

Mark Scheme (Results) Summer 2010

GCE

GCE ECONOMICS (6EC03) Paper 01

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General Observations

Up to 2 marks can be awarded for knocking out incorrect options, if a valid reason is given, with one mark for each. The letter of the excluded option must be given.

If the letter option chosen is incorrect there is a maximum of 2 marks for explanation, except in circumstances which make it clear the candidate made a clerical error.

Question Number	Answer	Mark
1	<p>D</p> <p>Marks may be awarded for</p> <ul style="list-style-type: none"> • Role of European Commission, e.g. promotes competition, acts as a surrogate for competition • Improving the interest of consumers • Data ref e.g. 75% is a monopoly, or Intel has reduced competition (1 mark) • Intel engaged in anti-competitive practices (1 mark) • Explanation that these practices limit competition (1 mark) • Intel has considerable degree of monopoly power and can, therefore, use this to undermine competitors e.g. collusion (1 mark) • Fine aimed as a deterrent or punishment to other companies from adopting such practices, or other effect on other firms (1 mark) 	(4)

Question Number	Answer	Mark
2	<p>C</p> <ul style="list-style-type: none"> • Definition of price elasticity of demand or formula e.g. $\% \Delta Q_D / \% \Delta P$ (1) • Demand less elastic in August (1 mark) and more elastic October (1 mark) which may be shown on a diagram • Observation that there is price discrimination (1 mark) with further development or diagram (1 mark) <p>Explanation marks are limited to 1 of the 3 marks if August is seen as more elastic than October</p>	(4)

Question Number	Answer	Mark
3	<p>B</p> <ul style="list-style-type: none"> • Recognition of economies of scale (1 mark) • Diagram showing falling long run average cost curve as output increases (1 mark) • Type of economies of scale e.g. technical 	

	<p>economies of scale; managerial, marketing (1 mark)</p> <ul style="list-style-type: none"> • Example of economy of scale as application e.g. high sunk or capital costs of rolling stock(1 mark) • Recognition of natural monopoly (1 mark) • Barriers to entry/exit (1 mark) 	(4)
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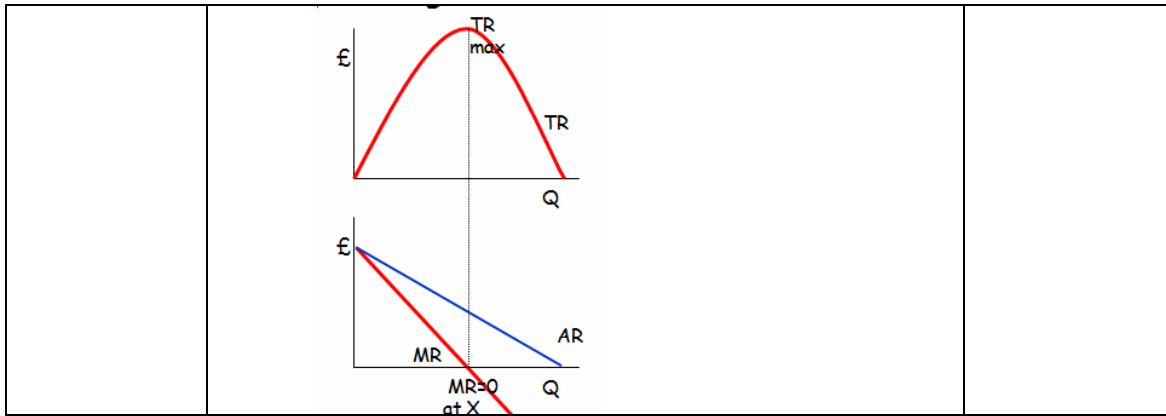
Question Number	Answer	Mark
4	<p>E</p> <ul style="list-style-type: none"> • Definition of satisficing, e.g. satisfying or sufficing different stakeholders, making just enough profit to survive, making enough profits to keep shareholders happy, firms have multiple and possibly conflicting interests (1 mark) • Identify stakeholder and/or an objective (1 mark) • Reason for stakeholder's objectives e.g. shareholder wants to maximise profits because their dividends depend of them (1 mark) • Diagrammatic analysis: costs/revenue diagram showing at least two objectives of firms, or profit diagram showing a satisficing range of profit (1 mark) 	(4)

Question Number	Answer	Mark
5	<p>C</p> <ul style="list-style-type: none"> • Definition: sales maximisation is at output at which $AR = AC$ which may be in diagrammatic form (1 mark) • Diagram showing outputs or prices for equilibria (1 mark) • Explanation that under sales maximisation lower prices or profits will deter new entrants or increase market share of the existing firm (1 mark) • Normal profits only will be earned (1 mark) • Accept analysis of limit pricing (1 mark) • Long run analysis e.g. sales max might equal long run profit max (1 mark) 	(4)

Question Number	Answer	Mark
6	<p>B</p> <ul style="list-style-type: none"> • Role European Commission, to promote competition, surrogate for competition or 	

	<p>protect consumer interests</p> <ul style="list-style-type: none"> Abnormal profit identified related to monopoly/oligopoly power Understanding of 'price caps' e.g. lower prices enforced, allow RPI-X (1 mark) Analysis based on lack of competition in the market (1 mark) Explanation of impact on consumer e.g. exploitation (1 mark) Application of data (1 mark) e.g. caps are tightening Monopoly diagram showing impact on profits of price cap: showing the price cap P2 (1 mark) and impact on profit area or efficiency changes P1BDC to P2GDC (1 mark) 	(4)
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Question Number	Answer	Mark
7	<p>E</p> <ul style="list-style-type: none"> Definition of AR or MR or formula $AR = TR/Q$ $MR = \Delta TR/\Delta Q$ (1 mark) Annotation of diagram or additional diagram to show falling AR and MR (1 mark) Diagram link X to $MR=0$ (or verbally) (1 mark) Imperfect competition or price maker (1 mark) Explanation of why AR and MR slope downwards e.g. if a firm wants to sell more it must cut prices (1 mark) Reference to price elasticity of demand elastic up to X then inelastic (1 mark) Algebraic explanation showing relationship between TR, AR and MR (up to 3 marks) 	(4)



Question Number	Answer	Mark
8	<p>A</p> <ul style="list-style-type: none"> • Definition of profit maximisation $MC=MR$ • Explanation of productive efficiency (lowest point on average cost curve) (1 mark) NB definitions are not sufficient for this mark. There must be some explanation • Explanation of allocative efficiency ($P=MC$) (1 mark) • Explanation of firms entering/leaving industry in long run, with no barriers to entry or exit (up to 3 marks) • Diagram illustrating long run equilibrium of a perfectly competitive firm (1 mark for horizontal AR, 1 mark for tangential AC) <p>Long-run equilibrium of industry and firm under perfect competition</p>	(4)

Question Number	Answer	Mark
9(a)	Theory 2 marks: identification that this is forward (1 mark) e.g nearer the customer/market or downstream,	

	<p>vertical integration (1 mark) e.g. same industry but different stages of production</p> <p>Application of vertical integration 2 marks: e.g. generating companies own networks that distribute electricity from Line 25, (1 mark) with explanation that the distributors are nearer the customers (1 mark)</p>	(4)
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Question Number	Answer	Mark
9(b)	<p>KAA 4 marks</p> <p>Answers must be based on evidence of a cartel. Do not award reasons why there is a cartel, or why cartels might break down as analysis points.</p> <p>Meaning of cartel e.g. an agreement between firms to operate together (1 mark)</p> <p>Evidence (up to 4 marks). Award as 4 or 1+3 or 2+2 or 2+1 or 1+1. Evidence might include:</p> <ul style="list-style-type: none"> • Germany has ‘highest prices in Europe’ • Profits expected to rise despite recession • Price rising even though cost of coal has halved (line 17), and gas and oil prices have fallen sharply (line 5) • Demand for electricity expected to fall by 5% but prices are high and in some cases rising (lines 4-5) • Suggestion that power stations being shut to cut supply • Two companies (E.ON & RWE) dominate the industry. Award use of concentration ratios in lines 20-22 • Reference to European Competition Commission (ECC) as a sign of acting as a cartel <p>(Award no more than 4 KAA marks)</p> <p>Evaluation 4 marks (4+0 or 3+1 or 2+2) might include:</p> <ul style="list-style-type: none"> • It may be just tacit or informal collusion • Prioritisation with justification • Missing information - ‘finding evidence of anti-competitive behaviour may be difficult’ • Risks of collusion e.g. fines by the European Competition Commission might be greater or less than potential gains. This might involve game theory or regulatory capture. Cartels are illegal 	(8)

	<ul style="list-style-type: none"> • Prices are high for other reasons, e.g. x-inefficiency, or other costs such as wage costs, or owing to reinvestment • Concentration ratio or prices are high for reasons other than the operation of a cartel, e.g. a natural monopoly 	
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Question Number	Answer	Mark
9(c)	<p>KAA 6 marks (of which 2 marks are reserved for game theory). If no reference to game theory there is a maximum of 4 KAA</p> <p>Award 6 KAA marks for good game theory which illustrates various ways to compete</p> <p>Consideration of game theory:</p> <ul style="list-style-type: none"> • Explanation of strategies and best solution • Tacit agreements such as price fixing • Pay-off matrix • Kinked demand theory • Recognition of rival behaviour and interdependence • Prisoners' dilemma • Informal collusion • A pay-off matrix drawn accurately and applied to RWE and E.ON 2 marks <p>Methods of competition include:</p> <p>Price competition</p> <ul style="list-style-type: none"> • Limit pricing • Predatory pricing • Sales maximisation <p>Non-price competition</p> <ul style="list-style-type: none"> • networks to distribute electricity, • advertising, • marketing; • special discounts to other distributing companies • Mergers, collusion or other ways to remove competition can be seen as a way to compete <p>Award best three points e.g. 4+2 or 3+2+1 or 2 + 2 + 2</p> <p>Do not award 'operating as a cartel', e.g. controlling</p>	(12)

		<p>networks, or simultaneously shutting power stations lines 6-7.</p> <p>Evaluation 6 marks. Award best three points, e.g. 3+3 or 3+2+1 or 2+2+2 etc.</p> <ul style="list-style-type: none"> • Regulator forcing companies to change their behaviour • Difficulty of using non-price competition when product is homogeneous • Critical assessment of game theory e.g. game theory leads to lack of competition not a way to compete • Critical assessment of the method of competition • Game theory shows that the worst outcome might be reached as illustrated by problems of Prisoners' Dilemma or price war • What looks like competition might be the emergence of monopoly power, e.g. duopoly pricing • Other critical assessment of game theory, e.g. lack of rationality, lack of information for consumers • How credible is the threat? e.g. predatory pricing might not be effective, or there may be international competition making limit pricing ineffective • Collusion is illegal • Gains from collusion might outweigh the possible fines • Collusion is difficult to prove, or other missing information <p>Quality of written communication will be assessed in this question based on the candidate's ability:</p> <ul style="list-style-type: none"> • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economics vocabulary appropriately • To use grammar, spelling and punctuation appropriately 	
Level	Mark	Descriptor	
Level 1	1-3	Definition of game theory (1 mark); application - to 2 companies E.ON & RWE (2 marks)	
Level 2	4-7	Definition of game theory (1 mark); application - to 2 companies E.ON & RWE (2 marks); other methods of competition (up to 3 marks); brief evaluation (1 mark)	
Level 3	8-12	Definition of game theory (1 mark); application - to 2	

	companies E.ON & RWE (2 marks); other methods of competition (up to 3 marks); Evaluation: 2 x 3 marks or 3 x 2 marks (6 marks);
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Question Number	Answer	Mark
9(d)	<p>KAA 8 marks Award up to 4 points: (3 + 3 + 2) or (4 + 4) or (2 + 2 + 2 + 2) marks or similar.</p> <p>Policies and factors include:</p> <ul style="list-style-type: none"> • Heavy fines could be imposed by Germany's regulatory authorities • Price caps • European Competition Commission has had some success in getting electricity companies to sell off distribution networks • Greater competition from renewable energy firms • Consumers switch to 'green alternatives' • Suppliers outside Germany as competition (e.g. energy imports) <p>1 mark for identification and up to 3 marks for explaining with reference to the data</p> <p>Evaluation 8 marks. Award up to 4 points: (3 + 3 + 2) or (4 + 4) or (2 + 2 + 2 + 2) marks or similar.</p> <ul style="list-style-type: none"> • Fines might not have much effect if profits are very high • Selling off distribution networks still leaves main electricity companies with considerable market power • High cost of renewable energy might not provide much competition • Critique of competition authorities e.g. regulatory capture • Are the green suppliers really making a difference (line 39)? • Prioritisation with justification • Short run/long run issues • Discussion of size of price elasticity of demand in relation to the price cap • Increased profits can be good, e.g. can lead to investment and economies of scale in the future, or it might encourage new entry. <p>Quality of written communication will be assessed in this question based on the candidate's ability:</p> <ul style="list-style-type: none"> • To present an argument and conclude on the basis 	(16)

	<p>of that argument</p> <ul style="list-style-type: none"> • To organise information clearly and coherently • To use economics vocabulary appropriately • To use grammar, spelling and punctuation appropriately 	
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Level	Mark	Descriptor
Level 1	1-3	Identification of policies and factors
Level 2	4-8	Identification of policies and factors (3 marks); explanation of each (up to 5 marks);
Level 3	9-16	Identification of policies and factors (3 marks); explanation of each (up to 5 marks). Evaluation (3+3+2 marks)

Question Number	Answer	Mark
10(a)	<p>Theory 2 marks: oligopoly (1 mark) Explain: A few firms dominate the market; interdependent firms (1 mark)</p> <p>Application to market for instant coffee (2 marks) e.g. concentration ratio: 2 firm 68%, 3 firm 73%, 4 firm 76% (2 marks), or high levels of non-price competition, £17m investment by Nescafe is a barrier to entry, 20 year innovation period (Ext 2 line 19) (up to 2 marks)</p> <p>OR Theory 2 marks monopoly (1 mark) Explain: one firm has more than 25% of the market</p> <p>Application: 51% market share for Nescafe (2 marks), £17m investment by Nescafe is a barrier to</p>	(4)

	<p>entry (up to 2 marks)</p> <p>OR Duopoly (1 mark) Explain: two firms dominate market</p> <p>Application: concentration ratio 68%</p>	
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Question Number	Answer	Mark
10(b)	<p>KAA 6 marks Award 3 points (2 + 2 + 2 or 3 + 3 or 3 + 2 + 1 or similar)</p> <p>Reasons include:</p> <ul style="list-style-type: none"> • Lower costs of production of raw material e.g. poorer quality coffee beans • Other costs higher: rent on cafés; wages of staff • Demand for coffee in cafés less price elastic than demand for instant coffee • Starbucks wants to establish its Via brand in the market i.e. market penetration pricing, stiff competition from Nescafe marketing • Potential economies of scale in production of Via coffee much greater than for filter coffee • Low costs of marketing on entry • Starbucks cross-subsidise firms • To under-price competition e.g. McDonald's McCafe • Recession - have to keep prices down, Extract 2, line 19-20 <p>Evaluation 6 marks (2 x 3 marks or 3 x 2 marks) might include:</p> <ul style="list-style-type: none"> • Prioritisation e.g. critical consideration of costs • Missing information e.g. no cost comparisons given in the information • Short run, long run issues, e.g. prices might be a short term policy only; raise price once established • As the recovery progresses, prices may rise • Recovery might have the reverse effect, as the product is 'cheap and tasteless' Extract 2 line 1, because instant coffee is seen as an inferior good • There is already much competition besides McDonald's so Via might not make much difference 	(12)

Question Number	Answer	Mark
10(c)	<p>KAA 4 marks (2 x 2 marks or 1 x 4 marks)</p> <p>Meaning of contestability e.g. in terms of low sunk costs, low barriers to entry or exit (1 mark)</p> <p>Consideration of reasons why market may be contestable: Award as 4 or 1+3 or 2+2 or or 2+1 or 1+1.</p> <ul style="list-style-type: none"> • Evidence of new entry e.g. Starbucks Via brand; McCafé espresso-based • Entry by supermarkets own label brands which have a relatively high market share (Figure 1) • Market for coffee growing so possibility of entry for niche suppliers • ‘A growing willingness among consumers to trade up to premium and speciality variants’ provides opportunities for new entrants. • ‘Growing awareness of health, wellbeing and ethical trading’ might provide opportunities for new entrants • Barriers to entry might fall as the internet has increased influence <p>Evaluation 4 marks</p> <p>Consideration of reasons why market is not contestable Award as 4 or 1+3 or 2+2 or or 2+1 or 1+1</p> <ul style="list-style-type: none"> • Highly concentrated market: Nescafe supplies over half the market which implies high barriers • Strong brand names - examples from Figure 1 - supported by heavy advertising (high sunk costs) • Cost of machinery required • Entry only by well-established firms • Patent on Via is a legal barrier • 20 years of research into Via • Extract 1 £17m promotional campaign by Nescafe <p>Candidate may take either approach (4 + 4e) or offer overall judgement, with justification.</p>	(8)

Question Number	Answer	Mark
10(d)	<p>KAA 8 marks. Award a maximum of four points: (2 + 2 + 2 + 2 or 3 + 3 + 2 marks or 4 + 4 marks or 4 + 2 + 2 + 1)</p> <p>Methods for US and UK</p> <ul style="list-style-type: none"> • Pricing strategies • Limit • Predatory • Sales maximisation • Non pricing strategies e.g. developing ‘ethical’ products or corporate social responsibility • Use of branding • Increased advertising expenditure • Avoidance of price wars (could use game theory) • Limit pricing - to deter new entrants • Merger activity to gain advantages such as economies of scale • Price competition: to increase market share • Development of new up-market brands to compete with filter coffee • Collusion or other ways to remove competition can be seen as a way to compete. <p>If no application to UK <u>and</u> US then cap 6/8 KAA marks</p> <p>Evaluation 8 marks. Award a maximum of four points: (2 + 2 + 2 + 2 or 3 + 3 + 2 marks or 4 + 4 marks or 4 + 2 + 2 + 1)</p> <ul style="list-style-type: none"> • High fixed cost associated with developing and marketing a new brand (and advertising) • Many new brands are unsuccessful • New brand might reduce market share of the company’s existing brands • Short run and long run effects • Limit pricing would reduce profits, at least in the short run • Firms might avoid price competition because of the risk of a price war. Game theory could be used to show why they do not engage in competition • Some strategies will attract the attention of the competition regulators • Assessing the wider impact of the measures e.g. redundancies <p>Quality of written communication will be assessed in this question based on the candidate’s ability:</p>	(16)

		<ul style="list-style-type: none"> • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economics vocabulary appropriately <p>To use grammar, spelling and punctuation appropriately</p>	
Level	Mark	Descriptor	
Level 1	1-3	Identification of methods	
Level 2	4-8	Identification of methods (3 marks); explanation of each (up to 5 marks)	
Level 3	9-16	Identification of methods (3 marks); explanation of each (up to 5 marks). Evaluation (3+3+2 marks)	

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