘Anytime’ travellers will be enjoying the same rail service as other group of travellers such as travellers travelling on ‘Advance’ tickets.

**Not an example of price discrimination**

Higher price for indirect route ticket

- Ticket prices for indirect route is higher and this could be attributed to the higher COP

- Indirect route requires travellers to switch to another rail, with the possibility of multiple stops à thus there could be longer travelling distance and thus higher COP à higher ticket prices

OR

Higher prices for First Class Anytime ticket

- Ticket prices for First Class Anytime is higher and this could be attributed to the higher COP

- Travellers who buy first class tickets are offered additional free Wi-Fi, complementary food and drinks. There is higher COP when Wi-Fi, food and drinks are offered to the consumers. Thus, the higher COP is passed on to the consumers in the form of higher prices.

2. AJC H2 Economics 2019 Preliminary Qsn 1

**The Pharmaceutical Industry**

**Figure 1: List Price of Humalog brand Insulin (US$)**

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Source**:** Truven Health Analytics, accessed 15 July 2019

**Extract 1: Why Insulin defies the normal rules of Economics and keeps getting more expensive**

Here's a basic economic principle: The price of a product usually falls over time. That's often because competitors offer alternatives, or new advances make past breakthroughs less valuable. Yet none of the typical pressures have driven down the price of insulin, a life-saving drug for diabetics.

"Insulin manufacturers charge so much for a really simple reason: because they can," said Shannon Brownlee, co-chair of the Lown Institute's Right Care Alliance, a Brookline nonprofit that advocates for affordable health care.

Here's one explanation for why life-saving drugs like insulin defy normal consumer economics: If a good is too expensive, consumers can hold off buying, but with insulin, Brownlee says, "Where is the downward pressure? Customers can't put downward pressure on it because they can't walk away. If they don't take insulin, they'll die."

According to Joseph Doyle, co-director of the Initiative for Health Systems Innovation at MIT's Sloan School of Management, a driver for insulin prices and other drug prices, is patents. He points out that patent laws allow the few dominant insulin makers to minimise competition by patenting incremental changes to their products, which makes it hard for cheaper generics to enter the market.

Talk of profit margins can seem a bit cold when lives are at stake. But drug companies wouldn't pursue lifesaving therapies if there weren't financial rewards, said Amitabh Chandra, director of health policy research at Harvard's Kennedy School of Government. The Massachusetts Biotechnology Council contends that pharmaceutical firms' ability to make large profits can actually save money in the health care system, overall. "If a drug can cure somebody and keep them out of the hospital, it will save trillions of dollars in the long run," said MassBio CEO Bob Coughlin. "And that's what we really need to focus on."

*Source: Boston’s NPR News Station, 25 June 2019*

(b) (i) Define contestability and state how the expiry of a patent will affect the contestability of the pharmaceutical industry. [2]

(ii) Using a diagram, explain how the expiry of a patent would lower the profits of a major insulin producer such as Humalog. [4]

Answers

(b) (i) Contestable markets are those that are served by one or few firms, and are kept operating at competitive price and output levels due to the threat of potential competition/ potential entry of new firms. (1) Expiry of the patents will increase the contestability (1) by reducing the barriers to entry.

(ii) When the patent expires, it allows for more firms to enter the industry (1) as the main firm no longer has the exclusive rights to produce insulin. The lowered BTE increases the level of competition and reduces the demand for the firm’s insulin. There is a leftward shift of the AR and MR lines. The increased level of competition also means more substitutes available, hence the slope of the AR and MR lines will become flatter (1). Profit maximising level is where MC=MR. Before the expiry of the patent, supernormal profits earned is at DPCE. After the expiry, Humalog is likely to earn normal profits as shown in the diagram. (1)

3. GCE A Level H2 Economics 2012 Question 1 (Micro)

**The Market for cotton**

**Extract 2: UK retail clothing firms far from cheerful about future of cheap fashion**

It was a sign of the times; fashion was so cheap it became "disposable’ as globalisation brought container-loads of low-cost clothes to the UK. But clothes retailers are now warning that the era of constantly falling prices is coming to an end and that prices could rise in 2011. A huge rise in the price of cotton to a 15-year high could not be ignored, they said. At the same time, retailers are facing higher labour costs in Asia, the impact of a weaker pound and a rise in Value Added Tax (VAT) from 17.5% to 20% from January 2011.

The chief executive of clothes retailer Next predicted that the prices of Next's clothes were going to rise by up to 8% in 2011. He said that he suspected that shoppers would have to cut back on the number of new outfits they buy: 'Our best guess is that if prices do rise by 8%, then volume of sales will be down by 10%. The clothing retail industry hasn't experienced price increases for 15 years and the truth is we don't really know what the response will be.’

The director of a leading research company said consumers are facing what could be a permanent change in the clothing market: 'Prices can't keep failing forever: they reach a floor, and we are now at a point where retailers' profits are really quite low. Because of the recession they are finding it difficult to maintain sales. This means that when costs rise, they have to be passed on to the consumer.'

Primark, a clothing company known for its ability to emulate designer looks at rock-bottom prices, has been at the forefront of the disposable fashion movement. Its breathtaking prices - this autumn you can still buy jeans for £8 and a top for £4 - caused a stampede when its first store opened, on London's Oxford Street in 2007, Another company. Asda, sold its cheapest pair of own brand jeans for £14.97 in 2000; now the price is down to £4.

Some have argued that the increase in the cotton price has its roots in the financial crisis of 2008, when farmers stopped planting low-value cotton and switched to higher-value crops such as corn and soya, When retail sales picked up, demand for cotton also rose and prices shot up - just at a time when major cotton-producing regions such as China and Pakistan were suffering devastating floods, and India, the second largest producer, was limiting exports.

The deputy chief executive of a well-known department store explains that 60% of the cost of clothing is in the fabric and about 30% of the fabric cost is in the raw materials: ‘The approach we are taking is to pass it on to customers and we think most other retailers will have to do the same.’ He says its prices will rise, like Next's, by up to 8%, He also points to Increased labour costs all around the world’, less spare capacity in Chinese factories, rising freight costs and the unfavourable impact of foreign exchange movements as other pressures being faced by retailers.

Some analysts argue, however, that the gloom is being overdone. The chairman of the department store John Lewis Partnership, which last week reported a 20% increase in fashion sales, certainty thinks the future is brighter than some of his peers say. ‘Prices may rise a little but tough competition will take some of the heat out of these rises.’

*Source: The Observer, 19 September 2010*

**Extract 3: Tesco, the supermarket chain, is set to take on its rivals with the opening of a specialist clothing store in London**

Tesco, which is more used to selling clothes in its supermarkets than high street boutiques, is planning to open a store dedicated to selling clothing in London's West End. The store would be branded F&F, after Tesco’s own-label clothing range. The move will see Tesco try to succeed where its competitors have failed. In 2008 arch-rival Asda closed its chain of specialist high street clothing shops following a four-and-a-half-year trial run, because it could not make sufficient profit,

Tesco's move could be partly driven by the fact that fashion brands are having to compete more aggressively in an ever-more-crowded marketplace. As well as being home to thousands of stores from established brands like Primark and Next, the UK is attracting a large number of international clothing brands. US chain Abercrombie & Fitch entered the UK market a few years ago, and chains such as Forever 21, Vero Moda and Victoria's Secret are also set to enter the UK.

If Tesco can get the look and feel right in a dedicated clothing store, then it could be a good way of building brand awareness.

*Source: Daily Telegraph, 9 July 2010*

(f) Using the evidence in the data, discuss how the market structure of the retail clothing industry in the UK will affect the ability of firms in this industry to make excess profits in the long run when faced with an increase in the price of cotton. [10]

4. GCE A Level H2 Economics 2016 Paper 2 Qsn 3

In Australia, small and remote communities face high and stable prices for petrol. The petrol is supplied by one or two small petrol stations owned by small independent retailers. Prices are lower and more volatile in the large cities, where there are a large number of big petrol stations owned by a small number of big oil companies. Source: Australian Institute of Petroleum

(a) Explain why less market competition might lead to higher and more stable prices. [10]

(b) Assess whether differences in the level of competition are likely to be the main reason for difference in the retail prices of petrol in rural and urban areas of Australia. [15]

5. MI Prelim 2019 Qsn 2

In 2018, the Competition and Consumer Commission of Singapore (CCCS) fined Grab and Uber over their merger. On the other hand, CCCS cleared the merger of two food court operators, Foodfare and Kopitiam as even with the merger, other strong competing operators remain in the market for the sale of cooked food.

(a) Explain the likely market structure that is consistent with the behaviour of firms in the ride-hailing industry and the market for the sale of cooked food before the merger. [10]

(b) Discuss the factors that CCCS considers when they decide on whether to allow firms to merge. [15]

6. CJC Prelim 2019 Qsn 2

The successful exploitation of new ideas is crucial to a business being able to improve its processes, bring new and improved products and services to market, increase efficiency and, most importantly, improve its profitability.

(a)Explain how innovation may affect efficiency in a market. [10]

(b) Discuss whether a firm’s decision to innovate is dependent solely on the barriers to entry in the market. [15]