

Market Structures and Contestability — Worksheet

Efficiency · concentration ratios · perfect competition · monopolistic competition · oligopoly · monopoly · monopsony · contestable markets

Name: _____

Class: _____

Date: _____

DEFINE allocative efficiency · **CALCULATE** a monopoly's supernormal profit and a concentration ratio · **CLASSIFY** an action as one type of non-price competition · **ANALYSE** how a contestable market can benefit consumers · **DISCUSS** whether a large firm should cut its prices when new firms enter · **EVALUATE** how far a natural monopoly is economically efficient

Sitting 1 — Topic practice

30 marks

MULTIPLE CHOICE

Task 1 — Six questions on market structures and contestability

6 marks

Choose one answer for each question.

1. In Rensa, four paint makers hold 30%, 25%, 20% and 15% of the market. Many small firms share the other 10%. Nothing else is known about the market. What does this evidence show?

- A The four firms collude, because together they hold 90% of the market
- B A few firms hold most of the market, as in an oligopoly, but the shares do not show whether they collude
- C The market is close to perfect competition, because no firm holds even a third of it
- D No new firm can enter the market, because the small firms hold only 10% of it

Answer:

2. Teo's farm sells eggs in a perfectly competitive market, where firms can enter freely. The price is \$5 a tray. At the farm's output, its marginal cost (MC) is \$5 and its average cost (AC) is \$4. Its lowest AC is \$3.50, at a smaller output. Nothing else changes. Which statement is right?

- A It is productively efficient now, because its price equals its marginal cost
- B It earns only normal profit, so no new farms enter and the price stays at \$5
- C It is allocatively efficient now; entry will lower the price towards \$3.50, where it is productively efficient too
- D It is allocatively inefficient, because its \$5 price is above its \$4 average cost

Answer:

3. A firm's lowest average variable cost is \$15, and its lowest average cost is \$28. The price is \$20. What should the firm do in the short run?

- A Stop producing, because the price is below average cost and it makes a loss
- B Stop producing, because the price is below the price it needs in the long run
- C Keep producing, because the price is high enough to earn supernormal profit
- D Keep producing, because the price covers its variable cost and pays part of its fixed cost

Answer:

4. Two shops in the same street sell the same bag of rice. One of the shops also delivers the rice to the buyer's home at no extra cost. What is this?

- A physical differentiation
- B marketing differentiation
- C distribution differentiation
- D not differentiation, because the product is identical

Answer:

5. Wenda's hair salon is in monopolistic competition, in long-run equilibrium. Its demand curve just touches its average cost (AC) curve at 40 haircuts a day and a price of \$12. Its lowest AC is \$10, at 60 haircuts. Its marginal cost (MC) at 40 haircuts is \$8. Which statement is right?

- A It earns supernormal profit of \$2 a haircut, because \$12 is above its lowest AC of \$10
- B It is productively efficient, because its price equals its average cost at 40 haircuts
- C It is allocatively efficient, because in the long run it earns only normal profit
- D It earns normal profit, is neither productively nor allocatively efficient, and has 20 haircuts of excess capacity

Answer:

6. Monopolistic competition and perfect competition differ in only one assumption. Which assumption is it?

- A The product is differentiated rather than identical
- B There are few firms rather than many
- C The firms already in the market control barriers that stop new firms from entering
- D Firms do not aim to maximise profit

Answer:

DEFINE Task 2 — The meaning of allocative efficiency

2 marks

Define the term allocative efficiency.

allocative efficiency

**Name one market structure in which firms are likely to be allocatively efficient in the long run.
(practice, not marked)**

EXPLAIN Task 3 — Two ticket prices at one cinema**4 marks**

Lumo is the only cinema in the town of Pela. It charges students \$5 and other adults \$9 to see the same film. Students must show a student card to buy a ticket, and tickets are checked at the door.

Explain why Lumo charges students a lower price than other adults.

Begin with the conditions that make this pricing possible.

CLASSIFY Task 4 — Car makers in the country of Doma**8 marks**

Rova, Melo and Tesa make most of the cars sold in Doma. They charge similar prices, so they compete in other ways.

Classify each action as one type of non-price competition from the key.

Key: Advertising and branding · Quality · Endorsement · Product placement · After-sales service

#	What the car maker does	Type
1	Rova pays for adverts about its new car on television every evening	
2	Rova puts the same logo and name on every car, so buyers know it and trust it	
3	Melo makes its cars with stronger steel, so they have fewer faults than its rivals' cars	
4	Melo fits a new engine that uses less fuel for each kilometre	
5	Tesa pays a famous football player to say that he drives a Tesa car	
6	Tesa pays a film company to show the hero of a popular film driving a Tesa car	
7	Rova repairs any fault in its cars at no cost for five years once a buyer owns one	
8	Melo collects a broken car from the buyer's home and lends the buyer a car until it is repaired	

CALCULATE**Task 5 — Supernormal profit at a ferry company**

4 marks

Vessa Ferries is the only firm that carries cars to the island of Oro. It maximises profit at 250 cars a day. At 250 cars a day, its marginal revenue and its marginal cost are both \$30. At 250 cars a day, buyers will pay \$46 a car. Its average cost at that output is \$39 a car.

Calculate Vessa Ferries' supernormal profit per car and its total supernormal profit a day.

Supernormal profit per car

Workings

Answer: \$

Total supernormal profit a day

Workings

Answer: \$

Write the formula first, then use the numbers from the case.

ANALYSE**Task 6 — A cloth maker that is the main employer in Bala**

6 marks

Asto Textiles makes cloth in Bala, a small town far from any city. No other large firm employs workers in Bala, and few workers can move to another town. Asto pays the same wage to every worker. To employ more workers, it must offer a higher wage to all of them.

Analyse how being the only large employer in Bala is likely to affect Asto and its workers.

Knowledge — name and explain the market structure (2)

Application — use the facts about Asto and its workers (2)

Sitting 2 — Mock section

54 marks

Source: Flights inside Tarvo

- 1 Until 2022, the government of Tarvo gave a licence to fly between Tarvo's cities to only one airline, TarvoAir. In 2022, the government ended this licence rule. Now any airline that meets the safety rules may fly any route inside Tarvo.
- 2 Several new airlines have started to fly in Tarvo since then. Figure 1 shows each airline's share of passengers in 2025. Most new airlines rent their aircraft from other firms. If a route does badly, they can return the aircraft or fly them on routes in other countries. But a new airline spends about \$2 million on advertising and on training its staff for Tarvo's airports. It cannot recover this money if it leaves.
- 3 The average fare fell from \$120 in 2021 to \$85 in 2025. In 2024, Tarvo's competition authority fined TarvoAir and Skylo, the two largest airlines. The two airlines had agreed to charge the same fares on six routes. TarvoAir's managers now plan to cut its fares again where new airlines fly. Some of the managers want to spend more on better service instead, such as better meals and more space for bags.

Figure 1: Share of passengers on flights inside Tarvo, 2025

Airline	Share of passengers (%)
TarvoAir	46
Skylo	22
Jetra	14
Bluwing	10
Other airlines	8

CALCULATE Task 7 — A concentration ratio from Figure 1

2 marks

Using Figure 1, calculate the three-firm concentration ratio for flights inside Tarvo in 2025.

Workings

Answer: %

EXPLAIN Task 8 — TarvoAir as the only airline until 2022**4 marks**

With reference to the source, explain why TarvoAir was a monopoly until 2022.

ANALYSE Task 9 — The end of the licence rule and passengers**6 marks**

With reference to the source, analyse how the end of the licence rule may have benefited passengers.

Knowledge — barriers to entry and exit, and sunk costs (2)

Application — use the facts and numbers in the source (2)

Analysis — your chain of reasoning (2)

EXAMINE Task 10 — The fare agreement between two airlines**8 marks**

With reference to the source, examine the likely effects of the fare agreement on passengers and on the two airlines.

Knowledge — explain interdependence and why it can lead firms to collude (2)

Application — use two facts from the source (2)

Analysis — one chain for passengers and one for the two airlines (2)

Evaluation — say what the effects depend on (2)

DISCUSS Task 11 — Cutting fares where new airlines fly

14 marks

With reference to the source, discuss whether TarvoAir should cut its fares where new airlines fly, illustrating your answer with an appropriate diagram.

Diagram

Knowledge — draw and label a diagram with the fare and passengers on the axes: TarvoAir's AR, MR, AC and MC, its fare now and a lower fare (2)

Application — use one fact from the source for the fare cut and one against (2)

Analysis — two chains, one for the fare cut and one against (4)

Evaluation — weigh the two chains and say what the answer depends on (6)

In many countries, one firm supplies all the water to a town through a single network of pipes. A second network would cost as much as the first.

Evaluate the extent to which a natural monopoly, such as a water company, is economically efficient, illustrating your answer with an appropriate diagram.

Diagram

Knowledge — define natural monopoly, and name the three kinds of efficiency you will judge (3)

Application — apply these ideas to a water company (3)

Analysis — draw the natural monopoly diagram (costs and revenue against output: AR, MR, MC and a falling AC), then one chain for efficiency and one against (6)

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