Mark Scheme (Results)

Winter 2010

GCE Economics (6EC03/01)

General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.

- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.

- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.

- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.

- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.

- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.

- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.

- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

General marking observations for supported choice questions

Up to (**2 marks**) may be earned for knocking out incorrect keys, if the letter of the key to be eliminated is provided and a valid reason is given, with (**1 mark**) per key/keys with reason. For the explanation, (**3 marks**) can be earned even if key is incorrect, where the explanation provides sufficient evidence that the question has been understood.

Question Number	Answer	Mark
1	C Definition of high concentration, e.g. reference to a few firms having a high market share **(1 mark)** Calculation of three/four/five etc firm concentration ratio CR 3 = 45.2% CR 4 = 55.2% CR 5 = 64.4% CR 6 = 73.0% CR 7 = 80.7% **(1 mark)** Market structure is oligopoly **(1 mark)** Other reference to data, e.g. strong brand names **(1 mark)**	(4)

Question Number	Answer	Mark
2	B Definition of economies of scale – falling **long run** average cost as output increases or LRAC diagram **(1 mark)** Identification **(1 mark)** and application **(1 mark)** of one type of economy of scale to airlines when they join together Horizontal integration explanation **(1 mark)** E.g. bulk buying (type) of fuel (application) = 2 marks	(4)

Question Number	Answer	Mark
3	B Definition of marginal cost e.g. cost of producing one more unit, or formula '**change in** total cost divided by **change in** quantity' **(1 mark)** Understanding that total costs are constant **(1 mark)** and therefore the marginal i.e. change in total cost is zero **(1 mark)** Allow 'no variable costs' **(1 mark)** but not 'all costs are fixed'. Possible knock outs: It is not C or D because average costs are falling, it is not A because total costs are constant	(4)

Question Number	Answer	Mark
4	**A** Definition of normal profit or supernormal profit verbally or as formulae normal profit A⸱⸱⸱⸱<AR **(1 mark)** Understanding of the exi⸱⸱⸱⸱ge which means that these profits **attrac**⸱⸱⸱⸱the industry benefitting from no or lo⸱⸱⸱⸱as sunk costs **(1 mark)** and therefore pro⸱⸱⸱⸱mark) Diagram to illustrate ent⸱⸱⸱⸱ up to **(2 marks)** If diagram has no industry⸱⸱⸱⸱rfectly competitive firm **(1 mark)** Firm Industry	(4)

Question Number	Answer	Mark
5	**E** Definition of profit maximisation MC = MR (1 mark) The use of diagram showing the fall in price, fall in output, constant AC and fall in AR and MR can be rewarded with full marks (**3 marks**) **cap diagram 2 out of 3 marks if AC or MC are shown to change.** **of which** shift left/down of AR and MR (1 mark), original and new equilibrium/price (1 mark), new profit area (1 mark). A written analysis should include explanation of falling prices **(1 mark)**, output **(1 mark)** and profits **(1 mark)**, more than just repeating key. **Up to 3 marks**	(4)

Question Number	Answer	Mark
6	**A** Price inelastic demand means that higher revenue for firms is gained when prices are higher **(1 mark)** Game theory: - Consumers have no choice but to pay the high prices because of market power **(2 mark)** - Possible collusion identification and application **(2 marks)** - Understanding that they tend not to trust each other and therefore they will most likely end up at cell D i.e. both low prices as a result of a price war **(2 marks)** Kinked demand approach: - Elastic demand if prices rise **(1 mark)**, but inelastic demand if prices fall **(1 mark)**. Diagram showing a kink in AR or demand **(1 mark)** Interdependence **(1 mark)**	(4)

Question Number	Answer	Mark
7	**C** Definition of monopolistic competition or at least one characteristic e.g. firms have differentiated products and therefore the demand is not perfectly elastic has low barriers to entry, many firms **(1 mark)** Explanation of lack of productive efficiency **(1 mark)** Explanation of lack of allocative efficiency **(1 mark)** Supernormal profits will be competed away in long run OR only normal profits in the long run **(1 mark)** Diagram to illustrate long run position showing allocative and productive inefficiency can rewarded up to **(2 marks)**	(4)

Question Number	Answer	Mark
8	**D** Role of a regulator **(1 mark)** After a certain amount of profit is earned, the marginal tax rate is 100% (everything is taxed) **(1 mark)** The company will be allowed to charge a price equal to the average cost of production **(1 mark)**, A 'fair' **rate of return** on capital is allowed for firms **(1 mark)** which removes all incentive to make efficiency gains or increase profits **(1 mark)**. Contrast with other forms of regulation **(1 mark)**.	(4)

General marking observations for data questions

50% of the marks are to be awarded for evaluation, in all **except** the 4 mark questions. The Levels of Response are to be used as general guidance, but marks must be awarded if criteria on the mark scheme are identified.

Question Number	Answer	Mark
9(a)	**Theory (2 marks):** a monopoly **(1 mark)** – at least reference to one characteristic **(1 mark)** or identification of Competition Commission legal definition of 25 per cent of market share **(1 mark)** **Application** to information provided **(2 marks):** e.g. 'BAA's ownership of London's three largest airports' (Extract 1, line 6) **(1 mark)** **Allow oligopoly up to 4 marks, if argued convincingly that there is a degree of competition in the London market. This must be supported by evidence**, e.g. reference to Luton and City Airport as non-BAA owned in Figure 1.	**(4)**

Question Number	Indicative content	**(14)**

9(b)	Concept of increased competition (e.g. there will be more firms in the market) **(1 mark)**
	
	 Benefits of competition up to **6 marks** for 2 or 3 benefits **(3+3 or 2+2+2 or 3+2+1)**. These may include:
	 Consumer benefits (passengers)
	 • Lower prices for consumers, as costs fall
	 • Better service – candidates could expand on this as a secondary point – for example
	  o Fewer delays
	  o Fewer bags lost
	  o Better experience
	  o Smaller queues
	  o Better transport links
	 Consumer benefits (airlines)
	 • Greater choice of airports
	 • Greater productive or allocative efficiency – candidates could try to compare monopoly with perfect competition to illustrate the gains
	 • Higher profits
	 Government benefits
	 • More tax income
	 • Improved trade
	
	 Answers must be focused in airports, but airlines can be viewed as customers.
	 Evaluation 7 marks - up to 3 marks + 4 marks for each evaluation point made, or 2 + 2 + 3 marks or 2 + 2 +2 +1 or similar, best four points only. Points might include
	 • Allocative inefficiency as firms spend money trying to compete.	

		• Loss of economies of scale causing LR average costs to increase	
		• Loss of integrated connections between airports	
		• Consumer confusion	
		• Discussion whether the airport market can sustain competition or whether it is essentially a natural monopoly.	
		• Even after the sale of airports an oligopoly will still exist which may exploit the consumer	
		• Reduced contestability	
		• Reduced profitability may deter new entrants or investment	
Level	Mark	Descriptor	
Level 1	1-3	Identification of one benefit **(1)** and explanation of this benefit **(2)**	
Level 2	4-7	Identification of three benefits **(up to 3)** and explanation of these benefits **(up to 3)** Brief evaluation **(1)**	
Level 3	8-14	Identification of three benefits **(up to 3)** and explanation of these benefits **(up to 3)**. Evaluation (2 points x 3 marks or 3 points x 2 marks) – **total for evaluation 7 marks**	

Question Number	Answer	Mark
9(c)	**KAA 4 marks (2 x 2 marks or 1 x 4 marks)** Factors might include:	
	• Role of Competition Commission (CC)**(2 marks)**	
	• Application to an industry, this may include airports or airlines **(2 marks)**	
	• Specific types of regulation or powers of the CC **(2 marks)**	
	• Enterprise Act 2002 e.g. the CC directs not just advises increased powers to fine 10% revenue for three years, jails term for directors, ability to force sale of assets **(2 marks)**.	
	Evaluation 4 marks (2 x 2 marks or 1 x 4 marks)	
	• Award counterarguments to the points above, either for or against regulation	
	• Indication of the problem that faces the authorities in trying to encourage competition e.g. regulatory capture, information asymmetry. This may include reference to the extract.	
	• Time for investigation is too long	
	• Cases need to be referred (selection or time issue)	
	• EC supersedes CC and other issues regarding international regulation	
	• Regulation meant to only be a short term solution until competition is possible	
	• Also reward the arguments offered in Extract 2 as to why regulation and planning would be better	
	• Government failure may reduce effectiveness of regulation	
	• Competition may cause problems outlined above – don't reward a repetition of the answer to 9b	

Question Number	Indicative content	(14)
9(d)	**KAA 7 marks**	

Reasons for policy (up to 4 marks 2 x 2 marks or 1 x 4 marks):
- Increased profits
- Increased revenue/demand
- Price inelastic demand/monopoly power
- Higher costs
- Increased market share in markets where demand is more elastic
- Prevent other firms from entering the more contestable markets
- Analysis of price discrimination
- Allow up to 2 marks for a firm sub-markets diagram showing different elasticities prices,
- Application of data e.g. Heathrow with low PED and Gatwick with higher PED (could be on diagram)

Consequences of policy (up to 4 marks 2 x 2 marks or 1 x 4 marks) might include:
- Profits/revenue/market share increase
- Involvement of the Competition Commission
- Lost consumer welfare as fare prices rise
- Effect on airlines – less profit, higher costs
- Deters new entrants

Evaluation: (up to 7 marks for 2 points 4+3 or 3 points 3+2+2 or 2+2+2+1 or similar)
Points might include:
- This is price differentiation/product differentiation NOT price discrimination
- Arrival of competition may mean that the policy cannot last in the long run
- If prices are too high this may have a wider impact on the demand for London as a tourist and business destination, which will force the regulator/competition commission to intervene
- Excess profits may attract undue attention from regulator
- Relative price of other airports
- Other costs might be more significant to airlines, e.g. fuel or cabin crew
- Other problems of price/product differentiation
- Other wider issues, e.g. externalities impact (the 'environment')

Level	Mark	Descriptor
Level 1	1-3	Definition of price discrimination **(1)**, identification of a cause and consequences of policy **(2)**
Level 2	4-7	Identification of several valid causes and consequences, with limited explanation/application
Level 3	8-14	Well applied and explained causes and consequences. Evaluation (2 points x 2+3 marks or 3 points x 2 + 2 +1 marks) – **total for evaluation 7 marks**

Question Number	Answer	Mark
10(a)	**Theory (2 marks):** An oligopoly **(1 mark)** - at least reference to one characteristic **(1 mark)** **Application** to pharmaceutical industry **(2 marks):** identification of characteristics in evidence provided	**(4)**

Question Number	Indicative content	

10(b)	**KAA 6 marks**
	Identification and explanation of up to 3 benefits **to Merck**
	(2+2+2 or 3+3 or 3+2+1)
	
	These may include
	
	    • Economies of scale (accept 3 economies of scale as different factors) - marketing, financial, risk bearing, R &D
	    • Access to new markets e.g. Schering 70% of market outside US
	    • Access to new patents
	    • Protection from unwanted predators
	    • Higher market share, e.g. elimination of competition, widening scope
	
	Must be benefits to Merck, not other stakeholders
	
	Evaluation: Award **6 marks (2+2+2 or 3+3 or 3+2+1)**
	
	Factors may include
	    • Diseconomies of scale
	    • Likely costs of the merger e.g. dilution of shareholder value
	    • Possible investigation by competition agencies such as the Federal Trade Commission
	    • Possibility that the merger might not succeed
	    • Possibility that the firms will not be able to adequately integrate
	    • Time lags in realising the benefits.
		(12)

Level	Mark	Descriptor	
Level 1	1-3	Identification and weak explanation of up to 2 benefits **3 marks**	
Level 2	4-6	Identification and explanation of up to 3 benefits **6 marks** Brief evaluation **(1)**	
Level 3	7-12	Identification and explanation of up to 3 benefits **6 marks** Evaluation: Identification and explanation of up to 3 evaluation **6 marks**	

Question Number	Indicative content
10(c)	6 KAA marks or which **(3 marks)** for price strategy and **(3 marks)** for non-price. Award as 3 marks for 1 point or 2 + 1 for two points Identification of one **price** strategy **(1)** and application and/or analysis **(2)**. Strategies may include: • Predatory pricing • Limit pricing • Sales maximisation • Revenue maximisation • Buy one get one free • Price discrimination • Undercutting rivals Identification of one **non-price** strategy **(1)** and application and/or analysis **(2)**. Strategies may include: • Further increases in efficiency • Investment into new technology to increase productivity. • Improve product quality • Marketing campaign to win business customers. • Advertising • Promotion through other means, bundling products (which may be identical) • Move production abroad • External growth **Award maximum 4/6 if no reference to the pharmaceutical industry**. **Evaluation (3+3 or 2+2+2 or 3+2+1)** A range of ideas could be developed, for example: ➢ It may be harder to make further increases in efficiency; all firms trying to engage in R&D ➢ Depends on PEDs ➢ There may be retaliation, e.g. price war ➢ Short term/long term success ➢ Investment /R&D is expensive and there is no guarantee of success. ➢ Improving product quality is expensive ➢ Marketing is expensive and no guarantee of success ➢ Predatory pricing is illegal so there might be fines ➢ Benefits or costs to other stakeholders.

Level	Mark	Descriptor
Level 1	1-3	Identification of one **non-price or price** strategy **(1)** and analysis **(2)**.
Level 2	4-7	Identification of one **non-price and price** strategy **(2)** and analysis **(4)**. Brief evaluation **(1)**
Level 3	8-12	Identification of one **non-price and price** strategy **(2)** and analysis **(4)**. Extensive evaluation **(Up to 6)**

Question Number	Indicative content
10(d)	**KAA 6 marks (3 marks for consumers and 3 marks for employees) of which (3 or 2+1)** Identification and explanation of advantages to **consumers** • Economies of scale and other synergies mean lower LRAC and therefore lower prices • Greater profits/R & D budgets mean more breakthroughs • Reduction in competition may mean firms can divide up market to research particular areas of expertise, so more choice for consumers Employees • Increased job security as profits rise • Higher wages/perks • Share options increase in value • More scope for promotion in larger firms • Allow non worsening situation as being in the interests of employees **Evaluation 6 marks (3 + 3 marks or 2 + 2 + 2 marks)** Factors may include: • Greater possibility of collusion to raise prices • Less incentive to innovate and produce better drugs • Increased chance of x-inefficiency and exploitation or price discrimination • Prices rise if there are diseconomies of scale • Worker redundancies • Morale issues • Less choice because there are fewer firms

Level	Mark	Descriptor
Level 1	1-3	Identification of advantages to consumers (**Up to 3 marks**)
Level 2	4-6	Some understanding of public interest – benefit to consumers. **1 mark** Identification and explanation of 2 advantages to consumers (**Up to 4 marks**) Limited evaluation (**Up to 2**)
Level 3	7-12	Identification and explanation of 2 advantages to consumers (**Up to 4 marks**) Extensive evaluation (**Up to 6**)

	Knowledge	Application	Analysis	Evaluation	Total
1	1	2	1	0	4
2	2	1	1	0	4
3	1	1	2	0	4
4	1	1	2	0	4
5	2	1	2	0	4
6	2	1	1	0	4
7	2	1	1	0	4
8	1	2	1	0	4
9a	1	2	1	0	4
9b	2	2	3	7	14
9c	2	2	0	4	8
9d	2	2	3	7	14
10a	1	2	1	0	4
10b	2	2	2	6	12
10c	2	2	2	6	12
10d	2	2	2	6	12
Total	18	18	18	18	
Total (%)	25	25	25	25	