Mark Scheme (Results)

January 2012

GCE Economics (6EC03) Paper 01

Edexcel and BTEC Qualifications

Edexcel and BTEC qualifications come from Pearson, the world's leading learning company. We provide a wide range of qualifications including academic, vocational, occupational and specific programmes for employers. For further information, please call our GCE line on 0844 576 0025, our GCSE team on 0844 576 0027, or visit our qualifications website at www.edexcel.com. For information about our BTEC qualifications, please call 0844 576 0026, or visit our website at www.btec.co.uk.

If you have any subject specific questions about this specification that require the help of a subject specialist, you may find our Ask The Expert email service helpful.

Ask The Expert can be accessed online at the following link:

http://www.edexcel.com/Aboutus/contact-us/

Alternatively, you can speak directly to a subject specialist at Pearson about Edexcel qualifications on our dedicated subject Advisor telephone line: 0844 372 2187

Pearson: helping people progress, everywhere

Our aim is to help everyone progress in their lives through education. We believe in every kind of learning, for all kinds of people, wherever they are in the world. We've been involved in education for over 150 years, and by working across 70 countries, in 100 languages, we have built an international reputation for raising achievement through innovation in education. Find out more about how we can help you and your students at: www.pearson.com/uk

January 2012
Publications Code UA030333

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.

If an incorrect key has been chosen, the maximum score is 2 out of 4.
Incorrect options can be knocked out, if relevant economic reasoning is given. If more than one key is knocked out for the same reason this will earn one mark only. There must be different reasons for each knock out. Marks are **not** awarded if the rational is that 'it's not A because it is B' – there must be some valid economic rationale.
Up to two knock out marks can be awarded for each supported choice question.

Question Number	Answer	Mark
1	**A** Definition of monopsony, e.g. single or powerful buyer, (1) **role** of competition authorities (1), with application to buying of grocery supplies e.g. short shelf life of perishable products, or other supermarket products (1), supplying firms cannot make a profit (1) and explanation of market power, e.g. push down prices, exploitation of suppliers (1). Allow purchasing economies of scale (1). Consequences of monopsony power e.g. passing on lower prices to consumers, farms go out of business, greater profits to supermarkets (1+1) and results of the Commission's findings (1)	**(4)**

Question Number	Answer	Mark
2	**B** Definition or formula of AVC (1) AR>AVC or P>AVC (1) Loss minimisation (1) A business will leave the industry when it is not covering the operating costs/factors which do not have to be paid if there is no output, i.e. shut down point is AR=AVC, or similar definition (1). If it can exceed these costs it makes a contribution to fixed costs/reduces the overall costs that must be paid (up to 2 marks). In the long run it will cover all costs or shut down, or 'in the long run all costs are variable' (1 mark) application to motor industry, e.g. strong brand name is exit barrier (1 mark) Diagram up to (2 marks): 1 mark for showing shut down point, 1 mark for price/AR below AC or ATC (1) loss area (1) and/or contribution area (1)	**(4)**

Question Number	Answer	Mark
3	**A** Identification MC=MR Characteristic of perfect competition (1) Data mark: Supernormal profits (SNP) are being made/SNP is £7000 to £8000 in the short run, or profits are maximised at 6 units in the short run. (1) Annotation of diagram in the question which adds to the answer (1) Firm is a price taker/perfectly elastic demand (1) TR has a constant gradient/linear (1) Diagram showing horizontal AR/MR (1) showing SNP (1) In the long run the supernormal profits will be eroded (1) Normal profits in the long run (1). Knock out mark example: it is not E because the firm is making a profit (1)	**(4)**

Question Number	Answer	Mark
4	**C** Definition of collusion, e.g. collaboration, secret agreement (1) Identification of oligopoly/as in identification of top left box/interdependence/duopoly/prisoner's dilemma (1) Hanna Ltd undercuts Jax (1) Annotation of top right box to illustrate the answer (1) making short term gain, e.g. market share rises for Hanna (1) Hanna's revenue rises to £1200 or by £200(1). will probably lead to retaliation/Jax will cut price (1) where both end at £800 (this may be illustrated using kinked demand analysis, but this is not required) (1) Firms are better off colluding (1) Collusion is illegal/anticompetitive/leads to fines (1) Bottom right hand box is dominant strategy (allow Nash equilibrium) (1) illustrating price war (1)	**(4)**

Question Number	Answer	Mark
5	**B** Definition of diversification, e.g. widening of product range outside current areas of specialism (1) explanation of conglomerate merger (1) application, e.g. that there is little crossover between poultry and football (1). Motives for takeover (1+1): Risks are spread through diversification (1) and when one industry faces difficult times another can cross subsidise (1) risk-bearing economies of scale (1) prestige for new owners of the football club (1) entering a new geographical market (1) Possible disadvantages of decision (1)	**(4)**

Question Number	Answer	Mark
6	**D** Definition/characteristic of monopolistic competition, e.g. slightly differentiated products. (1) Explanation of *lack of* both types in efficiency (not just definitions) e.g. ' the firm is not operating at lowest cost per unit' and 'the firm is not operating to maximise welfare'. Accept formulae demonstrating $AR \neq MC$ and $AC \neq MC$(1 + 1) Application to snack food, e.g. very similar food types (1) low ability to create strong market allegiances (1) Diagram showing long run equilibrium positions (1) with reference on diagram to P=MC and/or Min AC not being achieved (1). Also credit short run diagram where this illustrates changes (2 marks)	**(4)**

Question Number	Answer	Mark
7	**C** Definition/identification of variable cost or AVC or formula (1) The firms are **inter**dependent (1) Diagram (up to 3 marks) showing rise in MC **and** AC (1) with new equilibrium price and quantity (1) and reduced profits (1), or equivalent verbal analysis (up to 3 marks), reason why output falls (1), reason why prices might rise, e.g. variable costs of production have risen (1) reason why profit falls, e.g. a smaller mark-up can be made, costs have risen (1)	**(4)**

Question Number	Answer	Mark
8	**E** Definition of monopoly or market power (1) Explanation that the horizontal integration increases market power (1) Diagram (up to 3 marks) showing constant AC and MC (1) with new equilibrium at new MR = MC (1) showing higher price on diagram (1) and lower output (1) loss of consumer surplus (1). Also award diagrams showing movement from monopolistic competition to monopoly where this clearly distinguishing the firm and industry. Or equivalent verbal analysis: Monopolisation/dominance would be reasons for raised price (1) and reasons for falling quantity (1) with examples e.g. Greggs (1) any discussion that there might be economies of scale in the long run so prices could fall, output rise (1)	**(4)**

Question Number	Answer	Mark
9(a)	**Theory (2 marks):** Action by firms in contravention of competition law (such as the 1998 Competition Act or the 2002 Enterprise Act) / illegal action (1) which works against public interest/reduces consumer surplus (1), or reduces competition in the market (1). Collusion (1), predatory pricing (1), artificial raising of barriers to entry (1) **Application (2 marks):** banks agree prices on loans (1), share information on the loan market (1) and pricing of their own loans (1), so that there is a higher interest rates charged to consumers (1), fewer loans are offered (1). Use of text e.g. 'illegally given pricing data' and fine £28m (1 + 1)	**(4)**

Question Number	Answer	Mark
9(b)	KAA 4 marks **Diagram (2 marks)** showing increased AR and MR (1) with new profit area shown (1), **or** falling AC only (if fixed costs have fallen) or AC and MC shift (if variable costs have fallen) (1)with new profit area shown (1) **Analysis/data (2 marks)**: AR and MR owing to increased demand after credit crisis, increased confidence, allows more businesses to demand loans from banks; **or** AC and/or MC costs may fall because staff costs fall , falling costs of inter-bank loans as economy recovers from credit crisis (2 marks) Evaluation 4 marks Award up to two evaluation points: 2 x 2 marks or 3+1 or 4+0 Points might include: • Lack of information provided, e.g. only first quarter profits are given • Possible impact on quality of service or worker morale • Judgement that banks are abusing their power over SMEs, e.g. charging high interest rates even though base rates have remained at an all time low, or other fairness issues • Banks are essentially nationalised, so the profits should go to the taxpayer; Extract 3 'we will not stand idly by' – the government must act • Questioning of the ceteris paribus assumption, set out as an argument. For example, costs might change as well as demand, or vice versa. Or there might be efficiency gains with new technology or redundancies but service suffers. • Profits are small in comparison with pre-credit crisis	**(8)**

	• Short run/long run issues, e.g. The firms may need to re-hire workers when full recovery takes place, recent developments 2011/12 and conditions have worsened since then, greater pressure from the government to lower profits in the future/ future punitive tax if there is no change • Advantages of profit of banks, e.g. to tax revenues? • Cost of redundancy payments	

Question Number	Answer	Mark
9(c)	KAA 6 marks Award 3 types/methods of regulation OR 3 types of efficiency for 2 marks each, or 2 x 3 marks, or a combination of the two: KAA marks are to be awarded for two/three reasoned **explanations**, either in terms of the **effects** of two/three different types of regulation on efficiency, or the **effect** of regulation on two/three types of efficiency, rather than for a simple **identification** of the types of either regulation or efficiency. • Possible examples of types of regulation include: monitoring; target setting; price capping (e.g. RPI-X); fines. • Possible types of efficiency include: productive; allocative; dynamic, x-inefficiency, with explanation (not just defined). These points may be illustrated by relevant diagrams, and KAA marks can be awarded for this. **Role** of competition authorities: to promote competition, to promote the public interest, to increase cost effectiveness (may be implicit) (1 mark) Examples of points might include: • How regulation affects costs and pricing e.g. likely to force banks to cut costs (more productive efficiency) by cutting bonuses, • likely to improve allocative efficiency as prices become lower, • increasing consumer surplus as regulators force prices down; • Impact on pay structure, Impact on banks' treatment of SMEs • Economies of scale, if linked to regulation N.b. answers might relate to OFT or Competition Commission, or other regulatory body such as the FSA or banking ombudsman, or direct intervention by government, e.g. punitive tax Evaluation 6 marks **Candidates can argue that the regulations are**	**(12)**

	advantageous or disadvantageous as evaluation marks • Now that many banks are essentially owned by the taxpayer this might change the objectives of banks • Small businesses are collectively the biggest employer in the UK, or other reasons to support SMEs • Banks should be allowed to recompense their staff in a manner that improves and rewards effectiveness which justifies the higher bonuses • Competition authorities do not have the power to address this issue • Increased regulations will make the market less contestable/efficient • Difficult to decide where P=MC • How big should the fines be • Regulatory capture • Diseconomies of scale as firms have to expand credit to SMEs, separating functions of banks to retail/wholesale • Conflict between quality of service (allocative efficiency) and reduction in costs (productive efficiency) • Firms might lose their best managers if pay is capped • Allow macro arguments if related to efficiency, e.g. banks might move abroad • conflicts inherent in some types of regulation, e.g. rate of return and efficiency • making mergers **easier** could be seen as decreasing regulation	

Question Number	Answer	Mark
9(d)*	**KAA 8 marks (award up to four points etc)** (2 + 2 + 2 + 2) or (3 + 3 + 2) or (4 + 4) Application (2): Barclays had used pricing information (1), but now they have reported it (1) Reasons might include: • To gain more market share (e.g. by cutting prices) • To damage RBS profits/image • To avoid being fined • To make more profit/revenue • Advantages of first mover If no reference to game theory or Barclays' changing behaviour then award a maximum of 6/8 KAA marks. For a well developed game theory analysis, 8/8 marks can be awarded. 2 marks for accurately labelled and contextual pay-off matrix, and 2 marks for discussion of prisoners' dilemma. **Evaluation (8) (award up to 4 points etc)** (2 + 2 + 2 + 2) or (3 + 3 + 2) or (4 + 4) • Firms unlikely to trust each other in future negotiations • Long term application of prisoners' dilemma – second rounds of the game • Problems in finding an equilibrium • Threat of fines and other actions by competition authorities might change the behaviour further • Not enough/inaccurate information provided • Use of game theory to evaluate is rewarded. • Kinked demand curve might be used to show why collusion is still more profitable • The may be other strategic reasons to break the agreement, apart from avoiding the fine • Discussion of why collusion is more likely in this market, in relation to market structure • Prioritisation of likely reasons, e.g. the fine is huge • Damage to brand image of Barclays in addition to RBS • Size of fine	**(16)**

Question Number	Answer	Mark
10(a)	**Theory 2 marks:** Identification of market structure (1) and characteristic (1): oligopoly – high levels of marketing, brand awareness, interdependence, a few firms dominate the industry, a high concentration ratio, high barriers to entry. Allow duopoly. Allow monopoly if linked to 25% market share. **Application 2 marks:** heavy use of marketing techniques, e.g. High levels of non-price competition and payment to search engines, bar chart illustrates five powerful firms, Danone and Yoplait are strong brand names, Danone and Yoplait dominate in the US, e.g. ‘’equally placed’. Lactalis’ bid of $1.76bn in $3.7bn industry. (1 + 1 or 2 marks for a well developed application.	**(4)**

Question Number	Answer	Mark
10(b)	**KAA 4 marks: Award two reasons (2 + 2)** Government intervention aims to restore or retain competition (e.g. lower prices, more choice), protect jobs, keep investment within a country, making collusion less likely. Allow macro arguments, e.g. protecting exports, economic growth, balance of payments, multiplier, tax revenue. Also allow political reasoning, such as falling employment will lose the government’s voters Evaluation 4 marks (2 +2 or 3+1 or 4+0) • There are advantages to inward investment, and mergers may benefit employment prospects if the firm is more secure when merged • such protectionism may encourage inefficiency • The buying of the firm might not change where the firm is located so tax revenues, employment, balance of payments etc. might not change • Government should **not** be concerned because cross-subsidisation might improve consumer welfare • Only 50% of the business will be sold, so the foreign buyer will not have controlling rights • magnitude of unemployment • reference to frailty in current economic climate	**(8)**

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>10(c)</td><td>
KAA 6 marks (2+2+2 or 4+2 or 3+3)
Benefits for PepsiCo (up to 4 marks):

Economies of scale (different forms might count as two factors),
Other benefits of diversification
Improve ‘healthy’ image
Emerging US market – increased potential for profit
Spreading risk
Buying into a ready-made distribution network, via General Mills

Benefits for consumers (up to 4 marks):

Increased choice and availability
Lower prices if cross subsidisation/economies of scale occurs with consequent welfare implications
Improved quality owing to innovation/investment by cross subsidisation
Can allow credit for consumers as employees
Improved health?

Cap at 4/6 marks if only one stakeholder is discussed

Evaluation 6 marks (2+2+2 or 3+2+1 or 3+3)
Costs for PepsiCo:

Lack of expertise in new markets
diseconomies of scale, e.g. Management problems, communication problems
Cost of takeover – potential damage to share price
PepsiCo will not gain complete control – PAI Partners are only selling 50%
Risk of investigation by competition authorities

Costs for consumers:

Increased prices/loss of consumer surplus
Increased price in the long run as market power/marketing costs increase
Health risks of Pepsi are blurred

Allow credit for all the usual evaluation points.
</td><td>(12)</td></tr>
</table>

Question Number	Answer	Mark
10(d)*	**KAA 8 marks Award up to four factors 2+2+2+2 or 3+3+2 or 4+4** Points might include: Pricing strategies: • Competition might make firms increase output and reduce prices; • predatory pricing, • limit pricing, • sales max pricing, • collusion • Competition might drive down profits so firms may have to cut costs or raise price to retain profitability, • temporary offers to reduce prices, allow BOGOF Increased non-price competition, for example: • coupons, • advertising, • website development, • investment in quality, • widening product range, • loyalty schemes, • BOGOF, • mergers, • collusion • social networking sites There may be no reaction Some firms may leave the industry Generously award the use of game theory, but not required for this question. 2 marks for accurately labelled and contextual pay-off matrix. Cap at 6/8 marks if no use of data **Evaluation 8 marks Award up to four factors 2+2+2+2 or 3+3+2 or 4+4** Firms might keep prices stable (e.g. kinked demand analysis), increase advertising (increase costs); operating at a loss on some products might catch the attention of the competition authorities (fines etc) Evaluation might take the form of a critique of game theory or other approaches • Distinction between *all* yogurts and Greek yogurt	**(16)**

	• Firms might keep prices stable (e.g. kinked demand analysis), increase advertising (increase costs); • operating at a loss on some products might catch the attention of the competition authorities (fines etc) • Other factors are not equal – e.g. in a recession the market may require higher levels of advertising or risk taking, or lower marketing costs if advertisers are keen to attract business • the reaction may be different in some countries than others, e.g. China vs US, or other use of data • predatory pricing/collusion illegal and would attract a large fine • barriers to entry e.g. economies of scale/reputation/advertising • *Yoplait Greek* made a sudden but very significant entry into the market – they might leave just as quickly • Barriers to entry are low once the brand name Yoplait is already established, other contestability issues such as questioning the costs of setting up production of new product • There may be no reaction (can be used as an evaluative point as a critique) e.g. because the firms are interdependent (this might be developed using game theory or kinked demand analysis) • Comment on the efficacy of non-price competition, • Critical development using game theory, e.g. price war, prisoners' dilemma • Prioritisation, e.g. non-price behaviour is more likely because it is an oligopoly • importance of behaviour/need to respond in short run/long run	

Item number	AO1	AO2	AO3	AO4	Total
1	2	1	1		4
2	2	1	1		4
3	2	1	1		4
4	2	1	1		4
5	2	1	1		4
6	2	1	1		4
7	2	1	1		4
8	2	1	1		4
9a	2	2			4
9b		2	2	4	8
9c		2	4	6	12
9d		4	4	8	16
10a	2	2			4
10b		2	2	4	8
10c		2	4	6	12
10d		4	4	8	16
TOTAL	18	18	18	18	

Further copies of this publication are available from
Edexcel Publications, Adamsway, Mansfield, Notts, NG18 4FN

Telephone 01623 467467
Fax 01623 450481
Email publication.orders@edexcel.com

Order Code UA030333 January 2012

For more information on Edexcel qualifications, please visit
www.edexcel.com/quals

Pearson Education Limited. Registered company number 872828
with its registered office at Edinburgh Gate, Harlow, Essex CM20 2JE

Llywodraeth Cynulliad Cymru
Welsh Assembly Government

Rewarding Learning