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Mark Scheme (Results)

January 2013

GCE Economics (6EC03/01)

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January 2013
Publications Code UA034388

General Marking Guidance

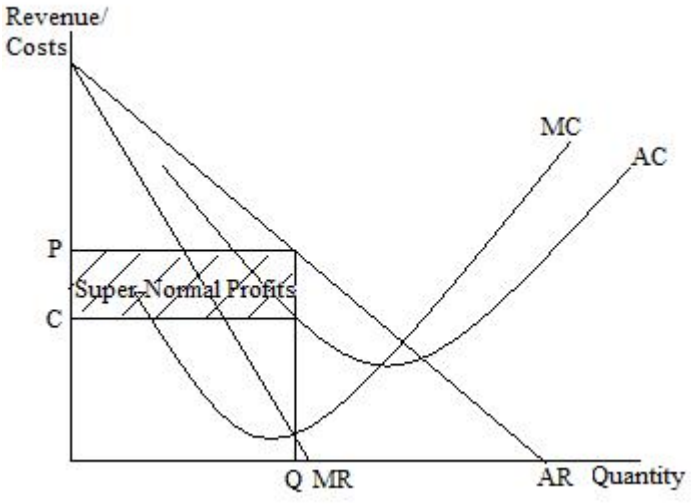
- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should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

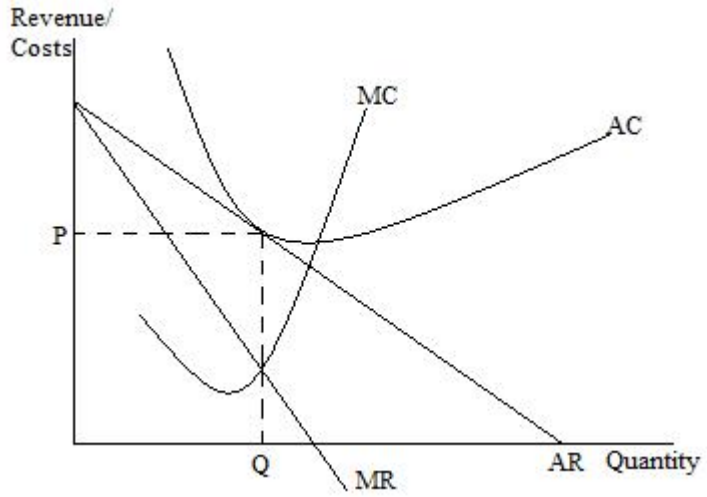
If an incorrect key has been chosen, the maximum score is 2 out of 4.

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 rationale 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	**D** Definition/identification backwards vertical meaning: the production is at a different stage (1) but moving closer to the raw materials or supplies end of the process, or previous stage (1). Application, e.g. coal is raw material, used to make, a component of steel (1) Benefits to the firm, e.g. control of supplies, prevent other firms from using the coal, buying the coal more cheaply, capture the profit from the coal company (1+1)	**(4)**

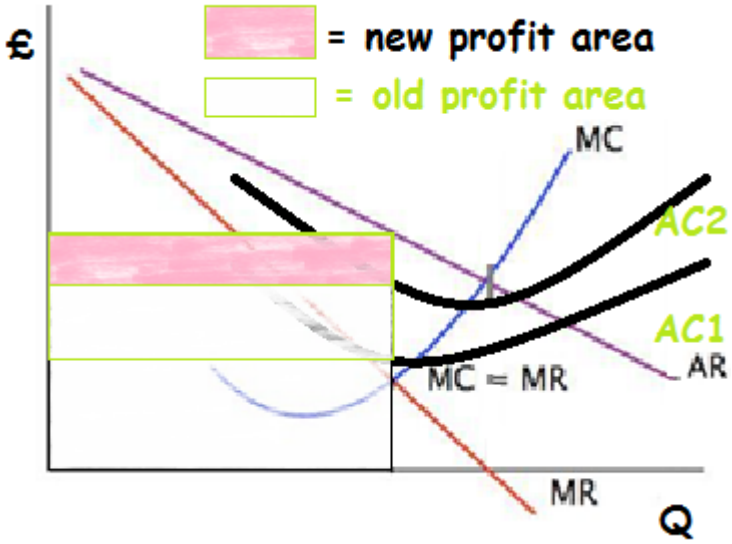
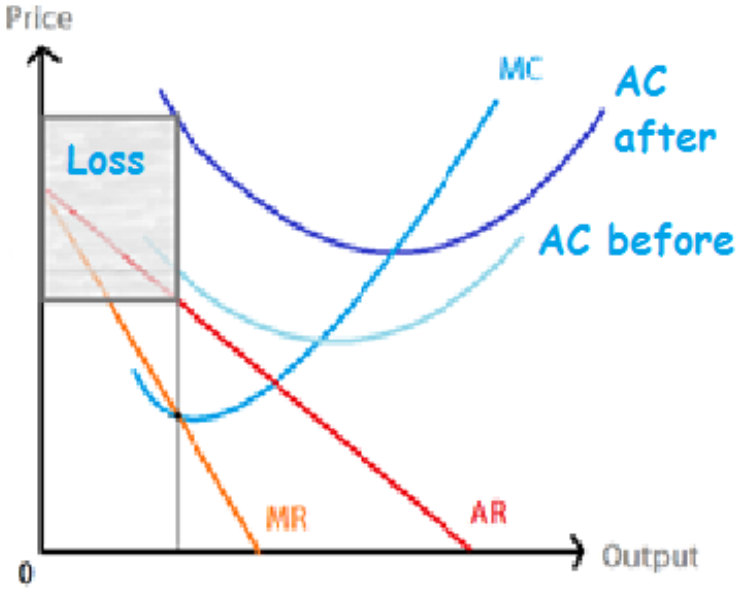
Question Number	Answer	Mark
2	**C** Definition/identification mark: Identification of perfect competition (1). Explanation that profit maximisation is MC=MR (1). Characteristics of perfect competition (1): AR=MR or perfectly elastic demand, price taker, low barriers to entry, homogenous product, lots of firms in the industry. Application e.g. that it is difficult to distinguish potatoes according which farm they were produced on (1) Diagram: showing horizontal AR=MR (1) **with** output occurs where MC=MR (1) Example of elimination mark: Knock out of A that she cannot sell as much as she can produce because costs will rise Knock out of B: not a monopoly because there are many firms in the industry	**(4)**

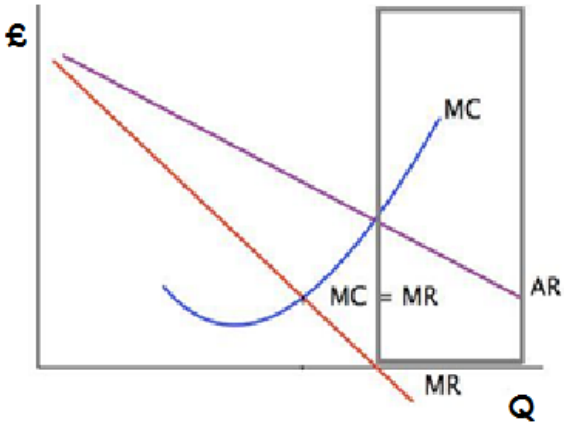
Question Number	Answer	Mark
3	**C** Definition/identification mark: price setting power, e.g. downward sloping demand curve, or average revenue downward sloping, or AR slopes downwards, firms can raise or lower price and still sell its product, or shared supernormal profits in the short run (1) Characteristic of monopolist as a single seller, one firm dominates, high barriers to entry, firm=market (1) Characteristic of monopolistic competition, e.g. as a market with many sellers, slightly differentiated products, (1) Application mark (1) e.g. examples of a monopolistically competitive firm, such as fast food outlets Further development marks can be awarded for: discussion that the price elasticity of demand is lower for monopoly, or less price elastic. Diagram or diagrams can earn up to 2 marks. Downward sloping AR (1) and difference between the models (1) illustrated below: for monopoly (which is equivalent to the diagram for monopolistic competition in the short run):  Diagram for Monopolistic competition in the long run. Note the AC is a tangent with AR:	**(4)**

	 Example of elimination mark: Knock out of A because monopoly has high entry barriers Not D as only monopoly can make supernormal profit in the long run	

Question Number	Answer	Mark
4	**C** Definition/identification mark: revenue maximisation: MR=0 is revenue maximisation or verbal identification that the firm cannot make any more money (1) Annotation of diagram **or** as written analysis: Total revenue is 0KHZ/shading of this area (1) with output at 0Z (1). Diagram: parabola shaped TR, upside-down U (1) and if this is connected to MR=0 or Z on the question (1) Application: There will be empty spaces in the car park (1) but if car park is full total revenue is lower (1). Further explanation marks: use of marginal analysis, e.g. if prices were cut total revenue would fall, and if prices were raised total revenue would fall (1) If calculation is shown, to scale, then award for total revenue, output and knockout marks, as appropriate (up to 3 marks). Example of elimination mark: Knock out of B as this is sales maximisation (1) Knock out of A as this would mean there is no revenue (1)	**(4)**

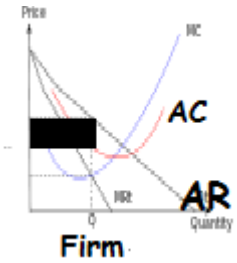
Question Number	Answer	Mark
5	**D** Definition/identification mark: The product is the same but the users are charged a different price. (1) Conditions for price discrimination (1). Rationale e.g. different elasticities of demand (1) and the women have more elastic/higher value PED than men (1) Diagram of price discrimination up to 2 marks: low price elasticity of demand for men, high price elasticity of demand for women (1) showing *high prices* in the low PED male sub-market and *low prices* in the high PED female sub-market (1) Application mark (1): women are charged less to attract them when they have more choices of entertainment, or other relevant application of the other keys Benefits to the firm (1): increased profit Further analysis mark (1+1): discussion of costs of keeping market separate, no resale between sub-market, discussion of product discrimination Example of elimination mark: Knock out of A, B, C or E as they are different products, with application (1) Knock out of A, B, C or E because there are different production costs (1)	**(4)**
Question Number	Answer	Mark
6	**B** Definition/identification mark: fixed costs, e.g. costs which do not change with output, firms must pay these even if they shut down (1) MC=MR written or explicitly labelled on diagram (1) Fixed costs do not affect MC (1) so there is no change in MC=MR (1). Application that fixed costs do not affect MC so finding marginal profit is not affected by setting up costs of the aircraft (1) Diagram (up to 2 marks) or equivalent verbal analysis, showing a shift upwards in **average costs**	**(4)**

	(or **fixed costs)** ***do not award shift mark if MC is shifted*** (1); falling profit area and/or price and output unchanged (1). Diagram can show smaller profit area:  Or a loss  Example of elimination mark: Knock out of A because costs rising mean that profits fall (1)	

Question Number	Answer	Mark
7	**B** Definition/identification mark: total revenue, marginal cost, e.g. ΔTC/ΔQ, or formula or definition of price elasticity of demand PED (1) Explanation of price **inelastic** demand (in context of the question), e.g. if prices are cut then demand rises by a smaller proportion. Cutting price when demand is relatively inelastic means total revenue falls, or MR<0 (1) Explanation of the Law of Diminishing Returns e.g. output cannot rise without rising marginal cost, or, as variable factors are applied to a **fixed** factor (1) the increase in costs eventually rises (1) Diagram (up to 2 marks) showing MR < 0 (1) and MC rising (1)  (The grey rectangle on diagram is range of operation) Further analysis mark (1) e.g. marginal profit increases if output is reduced, or firm is not rational if it operates where MR<0 Example of elimination mark: Knock out of A or C because economies of scale are long run concepts Knock out of D: if costs rose and revenue fell, profits would fall	**(4)**

Question Number	Answer	Mark
8	**A** Definition/identification mark: Definition or LRAC diagram of economies of scale or diseconomies of scale (1) Explanation of demerger, e.g. that a firm decides to split into separate firms (1) Reasons for demerger: for example lowers range of functions in a business which may reduce costs, or avoid the attention of the competition authorities, increased returns or share value for shareholders (1+1) Application of diseconomies of scale e.g. unwieldiness, coordination problems, communication problems, culture clash, fall in management costs, lack of synergy (1+1) **Diagram** output FALLING (1) and costs FALLING (1). Example of elimination mark: Knock out of C because TalkTalk have lost their exclusive retail outlet in the demerger Knock out of D because it will be easier for other firms to enter the market.	**(4)**

Question Number	Answer	Mark
9(a)	Theory 2 marks: Sense of lease, rent or pay-as-you-go (1) Major projects or infrastructure, built by private sector, government uses the resource, long term, 25-30 years, a form of partnership between private and public sector, or public private partnership (1) Application 2 marks: Reference to data (1+1) • 700 major items • £70 billion of capital • hospitals • schools • prisons • new roads • private sector takes the risk • PFI pays fines • Olympic Delivery Authority delivered 2012 Games • McAlpine lost £100 million on Dudley hospital • Jubilee Line extension/collapse of Metronet • Fire Control Centre – nine regional sites/£342 million • Contracts cannot be got out of except at high expense • 22 NHS trusts use of PFI for building	**(4)**

Question Number	Answer	Mark
9(b)	KAA 4 (2 + 2 diagram) Monopoly diagram showing AR>AC or TR>TC (2) Correct MC=MR output level determining price (1) and profit area (1)  Firm (Shaded black rectangle is profit area.) Explanation (2 marks 2+0 or 1+1) • Price of contract is fixed over a long period, so if costs are cut the firm makes supernormal profit (2) • If PFI operator can cut costs e.g. through poor service, or using cheaper materials • If PFI can raise revenue through high maintenance charges then profits rise (2) • Bid rigging at the start to ensure supernormal profits (2) • Barriers to entry once contract has begun meaning the market is uncontestable/closed (2) • No risk of a new entrant, no need to cut prices; therefore monopoly can charge higher prices than if there were competition (it is a price maker) (2) • Private sector can cut costs by being more efficient, e.g. if there are financial economies of scale (2) • Extract 2 line 11 Firms can increase charges in line with inflation Award reference to data (up to 1 mark) e.g. once the contract is signed, firms operate in an uncontestable market (line 20), or 71% Extract 2 line 19. Evaluation 4 marks (2 + 2 or 3 + 1 or 4 + 0) • sometimes they make a loss – use of McAlpine (Extract 1 line 10) etc from the data to support this • profits might be appropriate to the transfer of	**(8)**

	risk involved • risk involved is hard to quantify • profits can be a good thing, e.g. increasing efficiency, or through investment and economies of scale • can be fined if not completed on time or at to high quality • private sector borrowing costs are higher Extract 1 line 13 • supernormal profits are needed as an incentive to bid. Rates of return must be comparable with other private investment projects • process of bidding is expensive and most fail • long term fixed contract could mean larger downside risks and the PFI firm is responsible for losses • tendering process is (at least theoretically) competitive so this might reduce supernormal profit • tendering might lead to bids being too low which compromises viability	

Question Number	Answer	Mark
9(c)*	KAA (6) Award best 3 factors 2 + 2 + 2 or 3 + 2 + 1 or 3 + 3 • Projects are high specification, and built on time • Projects arrive more quickly than by traditional procurement processes • Projects are often in supporting health or education which will improve productive capacity, increase economic growth and can therefore be funded out of future incomes that the projects help to generate • Services are guaranteed 20-25 years ahead • Shorter waiting times, better service, efficient use of modern technology or IT • Government spending is reduced in the short run. Opportunity cost arguments, for example in discussing what else the money could be used for • Taxes are lower in the short run • Macro benefits e.g. increased employment, multiplier • PFI firms pay tax which in theory could make the projects cheaper overall for the government • If projects are over-budget the private firm pays the bill, so taxes are lower overall • Lower risk (where consumer is the government) If no application using the data provided then cap the KAA at 5/6 e.g. Olympic Delivery was successful ***Consumers may be regarded as the government or final consumer or both*** Evaluation (6) Award best 3 factors 2 + 2 + 2 or 3 + 2 + 1 or 3 + 3 *Allow a broad range of responses. This may be **costs** to consumers, or other evaluative approaches.* • Longer patient delays (Extract 2 line 15) • Other service issues (Ext 2) • Infrastructure is not designed to last more than the length of the contract. • Computer project had to be abandoned (Extract 2) • Costs are much higher (with use of data to support this) (Extract 1) • Projects have to be paid for even if they are not used, or built to the wrong specifications e.g. fire	**(12)**

	control centres (Extract 1) • Higher taxes in future: The costs fall heavily on future generations • Difficult to adjust to changes, e.g. population changes, renegotiating contracts impossible to get out of except at enormous expense (Extract 1) • opportunity cost of projects • consumers as taxpayers may not get value for money or allocative efficiency • answers may be illustrated with welfare loss diagram • short term/long term issues e.g. political benefits in the short run, economic costs in the long run • PFI is a one way bet – either the government picks up the pieces or the government pays costs which are too high, i.e. lower risk to the firm • Collusion in the tendering process? • Government failure: conflicts with other objectives, e.g. through lower worker wages in the private sector, temporary employment contracts	

Question Number	Answer	Mark
9(d)*	KAA 8 Award best four points or fewer e.g. 2 + 2 + 2 + 2 or 3 + 3 + 2 or 4 + 4 • Price capping (ref Extract 1 final paragraph). Allow as more than one point, e.g. RPI-X and RPI+K • Regulation • Deregulation (ref Extract 1 final paragraph) • Promotion of contestability or removing of barriers to entry, e.g. giving grants and tax breaks to small firms, removing legal barriers • Performance targeting • Privatisation • Competition policy, mergers and acquisition policy, e.g. use of fines • Nationalisation • Entry into wider competition • Contracting out • Rate of return regulation, or profit capping • Windfall tax • Monitoring of prices • Investigation of unfair or anti-competitive behaviour/collusion • The government can increase awareness of inefficiency, by bringing to the public's	

	attention actions which are likely to damage their reputation. E.g. 'name and shame' Evaluation (8) Award best four points or fewer e.g. 2 + 2 + 2 + 2 or 3 + 3 + 2 or 4 + 4 • inconsistency of nationalisation/privatisation • firms do a better job if they know they must sink or swim, so saving firms such as banks means that firms become complacent • efficiency is not always a good thing – does it cost in terms of jobs? • deregulation could be used as an evaluation of regulation, or vice versa. Banks might be a good example. • price capping could be a disincentive for investment, may reduce efficiency in the future • regulatory capture • information asymmetry • other Government failure, e.g. targeting causing problems in other areas, high cost of implementation, administration costs (can count as more than one point) • monitoring targets can fail unless anything is done • allow high should X be, and for how long before it is negotiated • there fines big enough to have any effect? Or are they too big? • natural monopoly arguments ***Do not award reference to PFI in KAA marks, but as a point of reference in evaluation, reference to PFI is permitted.***	**(16)**

Question Number	Answer	Mark
10(a)	Theory 2 marks Award **one** reason. Award 1 mark for identification for a reason and 1 mark for explanation of why this is a benefit. Reasons might include: To integrate vertically. This might be backwards (closer to raw materials) or forwards (closer to customer) e.g. to absorb profit margin Economies of scale **if type given** e.g. managerial, financial, technical Cut intermediary costs Remove suppliers, information from competitors Reduce contestability Gain profit – know their customers **even** better Remove the risk that Dunnhumby might go out of business or be bought out by another firm, reduce over-dependence Application: Reference to data (2) gain customer knowledge, Extract 1 line 17 'detailed knowledge of 15 m', lines 18-19 'opening a lead over UK supermarket rivals', reconnecting with customer line 10, loyalty cards as example	**(4)**

Question Number	Answer	Mark
10(b)	KAA 4 marks (2 + 2 diagram) Definition/explanation that hairdressing is likely to be monopolistic competition (1) Other market structures allowed if justified. There may be a reference to loyalty (for monopoly). Diagram (2 marks reserved for this): downward sloping AR (with short run/long run diagram, if monopolistic competition (1) showing supernormal profits or normal profit indicated if long run(1); allow monopoly diagram (may be a local monopoly). Explanation (up to 2 marks) • customers are unlikely to leave is a sign that high prices can be charged, i.e. they have price setting powers • inelastic demand/brand loyalty means that people do not shop around • there are cheaper or more convenient alternatives but people do not go there • allow use of other data not from paragraph 1. Four-firm concentration ratio in Fig 1. • use of non-price competition to improve loyalty line 8 • cutting prices does not increase demand (extract 2 line 6) • allow start-up costs, training costs Evaluation (4) – counter-argument to the above. This can be arguing that profits are high, low or there is normal profit. (2 + 2 or 3 + 1 or 4 + 0) • long run profits are only normal profits as new firms enter the industry (if it has been argued that there are short run profits in the industry)	**(8)**

	• some hairdressers are highly profitable e.g. the franchises (if it has been argued that profits tend to be low) • the low pay is not because of the market structure but for other reasons, e.g. it is a highly contestable market • if the top stylists leave, profits plummet • associated products of hairdressing might be more profitable, e.g. nails • Hairdressers' encompasses a wide range of products • changes in recession? – more people cut their own hair or colour their own hair • variability across the industry – different hairdressers operating in different sub-markets, e.g. male, female	

Question Number	Answer	Mark
10(c)*	KAA (6) Award best 3 strategies applied to the industry of your choice: 2 + 2 + 2 or 3 + 2 + 1 or 3 + 3 Award appropriate use of game theory up to 6 marks, reserving at least 2 marks for game theory. If no game theory used the marks are capped at 4/6 KAA marks. This might take the form of: • 2 marks for a **suitable and applied** pay-off matrix • **explanation** of interdependent firms basing their decisions on likely reactions of other • undercutting or betraying rivals • prisoner's dilemma explained in context of consumer loyalty **Strategies** award the best 3 strategies. These might include: • price strategies (can count as more than one factor) e.g. predatory pricing, limit pricing, sales maximisation, if linked to loyalty, coupons, undercutting or raising prices • non-price strategies applied to the chosen industry (can count as more than one factor) e.g. advertising, BOGOF techniques: after sales service, loyalty cards, free delivery, online ordering, free gifts, guarantees, customer service, click and collect • product development e.g. linked goods • collusion – firms might fix a tendering process to ensure contractors stay with certain customers • merging – use of name such as Tesco can increase customer loyalty at convenience stores, or to remove competition If no reference to any industry then cap at 5/6 KAA marks. Evaluation (6) Award best 3 factors 2 + 2 + 2 or 3 + 2 + 1 or 3 + 3 • problems of pricing strategies. These might be explained using game theory, e.g. that price cutting might lead to a price war • cost and sometimes ineffectiveness of non-price strategies e.g. loyalty schemes cost money	**(12)**

	• illegality of collusion/risk of fines/being subject to negative publicity • costs and other problems of merging, e.g. lack of synergies • short run/long run issues, e.g. how long does the loyalty last. Does it last as long as the offer runs? • External shocks to loyalty, e.g. bad publicity, 'horseburgers' • Kinked demand curve may be used • Other firms may simply copy strategy so the strategy won't work. Game theory equilibrium points could be used to develop the evaluation.	

Question Number	Answer	Mark
10(d)*	KAA (8) Award best four points or fewer e.g. 2 + 2 + 2 + 2 or 3 + 3 + 2 or 4 + 4 **Allow arguments for why firms dominate as KAA and reasons why they do not dominate as evaluation, or vice versa.** KAA For large retailers dominating: **Reasons** must be given for dominance. No marks awarding for simply stating that there is dominance, e.g. it is an oligopoly. • High barriers to entry e.g. supermarkets have strong brand image or network, statutory barriers such as health and safety regulation • Vertical integration e.g. control of suppliers • Monopsony power • Greater potential for collusion or price leadership • Supermarkets have become umbrella shopping experience • High sunk costs • Use of price competition – limit pricing, predatory pricing, price discrimination • Use of non-price competition • Economies of scale (may count as more than one factor) • Ability to use pricing and non-pricing policies to establish market revenue and profits • Low level of contestability in the industry • Benefits of growth (may count as more than one factor): o Gain market power to influence price and output decisions o Survival is driven by cost advantages, so mergers are more likely o Increased market share/ sales o Increased profit margins o Avoid the threat of being taken over themselves (becoming too big to buy out) Use of data, e.g. large firms can use loyalty cards to track their customers, 76.1% concentration ratio in Figure 1 (1+1) Evaluation (8) Award best four points or fewer e.g. 2 + 2 + 2 + 2 or 3 + 3 + 2 or 4 + 4. Reasons may	

	involve the reverse of the above, for example that there are many firms competing rather than dominating in the food retailing industry/or there is market dominance in the hairdressing industry Evaluation: For small firms: • Hairdressers can do very little to increase loyalty – not cost effective • No significant economies of scale • People want hairdressers to be in town centres, which might mean capacity/cost constraints • High level of contestability in the industry • Need to train staff, and keep them keen • People want personal individual services from hairdressers • Niche market/unscaleable business • Low minimum efficient scale • Lack of resources to get bigger – need to buy in expensive stylists which can't be afforded • Lack of motivation – they are lifestyle choices, satisficing • There are substitutes for hairdressing – more choice (cut at home) and less frequent, therefore higher PED • Tax thresholds and VAT registration can keep businesses small Other evaluation factors might include: • 3.9% of market share is not controlled by large supermarkets – there are many small firms with low barriers to entry • diseconomies of scale (may count as more than one factor) • use of data, e.g. hairdressing customers are 70% truly loyal • small firms advantages – more dynamic, respond quickly to change, tighter management • extract makes it clear that non-price competition is not very effective • same theory might be used to show difficulties of increasing loyalty • niche markets in retailing mean some firms are very small	**(16)**

	• some industries with small firms have low levels of contestability e.g. customer loyalty to stylists (extract 2) • some industries with large firms have high levels of contestability, e.g. online retailing • franchises in hairdressing do in fact dominate the market e.g. Tony and Guy	

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Order Code UA034388 January 2013

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