



# Edexcel A - A Level Economics

## Theme 3 – Business behaviour and the labour market

### 3.6 Government intervention

#### Worked Examples

# Contents

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- Government intervention
- The impact of government intervention

### 3.6 Government intervention

#### Exam Style Question 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 [3]



### 3.6 Government intervention

#### Exam Style Question 1

Answer:

Answer: D – remain unchanged in real terms. [1]

Explanation:

In 2014, the UK Government changed the rule for how much rail fares could go up. Instead of allowing an increase of **RPI + 1%**, they changed it to just **RPI + 0%** which means fares could now only rise **in line with inflation**, not above it. [1]

- **RPI (Retail Price Index)** is a measure of inflation, it tells us how much prices in general are rising.
- A **price cap** sets a limit on how much companies (in this case, train companies) are allowed to raise their prices. [1]
- **Real terms** means we ignore inflation. So, if prices rise exactly with inflation, then in real terms, **they haven't really gone up**. [1]
- So, when fares rise by **RPI + 0%**, they're keeping pace with inflation, but **not going above it**.

That means prices are **unchanged in real terms**, even though they may look higher in pounds and pence (nominal terms), your purchasing power stays the same. [1]

This also reduces **monopoly power** and **protects consumer surplus**, but it could mean **less profit** and **less investment** by train companies. [1]

Quick reason why the others are wrong:

- **A** – wrong as the extra 1% was removed. Now its RPI + 0%, not RPI+1%.
- **B** – wrong as fares now rise with inflation, not above it. So, there's no real-terms increase.
- **C** – wrong as fares still increase in line with inflation – so they do not change in nominal terms.
- **E** – wrong as prices rise, not fall. RPI+0% means fares go up with inflation, not down.

### 3.6 Government intervention

#### Exam Style Question 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 [3]



### 3.6 Government intervention

#### Exam Style Question 2

Answer:

✔ **Answer: E** – LloydsTSB had a high market share in the retail banking industry. [1]

Explanation:

**Market share** = the percentage of total sales in an industry that one company holds. [1]

In 2013, the UK government stepped in and forced LloydsTSB to split into two separate banks. Why? Because they were **too big**, and when one firm holds a **high market share**, it can start to dominate the industry. So, this is a way to reduce dominance in the market. [1]

This is a **competition issue**. When one bank has too much power:

- It can set higher prices or offer worse service without fear of losing customers.
- It can block new competitors from entering the market.
- Consumers lose out due to reduced **choice** and possibly worse outcomes.

By forcing a demerger, the **competition authorities** were trying to **increase competition**, which should lead to better deals and service for customers. [1]

✘ **Why the other options are wrong (quickly):**

- **A** – *Diseconomies of scale* are about costs going up when firms get too big, but that's not the main concern here. It's about market dominance.
- **B** – *High contestability* means it's easy for new firms to enter, but if that were true, the regulator wouldn't need to step in!
- **C** – *Horizontal integration* (joining firms at the same stage) increases power, not consumer surplus.
- **D** – *Vertical integration* means merging with suppliers or distributors. This wasn't the case with LloydsTSB.

### 3.6 Government intervention

#### Exam Style Question 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 falling 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.

The intended purpose of such performance targets is to increase the [1]

- 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]



### 3.6 Government intervention

#### Exam Style Question 3

Answer:

✓ **Answer: A** – Quality of service where lack of competition might lead to poor results. [1]

Explanation:

**Performance targets** = goals set by regulators to keep service quality high (e.g. % of trains arriving on time). [1]

Network Rail is a **monopoly**; it runs the UK's rail infrastructure and doesn't face real competition. In markets like this, there's a risk the firm gets **lazy** or **inefficient** because it doesn't need to fight for customers.

That's why regulators like the **ORR** set **performance targets**, they're rules to make sure standards (like train punctuality) stay high and they act as a surrogate for competition. If the company misses the target (as Network Rail did, with only 87% of trains on time vs the 92% target), they get **fined**. [1]

The purpose of the fine is to **improve customer service**, not to raise government money or boost the firm's profits. It's a **motivator** to make sure monopoly firms don't underperform just because they don't have rivals. [1]

✗ **Why the other options are wrong:**

- **B:** The rail infrastructure sector isn't contestable; no new firms are entering to build their own rail networks.
- **C:** Targets might help reduce this, but the question asks what the *main purpose* is. Improving quality is the focus.
- **D:** This is about the firm making more profit. The fine shows this is about service, not boosting profits.
- **E:** The fine isn't to fix the government's finances, it's to pressure the firm to do better.

## 3.6 Government intervention

### Exam Style Question 4

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]

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## 3.6 Government intervention

### Exam Style Question 4

Answer:

✓ Answer: D – Vertical integration can create a barrier to entry. [1]

Explanation:

**Vertical integration** is when a company owns multiple stages of the supply chain, for example, an energy firm that **generates, supplies**, and maybe even **distributes** electricity all by itself. [1] This gives them a lot of control, and that's what Ofgem was worried about. Ofgem's role is to promote competition and act in the consumer's interest. [1]

When big firms like EDF Energy (which controls 24% of the market) are vertically integrated, they can **dominate the supply chain**, making it really hard for **new or smaller firms to enter** the market. These are called **barriers to entry**. [1]

If you're a new energy company trying to compete, but you can't access the same distribution networks or negotiate good deals, you're basically stuck on the sidelines. [1]

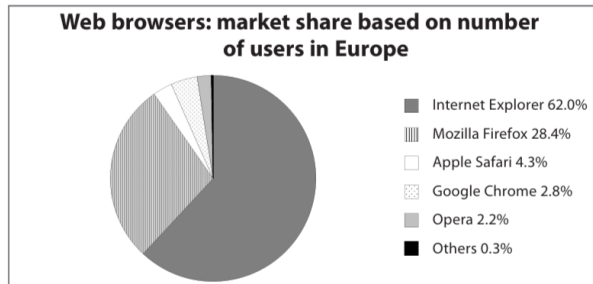
✗ Why the other answers are wrong:

- **A:** Producer surplus is the profit above production cost. But vertically integrated firms tend to make more, not less.
- **B:** Nope. Vertical integration actually strengthens big firms and often **increases** market concentration.
- **C:** Not the main issue. The concern is **barriers for new competitors**, not internal firm size.
- **E:** EDF is **not** a legal monopoly they just have a big market share, not exclusive rights.

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## 3.6 Government intervention

### Exam Style Question 5



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 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 [3]

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

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## 3.6 Government intervention

### Exam Style Question 5

Answer:

✓ Answer: E – A decrease in market share for Internet Explorer. [1]

Explanation:

**Market share** is the percentage of total sales or users controlled by one firm. In this case, Internet Explorer (IE) held a dominant **62%** of the European browser market. This means IE almost had legal monopoly power. [1]

Also, Microsoft was **pre-installing IE** on all Windows computers. That gave them an unfair edge and **blocked competition**. So, in 2008, the **European Commission fined Microsoft** €1.68 billion and made them **let users choose** their browser instead of forcing IE on them. [1]

Therefore, users get a choice and:

- **More competition** enters the market.
- **Other browsers** like Firefox and Chrome have a chance to grow.
- As a result, **Internet Explorer's market share goes down**. [1]

This is called **increased contestability**, when barriers to entry are lowered and more firms can join the market. [1]

✗ Why the other options are wrong:

- **A – Five-firm concentration ratio would decrease**, not increase.
- **B – Microsoft would likely lose profits**, not gain.
- **C – Less users = less ad revenue for IE**.
- **D – More competition usually means better browser quality**, not worse.

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### 3.6 Government intervention

#### Exam Style Question 6

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 [3]



### 3.6 Government intervention

#### Exam Style Question 6

Answer:

✔ Answer: E – Wanted to commence a major project without raising the finance at the initial stage. [1]

Explanation:

**Private Finance Initiative (PFI):** when the **private sector** (businesses) helps **fund and build** major public projects, like roads, hospitals, or schools, and the government pays them back over time (often 20–30 years). Like the project rented back to the government [2]

The government used a **Private Finance Initiative (PFI)** to fund the M25 motorway project. This means that **private companies paid to build and maintain** the road, and the government would pay them back over time.

This allows the government to:

- Start **big, expensive projects right away**
- Avoid **raising taxes** or **borrowing large amounts** of money up front
- Spread the cost over many years, even decades. [1]

The contract included **penalties** for late completion, meaning the private firm had a **profit motive** to be efficient and meet deadlines, something that isn't always as strong in the public sector. [1]

✘ Why the other options are wrong:

**A:** That's the opposite of what they did. They used the **private** sector.

**B:** Not true. Performance targets can still be used in both sectors.

**C:** The government might not build roads themselves, but they could contract public agencies. Lack of expertise wasn't the main reason.

**D:** That's about boosting firm profits; not the government's goal here.

Please see the '3.6 Government Intervention  
Revision Notes' pack for detailed notes.

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