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Mark Scheme (Standardisation)

Summer 2008

GCE

GCE Economics (6354/01)

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General Marking Guidance

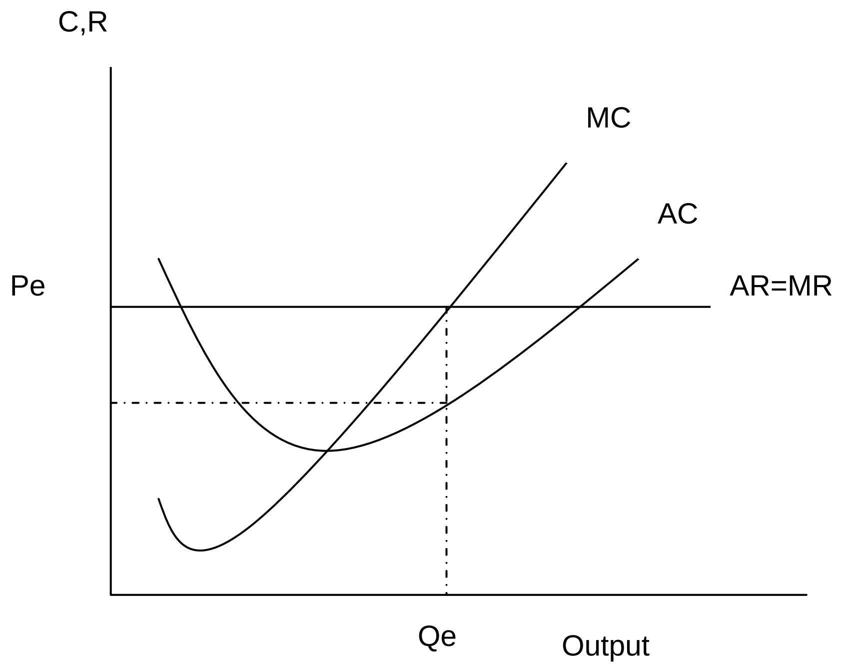
- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should 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.

Supported multiple-choice

Note: If incorrect key is selected, award a maximum of 2 explanation marks.

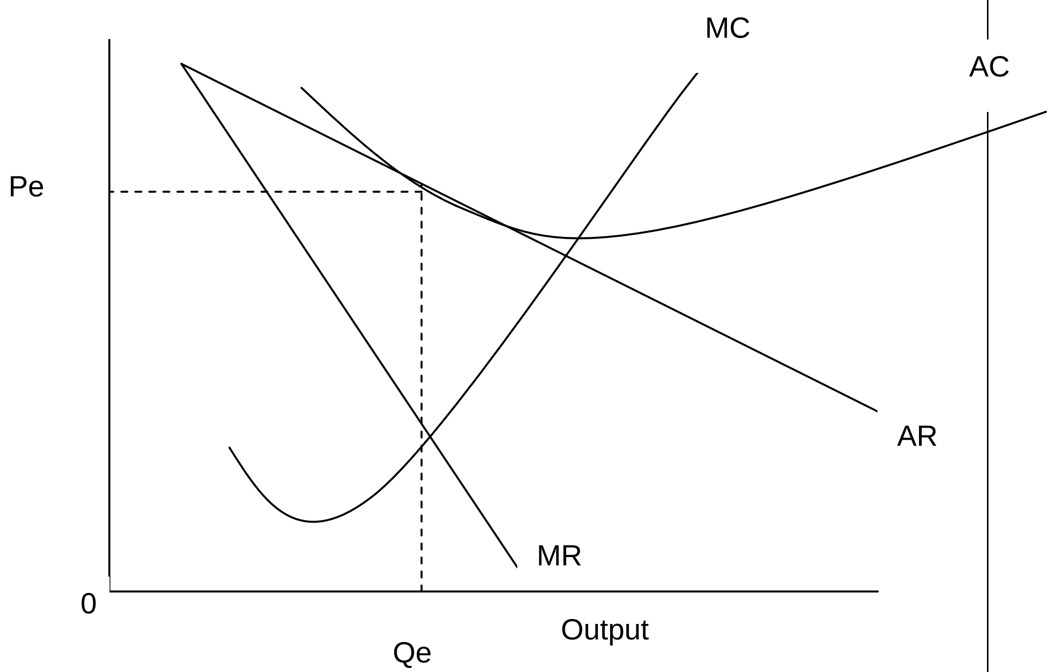
Note: Up to 2 marks are available (1+1) for explaining up to two incorrect options.

Question Number	Answer	Mark
1	C ➢ Application - the merger between British Energy and Drax would lead to 28% market share (candidate must state 28% to gain the mark) **(1).** ➢ Reference to a monopoly / legal monopoly is 25% or more market share – **must be explicit (1).** ➢ Role of Competition Commission is to protect public interest / consumer interest by promoting competition within markets **or** explanation of an advantage of competition in terms of lower prices & greater consumer choice **(1).**	**(1)** **(3)**

• Question • Number	• Answer	• Mark
• **2**	• C ➢ Definition of marginal profit (the addition to total profit from one more unit of output) **(1).** ➢ Marginal cost equals marginal revenue is profit maximisation. **(1)**. ➢ Marginal analysis: a change in output will lead to either marginal costs exceeding marginal revenue or vice-versa **(1).** ➢ Total profits are maximised so marginal profit must be zero (**1**). ➢ Application - correct diagram of perfectly competitive firm in short run equilibrium making supernormal profits **(1).** 	• **(1)** • **(3)**

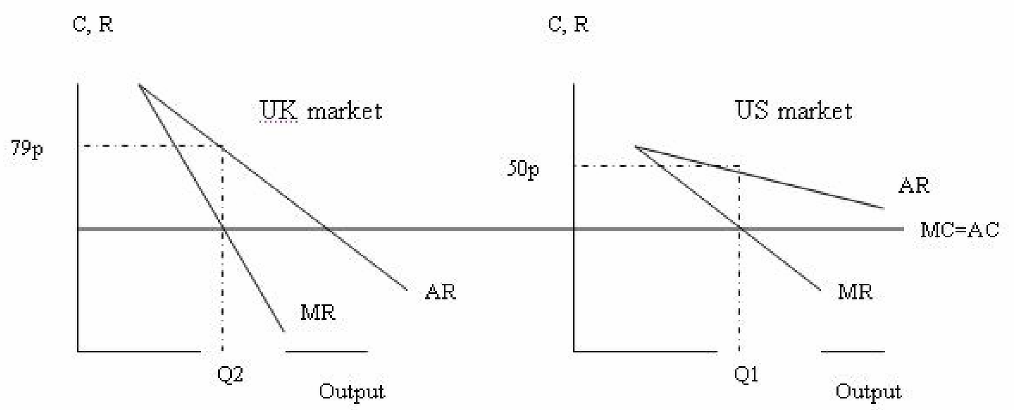
Question Number	Answer	Mark
3	E ➢ Definition of fixed cost or formula of average fixed cost (Total fixed cost ÷ total output **or** fixed cost per unit of output) **or** annotation on diagram, showing total fixed costs as a horizontal line **(1).** ➢ Application - correct calculation: £10,000 ÷ 1000 = £10 **(2).** (**NB** 1 mark for identifying fixed cost	**(1)** **(3)**

	as £10,000). ➢ NB a maximum of 2 marks from calculation.	

Question Number	Answer	Mark
4	E ➢ Low entry & exit barriers mean firms can enter the market and compete the supernormal profits away in long run /so only make supernormal profits in the short run **(1).** ➢ Application – correct diagram of monopolistically competitive firm in long run equilibrium **(1)**.  ➢ Application to plumbing services e.g. product differentiation as different kinds of plumbing services such as gas central heating / water / sewerage / reputation of plumber **(1).** ➢ Definition of normal profits (minimum profit required to keep resources in their current use) **or** idea that total revenue equals total cost **or** price equals average cost **(1).**	**(1)** **(3)**

Question Number	Answer	Mark
5	D ➢ Revenue maximisation is where average revenue multiplied by output is at a maximum **(1)**. ➢ Application – the diagram shows the total revenue curve is at the highest point / the gradient is zero / diagram showing a falling MR curve and being equal to zero when TR is maximised **(1)** ➢ Revenue maximisation is the output where marginal revenue is zero (MR=0) **(1)**. ➢ Marginal analysis: for example, to the left of output Qe MR is positive / TR is rising, to the right MR is negative / TR is falling (**1**). **Also award** candidates who knock out up to two incorrect options for two marks e.g. ➢ Key 'A' is incorrect as this is where total revenue equals total cost / break even point **(1)**. ➢ Key 'B' is incorrect since profit maximisation is at output Q3 **(1)**. ➢ Key 'C' is incorrect since sales maximisation is at output Q5 **(1)**. ➢ Key 'E' is incorrect since allocative efficiency is output where MC=Price **(1)**.	**(1)** **(3)**

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>6</td><td>E

Conditions of price discrimination:
Ability separate iPod consumers into different markets and prevent leakage / prevent resale (prevent arbitrage) (1).
Apple has monopoly power over iPod sales so consumers have little alternative (1).
Different price elasticities of demand exist between UK and US markets (1).
Also development:
Explanation of more price inelastic demand for UK than US consumers, thus a higher price for UK than US consumers (this may be shown by diagram) (1).


Note: at least two conditions for price discrimination are required for full marks.

Note: No marks awarded for definition of price discrimination as it is already in the question.</td><td>(1)

(3)</td></tr>
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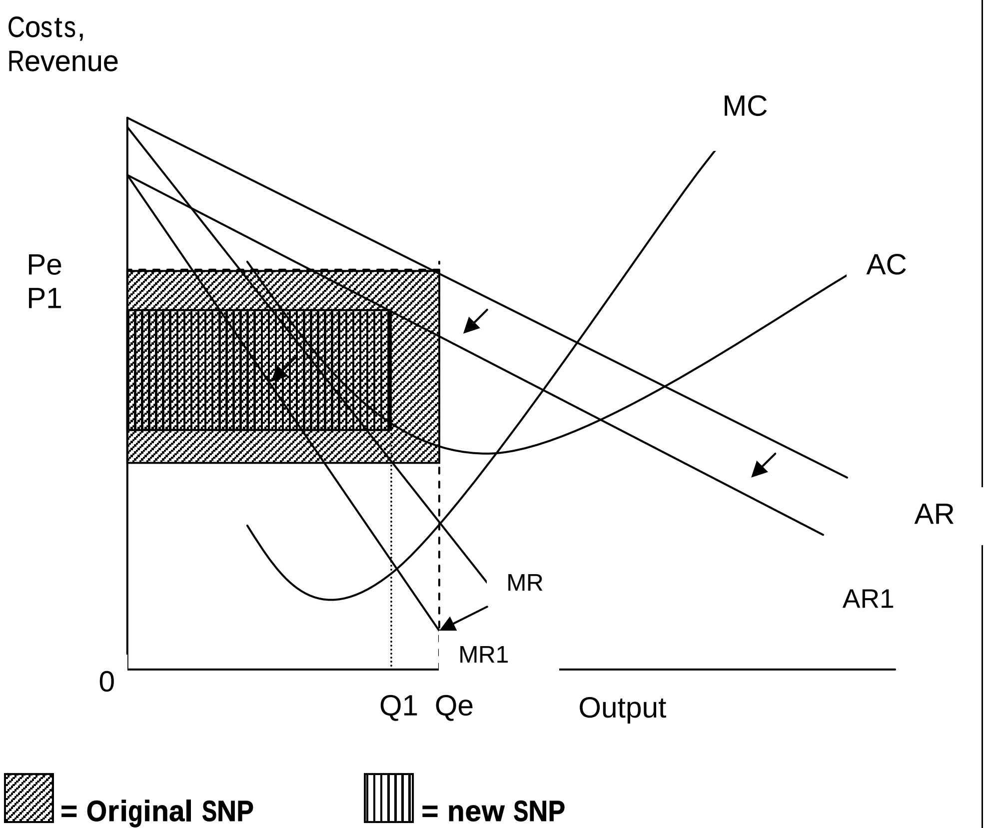
Question Number	Answer	Mark
7	B ➢ RPI is the retail price index / measure of inflation (**1**). ➢ Application – Water bill Increase in nominal terms by 7% **or** nominal terms mean a rise in the money price **(1)**. ➢ Application - Water bill increase in real terms by 3.1% **or** explanation of real terms (water bill increase at a faster rate than inflation) **(1)**. ➢ Explanation of role of regulator (to promote competition or mimic competition / protect consumer interest) **or** 'k' means water bills allowed to rise at a faster rate than inflation in order for firms to have sufficient funds for improving quality of water / service **(1)**. ➢ If candidate explains the meaning of real and nominal price increases with full use of the data, award full marks. **Note:** No mark awarded for discussion of 'x' as an efficiency gain.	**(1)** **(3)**

Question Number	Answer	Mark
8	C ➢ Definition: predatory pricing (firm sets price below average cost) (also accept price below average variable cost). **(1)**. ➢ Reason: – the intention of Intel is to knock-out rival firm(s) to gain market share / monopoly power / higher profits **(1)**. (Do not accept the term 'decrease competition' on its own as this is the key). ➢ Feature of predatory pricing e.g. a temporary loss is made and firm can raise price back up to make profits once rival firm(s) knocked out **(1)**. ➢ Diagram showing predatory pricing **(1)**.	**(1)** **(3)**

	Note: No mark for stating predatory pricing is illegal.	

Question Number	Answer	Mark
9	A Application to diagram showing: ➢ A decease in average revenue marginal revenue curves e.g. from AR and MR to AR1 and MR1 **(1)**. ➢ A lower price and output e.g. from Pe to P1 and Qe to Q1**(1)**. ➢ A decrease in profits **(1)** e.g. shown graphically the new profit area.  **If no application to diagram, award a maximum of (1+1) explanation marks**.	**(1)** **(3)**

Question Number	Answer	Mark
10	B Definition of sunk costs (fixed costs which cannot be recovered by firm on exit from an industry) **(1)**. Application – the £8 million advertising expenditure has created brand loyalty / led to lower price elasticity of demand, which will deter new entrants **(1)**. **NB Merely stating advertising is a sunk cost does not merit a mark.** One other example of sunk costs: high start up costs in terms of factory & machinery / weak second hand market / economies of scale achieved by Coca Cola / difficulty in obtaining market outlets **(1)**.	**(1)** **(3)**

Question Number	Answer	Mark
11(a)	➢ Market structure is an oligopoly **(1)**. ➢ Definition: 'Few sellers and many buyers' / 'large scale industry dominated by a few firms' / 'A few large firms' **(1)**. ➢ Reference to data e.g. for Figure 1, a concentration ratio can be calculated **(1)**. NB a precise calculation is required. Six firm concentration ratio of 71.9%. Five firm concentration ratio of 65.4%. Four firm concentration ratio of 54.5%. Three firm concentration ratio of 42.0%.	**(3)**

Question Number	Answer	Mark
11(b)(i)	➢ Horizontal integration **(1).** ➢ Two firms merge at the same stage of production / BOD accept same level of production **(1)**. ➢ One example from the text or figure 1 e.g Lloyds merger with TSB, Santander Bank takeover of Abbey, or Royal Bank of Scotland taking over National Westminster Bank **(1)**.	**(3)**

Question Number	Answer	Mark
11(b)(ii)	Four or more factors required **(2+2+2+2)** at least one advantage and one disadvantage for full marks. Each factor identified needs to be explained for 2 marks. **If just one side considered then cap this section at 6 marks.** **NB Only give credit for advantages / disadvantages for those firms involved in the merger i.e. not consumers, not other banks.** Advantages include: ➢ Types of economies of scale (managerial, technical, purchasing, marketing, financial, risk-bearing). Each type can be classed as one factor. ➢ Cost savings through rationalisation e.g. closure of unprofitable bank branches. ➢ Increase market share (a fast way to grow) / total revenue / profits. ➢ Higher share price & dividends. ➢ Reduce competition / create barriers to entry / compete more effectively with larger banks. ➢ Award 1 mark for diagrammatic analysis of lower costs leading to higher profits. Disadvantages include: ➢ Types of diseconomies of scale (managerial, coordination). ➢ Redundancy costs from rationalisation programme. ➢ Merger / takeover cost. ➢ Hostile takeover. ➢ Bad publicity of takeover may harm brand. ➢ Eligibility of future OFT enquiry and/or referral to the Competition Commission. **Evaluation (2+2)** ➢ A conclusion that sums up the arguments. ➢ Prioritise between the advantages and disadvantages. ➢ Magnitude – do the advantages outweigh the disadvantages to banks? ➢ Time factor: the long run benefits could outweigh the short run costs involved with a merger.	**(12)**

Question Number	Answer	Mark
11(c)	**Explanation and application (2+2+2+1) or up to 3 marks for a very well developed point. A minimum of three points are required for achieving 7 marks.** ➢ Data application e.g. major loss of consumer welfare in inner cities and rural areas **(1).** ➢ Data application to Figure 2 e.g. Britain already has fewer bank branches per million people than other selected countries – this implies more branches are required **(1).** **2 or 3 marks for each well developed point e.g.** ➢ Choice of banks / bank branches in an area. ➢ Distance from local branch means more time and travel cost. ➢ Bank branch could have local monopoly power so raise charges / fees. ➢ Quality of service / product innovation. ➢ Quality of provision has become more unequal – could be undesirable consequences in creating pockets of poverty. **If no evaluation then award up to a maximum of 7 marks.** **Total evaluation marks available 5: (Up to 3 marks for a well developed evaluative point - this means at least 2 evaluation points required for full marks).** **Arguments for an increase and decrease in consumer welfare in the same response is considered as evaluation.** ➢ Magnitude of decline since 1995 – huge since -20% or 4,041 branch closures. ➢ Time factor – the decline might be part of a long term trend which could be a major concern. ➢ Prioritisation of factors affecting consumer welfare. Impact on consumer welfare is variable ➢ Branch closures may enable bank to improve service at remaining branches / cut costs / increase size / extend opening hours. ➢ Growth of internet and telephone banking may mean the branch closures is less of an issue – **-** extract mentions that internet banking is very popular so bank branch closures have little impact for regular internet bank users. ➢ Some consumers may gain e.g. 1,074 new branches opened up though mainly in out-of-town shopping centres and business parks in prosperous south east.	

	➢ The information does not include building societies – so hard to assess impact of bank branch closures.	**(12)**

Question Number	Answer	Mark
11(d)	➢ Profits are likely to fall **(1)** and development of this point e.g. the firm may be ordered to refund customers / the refunds mean higher costs to the banks / profits may not fall too much since they also make profits in other areas **(1).** ➢ Application to extract e.g. £2.6 billion already paid out to 3.8 million customers **(1)**. ➢ Application to extract: another million claims to be settled, depending on the OFT / High Court decision so profits likely to fall **(1)**. ➢ Also award for role of OFT in promoting competition/ protecting consumer interest / fines of up to 10 per cent of annual turnover **(1).** ➢ Also award relevant diagram showing falling profits **(1).**	**(4)**

Question Number	Answer	Mark
11(e)	**Identification and development of entry barrier (1+1)** ➢ The entry barriers may include: high start-up costs; economies of scale; brand loyalty to existing firms; asymmetrical information; technological barriers; cultural barriers; limit pricing; Bank of England license/regulation. **(2+2)**. **NB Do not accept predatory pricing as an entry barrier** **Evaluation (2)** ➢ Possible to overcome 'high start-up costs' if firm has significant financial resources such as Santander bank. ➢ Possible to overcome brand loyalty by taking over existing UK firm. ➢ Possible to reduce problem of asymmetrical information by taking over existing UK firm. ➢ Technological / cultural barriers could prove to be long term problems. ➢ Magnitude - overall impact on performance of firm e.g. revenue, costs and profits; sales growth. ➢ Prioritise between the two barriers – which one is the most significant and why?	**(6)**

Question Number	Answer	Mark
12(a)	**Cap 2 marks maximum without data reference.** ➢ Application to extract / Figure 1, for example, Wrigley's market share has fallen from 98.5% to 84% so monopoly power falling / nearly 100% but falling **(1).** **Further points include:** ➢ Identification of monopoly **(1).** ➢ Definition of monopoly e.g. a single seller of a good **/** Wrigley has more than 25% of the market share **(1)**. ➢ Market moving towards a duopoly / oligopoly **(1)**.	**(3)**

Question Number	Answer	Mark
12(b)	**Any three of the following points (2+2+2):** ➢ Cadbury purchased Adams, a chewing gum company **(1)** so able to quickly gain expertise in the market **(1)**. ➢ Cadbury's £10 million advertising campaign **(1)**. This raised consumer awareness of Trident brand / creating demand **(1)**. ➢ £20 million spent on perfecting product **(1)**. This created a high quality product that consumers are buying / offers choice to consumers **(1)**. ➢ Cadbury is an established firm in confectionary **(1)**. For example a distribution network / application of appropriate economies of scale / Trident brand is available in many retail outlets and so makes it highly accessible to consumers **(1)**.	**(6)**

Question Number	Answer	Mark
12(c)	**Three or more factors required, at least one advantage and one disadvantage (2+2+2).** **If just one side considered, award a maximum of 4 marks in this section.** Advantages include: ➢ Application of economies of scale e.g. risk-bearing, marketing, managerial, technical, purchasing, financial. (Accept two types of scale economies as two separate factors if answered well). ➢ Possible for company to cross-subsidise brands. ➢ Easy to launch new products due to existing distribution networks. ➢ Brand name of Cadbury makes it easier to produce a range of products. ➢ It may provide continued sales / profits growth when traditional product markets reach saturation point. Disadvantages include: ➢ Application of diseconomies of scale e.g. managerial / co-ordination problems alienation from end product. ➢ Lack of expertise in production of individual goods. Company may spread its resources too thinly so cannot properly fund products. ➢ Currency fluctuations could affect internal transactions and profits. Asymmetric information in different markets. ➢ Salmonella scare has damaged reputation of Cadbury brands. **Evaluation (2)** ➢ Prioritise between the advantages and disadvantages (including limitations of them). ➢ Magnitude – do the advantages outweigh the disadvantages of producing different goods in different markets? ➢ Time factor: the long run benefits could outweigh the short run costs involved with launching new products into markets.	**(8)**

Question Number	Answer	Mark
12(d)	Three or more consequences required, at least one for producers and one for consumers **(2+2+2)**. **If just one group considered, award a maximum of 4 marks in this section.** **The focus of the answer should be on a price war rather than non-price competition.** Producers ➢ Impact on / revenue / sales (Kinked demand curve may be used here). ➢ Impact on profits / losses may even be made in extreme cases. ➢ Firms may attempt to cut costs e.g. raw materials and labour. ➢ Impact on investment and product development / less funds available. ➢ Deter market entry / Perfetti may be reluctant to enter market. ➢ Impact on share price and shareholder dividends. ➢ Reduce producer surplus. Consumers ➢ Impact on consumer surplus – will increase. ➢ Impact on consumer perception of gum if price is very low. ➢ Product quality may fall if producers cut costs e.g. source inferior ingredients. ➢ is price inelastic in demand - a price war will cause a fall in total revenue to producers. **Evaluation (2+2)** ➢ Time - difficulty in ending price war. ➢ Magnitude of price war – how large are the price cuts and does this lead to losses and eventual market exit? This is unlikely as both firms have invested heavily and have high sunk costs. Candidates may bring in the idea of predatory pricing here and its effectiveness. ➢ Consumer surplus may increase in the short run but decrease in the long run. ➢ Impact on consumer choice in long run if firms exit market. ➢ It may lead to increased monopoly power in long run / higher prices / and less efficiency in production. ➢ Price war is unlikely to lead to a significant growth in sales since market has been declining over recent years. ➢ Chewing gum is a relatively small part of consumer expenditure and so the benefit is relatively small.	

	➢ Will collusion occur in long run as firms agree not to compete on price?	**(10)**

Question Number	Answer	Mark
12(e)	**This can be argued both ways and a candidate that does this also evaluates:** Award up to **3 marks** for one side of argument; if both sides considered award a further **2 marks** for evaluation. **NB If no application to confectionary manufacturers award a maximum of 4 marks.** **Consumer welfare not damaged since:** ➢ High profit margins may reflect that consumers are prepared to pay for product. ➢ High profit margins enable firms to invest into new product development (£20m) and so consumer welfare may increase in long run. ➢ Confectionary products are relatively insignificant to consumer welfare – especially chewing gum which accounts for a tiny percentage of a consumer's income. **Consumer welfare damaged since:** ➢ Time factor – if high profit margins remain in long run then this suggests the market is not working properly and that consumers are exploited (depends on whether monopoly profits or normal profits made). ➢ More consumer surplus captured by firms – a disadvantage to consumer welfare. ➢ Magnitude – the extract states that Wrigley achieved 30% profit on turnover which is very high. This suggests consumers are being exploited. ➢ A theoretical approach is acceptable e.g. price set above marginal cost resulting in allocative inefficiency.	**(5)**

Question Number	Answer	Mark
12(f)	➢ Definition of contestable market in terms of low entry & exit barriers / low sunk costs (or understanding of the term) **(1)**. **Note: Candidates that argue for and against contestability effectively evaluate and so be prepared to award maximum marks:** **NB Award up to 2 marks for each factor but if only one side of the argument given, maximum 5 marks.** **The market is unlikely to be contestable since** ➢ High start-up costs in terms of capital - factory & machinery. ➢ Research & development costs - Cadbury Schweppes spent over £20 million on perfecting Trident brand. ➢ High advertising costs - Cadbury Schweppes spent £10 million in first few weeks for the launch of Trident). ➢ Strong brand loyalty – Wrigley has been in UK for almost 100 years / synonymous with chewing gum / main sponsor of TV programmes & Premiership. ➢ Economies of scale for Wrigley through having such a large production (still 84% market share). ➢ A new entrant will require strong retail distribution network – very few firms have this. ➢ Price war between Wrigley and Cadbury Schweppes will deter new entrants e.g. Perfetti. **The market may be contestable since**: ➢ Cadbury successfully entered the market. ➢ A large firm may have substantial financial resources; also it might be possible to recover some of the marketing costs by selling brands on to another company (note Cadbury is seeking to sell Schweppes - its soft drinks division in US). ➢ A niche market could be developed and so avoiding direct brand competition e.g. Cadbury is focusing on use of sweet flavours in chewing gum while Wrigley remains focused on spearmint & health related gum. **Also accept as evaluation** ➢ Magnitude of the barriers - e.g. the size of the advertising expenditure / research & development costs. ➢ Advertising / branding expenditure may recovered if firm is able to sell rand names on. ➢ Time – it took almost 100 years before a major competitor appeared to rival Wrigley. This suggests the market is not contestable. ➢ Prioritise – what is the most significant entry barrier and why? ➢ Data provision – require specific data to answer	

	question e.g. access to retail distribution outlets is key to successful entry.	**(8)**

Unit 4: Assessment Objectives Grid for June 2008

Question	Knowledge	Application	Analysis	Evaluation	Total
Section A					
Qu.1	2	1	1		**4**
Qu.2	1	1	1	1	**4**
Qu.3	2	1	1		**4**
Qu.4	2	1	1		**4**
Qu.5	2	1	1		**4**
Qu.6	1	1	1	1	**4**
Qu.7	1	1	1	1	**4**
Qu.8	1	1	1	1	**4**
Qu.9	2	1	1		**4**
Qu.10	1	1	1	1	**4**
Total	**15**	**10**	**10**	**5**	**40**
Section B					
Qu.11 (a)	1	1	1		**3**
Qu.11 (bi)	1	1	1		**3**
Qu.11 (bii)		2	6	4	**12**
Qu.11 (c)	1	2	4	5	**12**
Qu.11 (d)		2	2		**4**
Qu.11 (e)	2	2		2	**6**
Total	**5**	**10**	**14**	**11**	**40**
Qu.12 (a)	1	1	1		**3**
Qu.12 (b)		3	3		**6**
Qu.12 (c)		2	4	2	**8**
Qu.12 (d)	2	2	2	4	**10**
Qu.12 (e)	1		2	2	**5**
Qu.12 (f)	1	2	2	3	**8**
Total	**5**	**10**	**14**	**11**	**40**
Grand Total A+B	**20**	**20**	**24**	**16**	**80**