

Mark Scheme (Results)

Summer 2014

Pearson Edexcel GCE  
in GCE Economics (6EC03/01R)

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## 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.

**Knockout marks:**

Candidates can be awarded up to 2 marks, 1 per point, for knocking out incorrect answers. This only counts if they have given a valid economic reason to go with their answer, where they have added value to the question.

E.g. for question 1, explaining it's not horizontal integration because that is where you merge/takeover a firm at the same stage in the production process/industry.

Candidates can also receive knockout marks without explicitly selecting a letter, if it's a clear reference is made to a **key**.

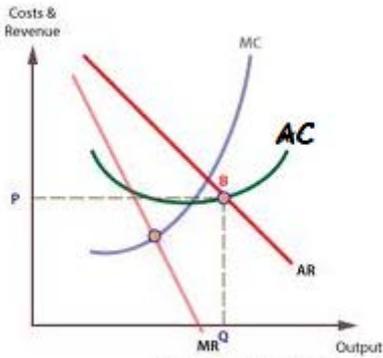
When the key is wrong a maximum of only 2 marks can be awarded (0+2)

Question Number	Answer	Mark
1	C	1
	Definition of forward vertical: merging with a firm at a <b>later stage</b> (e.g. closer to the customer, further away from the production stage) (1) of the same <b>production process</b> (1). Advantages to Ford might include: concentrated outlet, dedicated sales force, stronger brand awareness, barrier to entry raised/preventing competitors accessing the Arnold Clark show room (1+1). Allow 1 mark for likely impact on consumers e.g. less/restricted choice, higher prices (1).	3

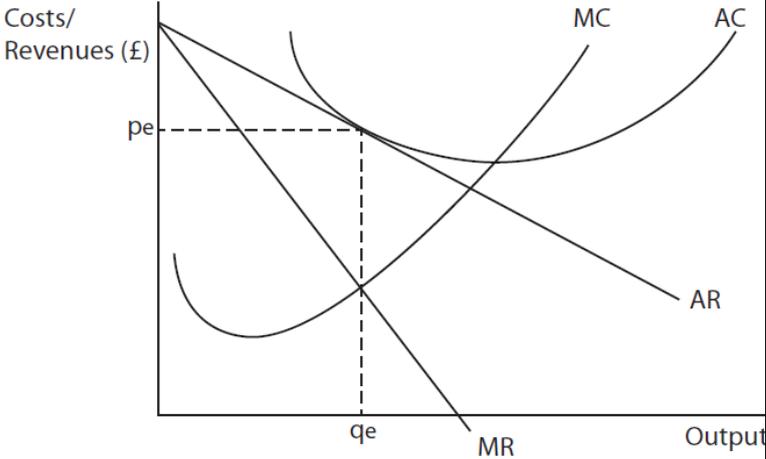
Question Number	Answer	Mark
2	D	1
	Perfect competition defined, or one characteristic (1), firm is making a loss ( $AC > AR$ ) (1) but $AR$ is covering $AVC$ so it is making a contribution (1) to fixed costs (1). In the long run it will leave the industry, if total costs unchanged (1). Shading of the diagram to show loss (1) and/or contribution area (1) and firms leaving the industry diagram (supply shifts left) with consequent higher price (1).	3

Question Number	Answer	Mark
3	C	1
	<p>Definition of supernormal profit, eg <math>P &gt; AC</math> or <math>(AR - AC) \times \text{quantity}</math> or <math>TR - TC</math> (1); profit maximisation occurs at <math>MC = MR</math> (1); use of marginal analysis; filling in columns correctly up to 4 units, see table below (1 mark for each correct column at least to output of 4 units)</p> <p>Example of rejection marks: it cannot be B because profit at output of 2 is £19 000.</p>	3

Output per week	Total revenue (£'000s)	Marginal revenue (£'000s)	Total cost (£'000s)	Marginal costs (£'000s)	Total profit (£'000s)
0	0	-	10	-	-10
1	20	20	14	4	6
2	38	18	19	5	19
3	54	16	28	9	26
4	68	14	42	14	26
5	80	12	63	21	17
6	90	10	93	30	-3

Question Number	Answer	Mark
4	C	1
	<p>Normal profits defined (e.g. the minimum necessary to keep resources in their current uses) (1); sales maximisation is <math>AC = AR</math> (1); rationale of the tyre company, e.g. to increase market share or knock out competition or limit pricing used as a barrier to entry (1+1). Diagram showing <math>AC = AR</math> (if not already awarded) (1) and the level of output marked (1)</p> 	3

Question Number	Answer	Mark
5	A	1
	<p>Identification of non-price competition, of which loyalty schemes are an example (1) Meaning of 'tacit' e.g. implicit, implied collaboration, informal (1). Firms are in an oligopoly/other sense of interdependence (1), reasons for tendency to collude, e.g. kinked demand so that when prices rise demand is elastic, and when prices fall demand is inelastic (1) with resulting loss in revenue (+1); firms try to avoid price wars (1); reasons for falling profits e.g. supermarkets have economies of scale (1). Collusion is illegal (1)</p>	3

Question Number	Answer	Mark
6	E	1
	<p>Characteristic/definition of monopolistic competition e.g. slightly differentiated goods, many firms, low barriers to entry (1)</p> <p>If there are supernormal profits, new firms will enter the industry (1)</p> <p>Normal profits defined (e.g. the minimum necessary to keep resources in their current uses) (1)</p> <p>Diagram showing long run monopolistic competition with <math>AR=AC</math> (1) at <math>MC=MR</math> output (1)</p>  <p>Example of rejection mark: it is not A because it operates where <math>AR=AC</math> which although at <math>MC=MR</math> this is not <math>AR=MC</math>.</p>	3

Question Number	Answer	Mark
7	E	1
	Large firms can increase monopoly power (1) meaning they have more control over price and output (1); increased competition (or preventing it being reduced) means that there are lower prices and more choice (1); application – the merged firm would have a market share of 34.9% (1) post merger the 2 firm concentration ratio would be 74.8% (1); cost of merger (nearly \$1 billion) is a sign of barriers to entry (1); role of competition authority – Federal Trade Commission (1)	3

Question Number	Answer	Mark
8	B	1
	Bensel will cut price because it gains higher returns (1) identification of overt collusion (1) Price war (1) with use of pay off matrix bottom right hand box (Nash's equilibrium) (1); long run possible return to top left hand box (Pareto optimum) (1); collusion is illegal (1); cut in prices when demand is relatively inelastic leads to lower total revenue (1); identification of oligopolistic market (1)	3

Question Number	Answer	Mark
Item 9a	Theory 2 marks: Oligopoly/Duopoly (1) – a few firms dominate the market (1) or interdependent (1) Monopoly (1) – single firm dominates the market (1) or abuses market power (1) Application 2 marks: Concentration ratio calculation(allow from 2 - 8 firms) (2); or other use of data, e.g. Otis is a strong brand name (1) very high fixed cost of manufacturing elevators (1); monopoly defined as more than 25% market share (1) plus Otis 27% (1)	4

Question Number	Answer	Mark
9b	<p>Types of barriers to entry and explanation (2+2) or (3+1):</p> <ul style="list-style-type: none"> <li>• high start up costs</li> <li>• network of consumers with low PED/high brand loyalty</li> <li>• knowledge and expertise of elevator manufacture</li> <li>• award comments on exit barriers, e.g. difficulty of selling off parts of the business. (Baumol: Entry barriers can be reduced to exit barriers.)</li> <li>• High CR means that firms have more market power</li> <li>• Higher super normal profits – with consequent arguments relating to profit</li> <li>• High CR might occur because of economies of scale – evidence in passages, e.g. economies of scale from increased standardisation of elevators</li> <li>• Minimum efficient scale arguments</li> </ul> <p>Barriers could be considered from the viewpoint of consumers, firms or other stakeholders. Candidates can analyse/evaluate either way on barriers being significant or otherwise.</p> <p><b>Evaluation</b> (2+2 or 3+1 or 4+0):</p> <ul style="list-style-type: none"> <li>• there are signs that the market will become more contestable e.g technological advances or competition authority rulings</li> <li>• the fines and other legal challenges mean that firms might be more welcoming to new entrants</li> <li>• difficult to know/lack of information</li> <li>• how cartel members rigged procurement contracts with a link to barriers to entry.</li> <li>• reference could be made to the relative impact on consumer and producer surplus</li> <li>• consideration of impact on price and loss of consumer surplus</li> <li>• magnitude of barriers</li> </ul>	8

Question Number	Answer	Mark
9c	<p><b>KAA 6 marks</b></p> <p>Award 2 reasons (2+2) or (1+3) Reasons for selling the mills:</p> <ul style="list-style-type: none"> <li>• loss of 1.8 billion euros, accounting for large part of 6 billion euros debt</li> <li>• Price below AVC, not covering variable costs</li> <li>• to raise finance to buy new companies and expand</li> <li>• to consolidate the business – remove inefficiency</li> <li>• to allow the firm to focus/specialise in areas it has most profitability/potential</li> <li>• selling off parts of the business as viable business concern before it becomes unsellable</li> </ul> <p>Diagram (2) showing <math>AC &gt; AR</math> (1) at profit maximising output <math>MC = MR</math> (1)</p> <p>Do not award more than 4/6 KAA marks if there is no diagram or reference to the data. For example of application: Extract 1 eg productive inefficiency, excess capacity, 'worst investment in the company's recent history'.</p> <p><b>Evaluation:</b> Award 3 factors up to 2 marks each or 2 reasons (3+3)</p> <ul style="list-style-type: none"> <li>• the mills are being sold at a loss. Is it a good time to sell? Are they still covering their AVC</li> <li>• benefits of vertical integration, e.g. vertical supply lines are ensured, competition is prevented, costs of supply will not have the intermediary mark up</li> <li>• The inefficiencies in the business could have been addressed and profits could have been made in the future.</li> <li>• May be a short-sighted decision. As the world economy recovers the demand, price and profits/losses of the plant may improve</li> <li>• The closing of the mills may result in loss of reputation for other parts of the business. <ul style="list-style-type: none"> <li>• The closure is probably a combination of many factors, inefficiency, excess capacity, lack of expertise, lack of finance, all of which made the closure inevitable</li> <li>• The effectiveness of authorities/regulatory capture</li> <li>• To what extent are new firms deterred from entry</li> <li>• Are the fines sufficient to deter uncompetitive practices?</li> </ul> </li> </ul>	

Question Number	Answer	Mark
9d	<p>KAA 8 marks</p> <p>Role of competition authorities – promote competition in consumer interest (1)</p> <p>Award 4 factors up to 2 marks each or 3 reasons (3+3+2) or (4 + 4)</p> <ul style="list-style-type: none"> <li>• Degree of competition/cartel/concentration ratio – e.g. rigged bids for contracts and shared information.</li> <li>• Is there collusion? Bidding practices/fixing prices</li> <li>• The public interest. Impact on consumer and producer surplus.</li> <li>• Discussion of barriers to entry in elevator industry (may refer to natural monopoly, but this term is not required)</li> <li>• Problems of regulation – regulatory capture</li> <li>• Asymmetric information</li> <li>• Government failure</li> <li>• Domestic vs global regulation powers</li> </ul> <p>Evaluation 8 marks</p> <p>Award 4 factors up to 2 marks each or 3 reasons (3+3+2) or (4 + 4)</p> <ul style="list-style-type: none"> <li>• size of fines can be very large</li> <li>• other regulatory powers can be very significant, e.g. jail terms for directors</li> <li>• some regulators do have expertise (symmetric information)</li> <li>• some kinds of regulation are more effective than others</li> <li>• Degree of competition/cartel/concentration ratio</li> <li>• Is there collusion? Bidding practices/fixing prices</li> <li>• The public interest. Impact on consumer and producer surplus.</li> <li>• Examine the contestability in the elevator industry.</li> <li>• The effectiveness of authorities/regulatory capture</li> <li>• To what extent are new firms deterred from entry</li> <li>• Are the fines sufficient to deter uncompetitive practices?</li> </ul>	(16)

Question 10 Supermarkets

Question Number	Answer	Mark
10a	<p>Theory (2) – surplus capacity means that the firm could sell more without increased fixed costs (1); average fixed cost/average cost rises (1) as less is sold with the same total fixed cost/total cost (1); TC relative to Q rises (1) why Q falls or TC rises (1+1). This can be shown by an upward shift in AC or AFC or an upward movement back along the AC curve (1).</p> <p>Application (2): Use of data might include consumers ‘falling out of love with hypermarkets (1) due to reason such as: transport cost, budgeting, online competition, discount store competition (1 + 1); hypermarkets are sharing outlets – “shop in shop...recognition...surplus space” (1), Tesco’s trying to get closer to consumers by buying coffee selling outlet H+H, buying Giraffe for £50 million (1) there are fewer hypermarkets (1)</p>	(4)
10b	<p>KAA 4 marks Award 2+2 or 3+1 Benefits of growth to H+H:</p> <ul style="list-style-type: none"> <li>• increased profits,</li> <li>• increased market share,</li> <li>• increased incomes for owners, access to shop space</li> <li>• stability of the firm through economic cycle, access to finance.</li> </ul> <p>Evaluation 4 marks. Award up to 2 factors (2+2) or (3+1). These may be the disadvantages of a link with Tesco, or other evaluative comments. Points might include:</p> <ul style="list-style-type: none"> <li>• The firm might lose its ‘artisan’ feel</li> <li>• Some people boycott/dislike Tesco on principle</li> <li>• Other problems of size – lack of dynamism, diseconomies of scale</li> <li>• Tesco is already experiencing falling profits <i>Candidates may suggest that H+H linking up with a company losing market share may not be a good idea. But Tesco is still by far the largest of the supermarkets.</i></li> <li>• Tesco’s short-termism means they take H+H profits rather than investing in them</li> <li>• Competitors respond</li> </ul>	(8)

Question Number	Answer	Mark
10c	<p>KAA 6 marks  For explanation award up to 4 marks.  Award 2 factors up to 2 marks each, or (3+1). There must be more than one reason.</p> <p><b>Demand</b> has decreased with falling demand from online competition, and Britons 'falling out of love with supermarkets'. More competition from other firms means demand has fallen, e.g. rise of Lidl. <b>Cost</b> of acquisition of H+H and other brands mentioned in the extracts or other. Other cost rises.</p> <p>Reserve 2 marks for diagram:  Diagram (award up to 2 marks) (AR and MR shift left (1) with new profit area (1)  And/or AC and MC rise (1) with new profit area (1) (if variable costs changing) or just AC rising if fixed costs changing  Or static diagram showing loss area when profit maximising (1)</p> <p>Do not award more than 4/6 KAA marks if there is no diagram or reference to the data.</p> <p>For evaluation 6 marks:  Award 3 factors up to 2 marks each or 2 reasons (3+3)</p> <ul style="list-style-type: none"> <li>• Difficult to know the magnitude of the demand or cost shifts, which is most significant, or other weighing together of factors</li> <li>• This might be over-optimistic about end of recession</li> <li>• Difficult to know – need more information such as trend figures or profitability before 2012</li> <li>• Tesco's future strategy may be successful resulting in increased profits and market share</li> <li>• The fall in profits may be temporary. For many years Tesco's market share and profits have been growing and may continue in the future</li> <li>• Tesco's retaliate online or discount stores</li> </ul>	(12)

Question Number	Answer	Mark
10d	<p>KAA 8 marks Award 4 factors up to 2 marks each or 3 reasons (3+3+2)</p> <p>Price strategies – predatory, limit, revenue maximisation (MR=0), BOGOF, cost plus, price discrimination. <b>Must be linked to revenue increases</b>, e.g. in the long run for predatory pricing Non-price strategies – loyalty cards, good sales information, after sales service, friendly service. <b>Must be justified as to why revenue increases</b></p> <p>Other factors might include:</p> <ul style="list-style-type: none"> <li>• The monopsonistic pressure put on suppliers to reduce cost which can then be passed on to consumers</li> <li>• The effect of pricing strategies may involve examination of PED/YED, for example groceries have low YED</li> <li>• The effect on total revenue of diversification eg banking, electrical goods pharmaceuticals etc. with high YED.</li> <li>• Collusive behaviour, use of game theory - price fixing, non price strategies</li> </ul> <p>Award maximum of 6/8 marks if no reference to price or non price competition or supermarkets.</p> <p>Evaluation 8 marks. Award 4 factors up to 2 marks each or 3 reasons (3+3+2)</p> <ul style="list-style-type: none"> <li>• Some policies might fail,</li> <li>• Depends on the actions of other firms (game theory might be used) – prisoners’ dilemma, whistle blowing, price war</li> <li>• Some policies such as collusion are illegal so will face fines</li> <li>• Cost of policies might outweigh the benefits, e.g. advertising</li> <li>• As real incomes have fallen over the past 5 years diversification may be counterproductive. ie demand may fall more than proportionately</li> <li>• Could raise revenues by opening new stores BUT profits may fall due to higher costs</li> </ul>	(16)



