Mark Scheme (Results)

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GCE Economics (6EC03) Paper 01

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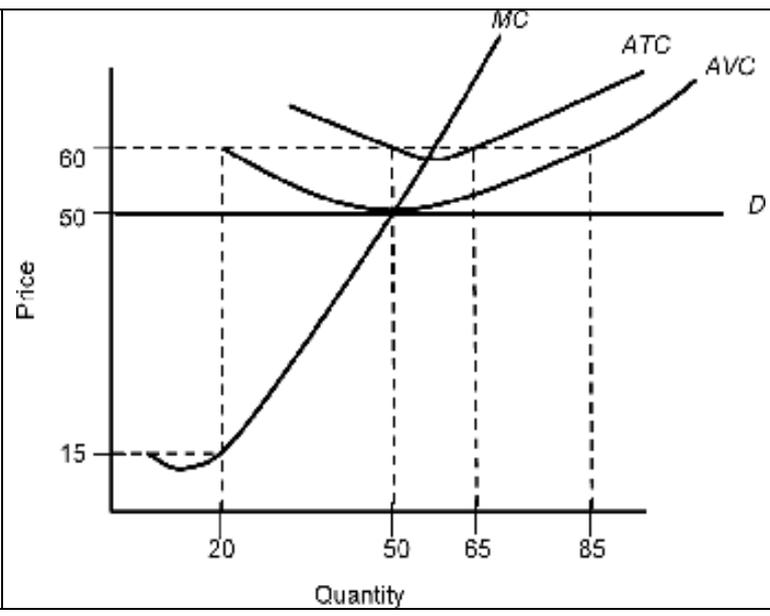You can also telephone 0844 372 2187 to speak to a member of our subject advisor team.

If an incorrect key has been chosen, the explanation can earn up to 3 marks on questions 1 and 2 ONLY. For questions 3 to 8, if the key is wrong, the maximum score is 2 out of 4.

Incorrect options can be knocked out, but the letter of the knocked out key must be given, along with relevant economic reasoning. If more than one key is knocked out for the same reason this will earn one mark. There must be different reasons for each knock out. Up to two knock out marks can be awarded for each supported choice question.

| Question Number	Answer	Mark
1	D Definition of AVC or AR (1) Identification of any characteristics of perfect competition e.g. that there are no barriers to entry/exit, or firms are price takers (1) Shut down point is AVC = AR or AVC>AR in short run (1) Firm is making a loss (1) staying in production means that losses would increase (i.e. reason for leaving) (1). No contribution is made to fixed costs (1) Losses act as a signal for firms to leave the market (1), In the long run the shut down point is AVC=AR because all cost are variable (1) Diagram showing short run loss-making firm (1) with industry diagram showing leftwards shift in supply (1) with long run rise in price (1) OR diagram showing AVC not or just covered (1) with shut down point (1) OR (ignore numbers)	(4)

Question Number	Answer	Mark
2	B Definition of overt collusion, e.g. that is spoken, open or traceable (1) application of text firms 'verbally agree' (1) which is a form of cooperation or collaboration(1) with rationale, e.g. that prices will be kept high or higher profits(1) application to PFI e.g. explanation of a tendering process (1) by private firms for government contracts (1) illegal (1) powers of competition policy e.g. fines (1) although sometimes hard to prove (1)	(4)

Question Number	Answer	Mark
3	C Definition of Concentration Ratio: the n firm CR is the proportion of the market controlled by the largest n firms or theoretical formula e.g. (Σ market share of n largest firms) Method mark 30.7% + 17.3% + 15.9% + 11.7% (1) The market is highly concentrated (1) Characteristics of oligopoly e.g. it means interdependence, a few firms dominate the market, or higher entry and exit barriers (or other definition of sunk costs) (1) with examples from grocery market e.g. advertising (1). Calculation of other concentration ratios: e.g. 3 firm 63.9% is a knock out mark (1) Application e.g. Tesco is a legal monopoly (1)	(4)

Question Number	Answer	Mark
4	B Definition of vertical integration e.g. joining with a firm involved in the same industry but at a different stage of production (1) Application of backwards: closer to the raw materials in the supply chain (1) e.g. buying crude oil supplies (1) with rationale e.g. to gain a reliable supply source or to cut costs of supply (1) Further application to oil industry e.g. crude oil is the largest cost for a petroleum firm (1)	(4)

Question Number	Answer	Mark
5	A Definition of marginal costs, or formula e.g. the cost of producing one more unit or $\Delta TC/\Delta Q$ (1) and relation to variable not fixed costs (1). Explanation that fixed costs do not change with output, or have to be	

	paid whatever the output (1) Marginal cost will be affected by changes in variable cost (1) Example of fixed costs, e.g. rent (1) Application to fixed costs that when they change it is not because one more is being produced, but the scale of production is changed (1) Marginal cost is the gradient of total costs (1) Diagram showing parallel upward shift in TC or TFC (1) with no change in gradient (1) or upward shift in AC (1) with no change in position of MC (1)	(4)

Question Number	Answer	Mark
6	E

Definition of marginal profit e.g. the increase in profit when one more unit is sold or the difference between MR and MC or MR-MC=0 (1) with MC=MR (verbally or as diagram)(1) and marginal analysis of this point with diagram showing TR and TC (1) with the greatest positive difference (1) marginal analysis showing what happens before and after MC=MR (1 + 1)

Diagram (up to three marks) might include elements of the following: Vertical line connects profit maximisation with MC = MR (1) Gradient of total profit curve is zero where marginal profit is zero (1)
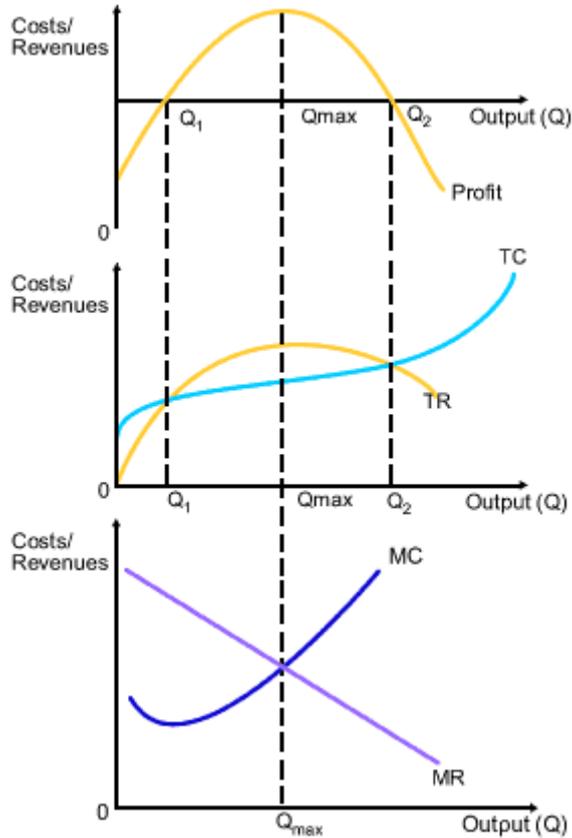
 | (4) |

| | Allow elements of this diagram (you are unlikely to see all of this), or other versions showing the difference between MC and MR as marginal profit, or shading area of total profit. | |

Question Number	Answer	Mark
7	**A** Definition of monopolistic competition, or at least one of the following characteristics: many buyers and sellers, low or no barriers to entry, slightly differentiated products. In the long run, AR=AC (1) with normal profit built into AC (1). Firms will enter because there are low barriers to entry (1) and profit acts as a signal for firms to enter (1) until the profit is competed away (1). Supernormal profit is FGHJ in the short run or shading on diagram (1) and zero in the long run (1). Diagram showing shift inwards of AR and MR (1) with tangential AR and AC (1). Knock-out of D: NKLM is the profit area for a revenue maximising firm (1)	(4)

Question Number	Answer	Mark
8	**E** Definition of performance targeting e.g. a goal is set by government or a regulator for firms to achieve (1). Role of regulator: improving consumer interests or reduce monopoly power or surrogate for competition (1 + 1) Application e.g. number of complaints, reducing queuing time, improved customer service (1) Role of fines as a deterrent through effect on a firms' costs or profits (1)	(4)

Question Number	Answer	Mark
9(a)	2 marks for theory of a patent – legal protection/rights (1) of an idea or process (1) which acts as a barrier to entry (1) or incentive to invest (1) giving property rights/receiving the rewards (1) for a certain period of time (1) 2 marks for application e.g. gives RB incentive to invest (1) and innovate without fear of competition from other large pharmaceutical firms meaning that the investment could not otherwise be recouped (1). Gaviscon Original patent expired in 1999 which means there are now many generic substitutes (1) so they can 'legally copy the ingredients' (lines 4-5); RB says it would lose 80% of its revenues (line 19); Gaviscon products could be sold more cheaply or the patent makes the prices higher (1) which would have saved the NHS £40m (1); external benefits of research in pharmaceuticals (1); new patent will last until 2016 (1) or old one expired in 1999 (1) innovation is particularly important in the pharmaceutical industry (1).	(4)

Question Number	Answer	Mark
9(b)	KAA (4 marks). Award up to 2 factors e.g. (2 + 2) or (3 + 1) or (4 + 0) The advantages might be seen as KAA and disadvantages as Evaluation, or vice versa. Advantages for consumers might include : • higher consumer surplus, increased allocative efficiency • Fall in demand for individual firms so prices fall/increased productive efficiency • Reallocation of income from firms to consumers • increased efficiency in firms/reduction in monopoly power may mean higher quality products and more choice • innovation is encouraged as firms need to keep ahead, improving consumer choice • where the consumer is the government/NHS, there is reduction in costs to government, decreased tax, increased spending elsewhere • where the consumer is in developing countries, there may be significant improvements in health/falls in poverty Award diagram (up to 2 marks) for firms seeing a fall in AR and MR, with consequent fall in price, output and profit OR market diagram showing lower prices and more choice as supply increases. Evaluation (4 marks). Award up to 2 factors e.g. (2 + 2) or (3 + 1) or (4 + 0) Points may include: • More competition might mean underinvestment in R&D/innovation/investment • Quality may be reduced as a cost cutting measure • It depends on the quality of the new products as to the extent of the benefit to the consumer • Firms may leave the market, meaning less choice for customers • Consumer benefits may be compromised if firms overcome the problem of competition by advertising/branding • Benefits to the NHS might not be passed through to consumers of NHS • Increased competition may have no effect if the brand image is strong/if NHS is not driven to reduce costs	(8)

| | • Competition might be wasteful, e.g. the economies of scale argument
• Asymmetric information in the buying of healthcare products | |

Question Number	Answer	Mark
9(c)*	**KAA (6 marks).** Award up to 3 factors e.g. (2 + 2 + 2) or (3 + 2 + 1) or (3 + 3) Definition of competition policy or role of OFT or role of Competition Commission e.g. laws or policies aimed at promoting market competition (1) Success of OFT/competition policy: • Fines and other penalties ensure that there is competition • Fear of action by OFT may prevent anticompetitive behaviour (i.e. deterrent effect) • Risk of bad publicity might ensure that firms do not restrict competition • Use of case studies to show improved consumer welfare or choice Success of competition policy more generally: • New powers since 2002 Enterprise Act • Fines based on up to 3 years' turnover, and managers can go to jail • Allow companies to use market solutions (lines 28-29) • The OFT is reducing the power of patents by reviewing barriers to entry Award application marks, e.g. case studies in Extract 1 or own knowledge **Evaluation (6 marks).** Award up to 3 factors e.g. (2 + 2 + 2) or (3 + 2 + 1) or (3 + 3). Reasons why competition policy is not successful might include: • Regulatory capture (Government failure) • Asymmetric information (Government failure) • If policies are too strict it could discourage investment • Administration costs of competition policy • OFT only covers UK but the firms involved are international • The organisations cannot work separately and are shortly to be merged • Failing of bodies to co-ordinate, within the UK and across international boundaries • Limitations of powers, e.g. reference to failure to regulate banks lines 30-32	(12)

- Inconsistencies of competition decisions
- Burden of proof is on the firms not the OFT, so there are cost and other implications for firms
- Limited resources of competition authorities means that they can make only a very limited impact on the level of competition between large and powerful firms
- Brand loyalty may limit the success of competition policy
- Significant benefits in cost reductions and research have not been seen in practice. Is the policy a lame duck?
- Patents reduce success
- Suggestion on how competition policy might improve in the future

KAA and evaluation marks may be awarded on either side of the case for and against a judgement of competition policy being successful.

Question Number	Answer	Mark
9(d)*	KAA (8 marks). Award up to 4 factors e.g. (2 + 2 + 2 + 2) or (4 + 2 + 1 + 1) or (3 + 3 + 2) Definition of increased contestability (1) Positive effects on firm's behaviour - Lower prices e.g. price war - better service - firms could enter so the firm must behave as if there were competition by cutting costs - Non profit-maximising pricing - Predatory pricing - Limit pricing - Lower profits force firms to become efficient - Use of pricing policies - Use of non-pricing policies - Use of game theory to explain collusion or other outcomes - Allow use of kinked demand theory to explain why there might be no change to firm's price - M&As - Off-shoring or outsourcing - Increased innovation or efficiency Award use of diagram (see below) showing falling profits. Award max 6/8 KAA if no reference to specific industrial case studies	

	Evaluation (8 marks). Award up to 4 factors e.g. (2 + 2 + 2 + 2) or (4 + 2 + 1 + 1) Factors might include: • More competition might mean underinvestment in R&D • It depends on the size of firms/market structure. If the competition is relatively small relative to the size of incumbents there will be little change in behaviour. • Firms might wait-and-see if the competition has any impact • Patents and other statutory monopoly power reduces impact • The firms might already be acting as if there were competition, if competition authorities act as a surrogate for competition • The importance of quality in the industry as opposed to pricing, so firms are constrained as to their reaction • Prioritisation with justification – e.g. limit pricing might be safer than predatory pricing when judged to be legal • Other differences in the long run • Also allow critique of points made in KAA	(16)

Question Number	Answer	Mark
10(a)	Up to two marks can be gained for a fully labelled and correct diagram. Diagram showing fall in AR/MR shift to the left or down (1) and new negative profit area (i.e. loss area) (1) No marks for demand and supply diagram Application 2 marks: Demand or sales falls (1) as it is too hot to eat chocolate , or 'customers eat less chocolate in warmer weather' (Extract 1 lines 9-10)(1)	(4)

Question Number	Answer	Mark
10(b)	KAA (4 marks). Award one factor (up to 4 marks) and up to 2 marks for a price discrimination diagram. Reasons might include: • Higher revenues/profits from price inelastic demand in shops • Larger market share in online sales • Penetration pricing in the online market • Increase loyalty and brand awareness in markets where prices are lower • Price discrimination. Conditions for price discrimination: different elasticities, low cost	

	of keeping markets separate and no arbitrage	
	• Different cost basis e.g. higher overheads or labour costs, Economies of Scale	
	• Different degrees of competition or contestability e.g. Thorntons offers lower prices where demand is more elastic – e.g. online there is more choice	
	• Increased brand loyalty	
	• Higher profits of firm might ensure quality is maintained or now products are brought to market	
	Evaluation (4 marks). Award up to 2 factors e.g. (2 + 2) or (3 + 1) or (4 + 0)	
	Factors might include:	
	• Internet not always more competitive – hidden brand loyalty	
	• There may be changes in the long run as more internet shopping is increasingly popular	
	• Conditions of price discrimination do not hold in the long run, e.g. over time the arbitrage becomes easier	(8)
	• Loss of consumer surplus for those with price inelastic demand	
	• Less choice, might lead to consumer loyalty decreasing in the long run	
	• Higher labour costs in running an effective website?	
	• Packaging and production cost are the same, the difference in cost is relative small.	

Question Number	Answer	Mark
10(c)*	KAA (6 marks). Award up to 3 factors e.g. (2+2+2) or (3+2+1). Reserve at least 2 marks for reference to game theory, but up to 6 marks can be awarded for a fully grounded game theory answer.	
	Factors might include:	
	• Award use of game theory and pay-off matrix, or kinked demand analysis as up to 2 factors of which 2 marks are awarded for a pay-off matrix	
	• Collusion	
	• Price competition	
	• Non-price competition	
	• Reaching a worse outcome than if the decision was made independently, e.g. prisoners'	

	dilemma	
	• Internal growth	
	• More mergers, the combined firm might be more competitive which may result in:	(12)
	o Lower prices	
	o Reduce cost	
	o Synergies	
	If there is no link (explicit or implicit) to increased market share/revenue then no marks are awarded for the point.	
	Mark cap 4/6 marks if no reference to game theory.	
	Evaluation (6 marks). Award up to 3 factors e.g. (2 + 2 + 2) or (3 + 2 +1).	
	Factors might include:	
	• Collusion is illegal – risk of fines. This may be developed using extensions of game theory.	
	• Tacit or overt collusion?	
	• Difficult to prove collusion	
	• Mars is in very different markets, or other magnitude comments about the competition	
	• Cost implications of non-price competition	
	• Other factors not equal	
	• A critique of points made in KAA	
	• Difficult to increase market share by changing price. This may be shown using game theory/kinked demand	
	• Lack of synergy which may lead to less market share (clash of cultures)	
	• Long term cost problem of merger	

Question Number	Answer	Mark
10(d)*	KAA (8 marks). Award up to 4 factors e.g. (2 + 2 + 2 + 2) or (4 + 2 + 1 + 1) + (3 + 3 + 2) Identification of the meaning of economic efficiency, e.g. increased output from the same amount of inputs, or producing where P=MC Impact of takeover to increase efficiency factors might include: • Rationalisation • Removal of wasteful competition	

- Economies of scale (different types can count as more than one factor) - Consideration of different types of efficiency, e.g. allocative, productive (different types can count as more than one factor) - Synergies - Extract 2 lines 28-29 Increased management efficiency - Extract 2 lines 16-17 reduce cost by offshoring **Award max 6/8 KAA marks if no specific reference to the information provided** **Evaluation (8 marks). Award up to 4 factors e.g. (2 + 2 + 2 + 2) or (4 +2 + 1 + 1) Impact to decrease efficiency factors might include:** - Costs to owners in terms of risk - finance issues - cost of buying company has direct costs, debt issues - Costs to employees who lose jobs, closure of plants, redundancy packages, bad industrial relationships , threat of industrial action and marketing issues from the bad press (extract 3) will increase costs to firms involved - Allow macro concepts of inefficiency in the sense of unemployed resources, e.g. unemployment is a sign of poor use of resources for the country - Depends on the economic climate/credit crisis - Depends on short run or long run issues - Some efficiencies are affected more than others - Conflict between productive and allocative efficiencies, e.g . cutting costs might damage welfare of the consumer - Diseconomies of scale - Might be subject to attention of competition authorities - Extract 2 lines 16-17 'Cadbury is already efficient' - Increased market power might lead to x-ineffciency - Extract 2 lines 30-31 management is already efficient at Cadbury, and 'in no need of lessons from Kraft' **KAA and evaluation marks may be awarded on either side of the case for and against a judgement of efficiency**	(16)

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