



*Rewarding Learning*

**ADVANCED  
General Certificate of Education  
January 2012**

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## **Economics**

**Assessment Unit A2 1**

*assessing*

**Business Economics**

**[AE211]**

**MONDAY 23 JANUARY, AFTERNOON**

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**MARK  
SCHEME**

## General Marking Instructions

This mark scheme is intended to ensure that the A2 examinations are marked consistently and fairly. The mark schemes provide examiners with an indication of the nature and range of candidate responses likely to be worthy of credit. It also sets out the criteria which they should apply in allocating marks to candidates' responses. The mark scheme should be read in conjunction with these general marking instructions which apply to all papers.

### Quality of candidates' responses

In marking the examination paper, examiners will be looking for a quality of response reflecting the level of maturity which may reasonably be expected of 18-year-olds, which is the age at which the majority of candidates sit their A2 examinations.

### Flexibility in marking

The mark scheme is not intended to be totally prescriptive. For many questions, there may be a number of equally legitimate responses and different methods by which the candidates may achieve good marks. No mark scheme can cover all the answers which candidates may produce. In the event of unanticipated answers, examiners are expected to use their professional judgement to assess the validity of answers. If an answer is particularly problematic, then examiners should seek the guidance of the Supervising Examiner for the paper concerned.

### Positive marking

Examiners are encouraged to be positive in their marking, giving appropriate credit for valid responses rather than penalising candidates for errors or omissions. Examiners should make use of the whole of the available mark range for any particular question and be prepared to award full marks for a response which is as good as might reasonably be expected for 18-year-old candidates. Conversely, marks should only be awarded for valid responses and not given for an attempt which is completely incorrect or inappropriate.

### Types of mark schemes

Mark schemes for questions which require candidates to respond in extended written form are marked on the basis of levels of response which take account of the quality of written communication. These questions are indicated on the cover of the examination paper. Other questions which require only short answers are marked on a point for point basis with marks awarded for each valid piece of information provided.

### Levels of response

Questions requiring candidates to respond in extended writing are marked in terms of levels of response. In deciding which level of response to award, examiners should look for the "best fit" bearing in mind that weakness in one area may be compensated for by strength in another. In deciding which mark within a particular level to award any response, examiners are expected to use their professional judgement. The following guidance is provided to assist examiners:

**Threshold performance:** Response which just merits inclusion in the level and should be awarded a mark at or near the bottom of the range.

**Intermediate performance:** Response which clearly merits inclusion in the level and should be awarded a mark at or near the middle of the range.

**High performance:** Response which fully satisfies the level description and should be awarded a mark at or near the top of the range.

## Making calculations

In marking answers involving calculations, examiners should apply the “own figure rule” so that candidates are not penalised more than once for a computational error.

## Quality of written communication

Quality of written communication is taken into account in assessing candidates’ responses to all questions that require them to respond in extended written form. These questions are marked on the basis of levels of response. The description for each level of response includes reference to the quality of written communication. Where the quality of candidates’ economics is not matched by the quality of written communication, marks awarded will not exceed the maximum for Level 2 in questions which have three levels of response or the maximum for Level 3 in those which have four levels of response.

For conciseness, quality of written communication is distinguished within levels of response as follows:

Level 1: Quality of written communication is limited.

Level 2: Quality of written communication is satisfactory.

Level 3: Quality of written communication is of a high standard.

Level 4: Quality of written communication is excellent.

In interpreting these level descriptions, examiners should refer to the more detailed guidance provided below:

**Level 1 (Limited):** The candidate makes only a limited attempt to select and use an appropriate form and style of writing. The organisation of material may lack clarity and coherence. There is little use of specialist vocabulary. Presentation, spelling, punctuation and grammar may be such that intended meaning is not clear.

**Level 2 (Satisfactory):** The candidate makes a reasonable attempt to select and use an appropriate form and style of writing, supported with appropriate use of diagrams as required. Relevant material is organised with some clarity and coherence. There is some use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are sufficiently competent to make meaning evident.

**Level 3 (High Standard):** The candidate successfully reflects and uses an appropriate form and style of writing, supported with the effective use of diagrams where appropriate. Relevant material is organised with a high degree of clarity and coherence. There is widespread use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of a sufficiently high standard to make meaning clear.

**Level 4 (Excellent):** The candidate successfully reflects and uses the most appropriate form and style of writing, supported with precise and accurate use of diagrams where appropriate. Relevant material is extremely well organised with the highest degree of clarity and coherence. There is extensive and accurate use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of the highest standard and ensure that meaning is absolutely clear.

- 1 (a) The Competition Commission define a monopoly as occurring whenever a firm has more than 25% market share. By this definition both Everything Everywhere and O2 could be described as a monopoly. An oligopoly occurs when a few large firms dominate a market. It can be defined as occurring whenever the top four firms have a combined market share of more than 60%. By this definition the UK mobile market could be described as oligopolistic since the top four firms have a combined market share of 88%.

Up to [3] for explaining why UK mobile market could be described as monopolistic

Up to [3] for explaining why UK mobile market could be described as oligopolistic

Constrained maximum of [5] [5]

- (b) Supernormal profits are defined as any profits over and above the minimum necessary to keep factors of production in their current use. They are earned when average revenues are in excess of average costs. UK mobile phone companies can earn supernormal profits in the long run so long as barriers to entry exist which prevent potential competitors from entering the industry.

Issue for analysis and discussion include:

- explanation of supernormal profits
- numerical example
- appropriate diagrams
- explanation of barriers to entry
- examples of barriers to entry in mobile phone industry – cost of entry, availability of spectrum
- appropriate examples.

#### Level 1 ([1]–[3])

Candidate shows little understanding of why mobile phone companies are able to earn supernormal profits. There is no significant analysis and application of the issues, and quality of written communication is limited.

#### Level 2 ([4]–[7])

Candidate provides some understanding of why mobile phone companies are able to earn supernormal profits. There is a degree of analysis and quality of written communication is satisfactory.

#### Level 3 ([8]–[10])

Candidate provides clear and comprehensive understanding of why mobile phone companies are able to earn supernormal profits. There is significant analysis and application, and quality of written communication is of a high standard. [10]

- (c) The aim of maximum roaming charges is to increase consumer welfare by reducing the cost of using a mobile phone abroad. It aims to increase efficiency by reducing price to a level that is closer to the marginal cost of production. These lower prices should also help to improve productive efficiency since firms will have more incentive to reduce costs to maintain profit margins. For firms, the maximum price may lead to lower revenues and profits which may in the long term impact on investment plans. In addition firms may look for other ways to increase revenue streams which may lead to higher prices for other services.

Issues for discussion and evaluation include:

- impact on consumer surplus
- impact on producer surplus
- impact on efficiency
- impact of PED on revenue
- impact on the price of other services as firms look to recoup lost revenue, e.g. domestic tariffs
- impact on profits
- impact on investment plans and resulting impact on network speed and capacity
- appropriate examples
- appropriate diagrams.

#### **Level 1 ([1]–[3])**

Candidate shows little understanding of the likely impact on consumers and producers of the introduction of maximum roaming charges. Quality of written communication is limited.

#### **Level 2 ([4]–[7])**

Candidate shows some understanding of the likely impact on consumers and producers of the introduction of maximum roaming charges. There is a degree of analysis, application and evaluation. Quality of written communication is satisfactory.

#### **Level 3 ([8]–[10])**

Candidate shows clear and comprehensive understanding of the likely impact on consumers and producers of the introduction of maximum roaming charges. There is significant economic analysis, application and evaluation, and quality of written communication is of a high standard.

[10]

- (d) Those who believe that Ofcom should be scrapped argue that the UK communications market is over regulated. They argue that the OFT and the Competition Commission already regulate the market and therefore there is no need for another regulator. They also argue that Ofcom has become too large and powerful and that it reduces democratic accountability since it is an unelected quango. They believe that many of Ofcom's powers should be returned to government ministers who are democratically accountable. They also argue that scrapping Ofcom would save the taxpayer huge sums of money.

Those who support Ofcom argue that an independent body is necessary to ensure that decisions are made which are in the best interest of the economy and not the narrow interests of a political party who may make popular decisions or who may be influenced by political lobbying. They also argue that Ofcom has played a significant role in reducing charges to consumers and regulating a highly complex market.

Issues for discussion and evaluation include:

- cost to the taxpayer of maintaining Ofcom
- lack of democratic accountability
- role of other regulatory bodies – OFT, Competition Commission, European Commission
- need for an industry watchdog with industry specific expertise
- need for an independent body free of political interference
- reference to regulatory capture
- reference to competing objectives of government ministers
- reference to impact of political lobbying on decision making
- role of Ofcom in reducing phone tariffs
- efficiency of government regulation
- appropriate examples
- international comparisons.

#### **Level 1 ([1]–[5])**

Candidate displays little understanding of the proposal to scrap communications regulator Ofcom. There is no significant evaluation of the issues, and quality of written communication is limited.

#### **Level 2 ([6]–[10])**

Candidate provides some understanding of the proposal to scrap communications regulator Ofcom. There is a degree of evaluation though this may lack depth or be one sided. Quality of written communication is satisfactory.

#### **Level 3 ([11]–[15])**

Candidate provides a clear and comprehensive understanding of the proposal to scrap communications regulator Ofcom. There is significant evaluation and judgement, and quality of written communication is of a high standard.

[15]

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## 2 Concentrated markets are more efficient than competitive markets

(a) Economic efficiency is a situation where individuals and firms get maximum satisfaction or benefit from their scarce resources. Economists have identified a number of different types of efficiency which include:

- allocative efficiency: which is achieved when the cost of producing a good is equal to the value consumers place on that good, which is reflected in the price they are willing to pay. It occurs when  $P = MC$
- productive efficiency: which is achieved when production takes place at the lowest possible average cost. It occurs when AC are minimised
- pareto efficiency: which is achieved when it is impossible to make someone better off without making someone else worse off
- dynamic efficiency: which measures improvements in technical and productive efficiency over time
- other less commonly used definitions of efficiency such as technical efficiency.

Appropriate development:

- appropriate definitions
- numerical examples
- relevant diagrams.

### Level 1 ([1]–[5])

Candidate provides little explanation of the term efficiency. There is no significant economic analysis and quality of written communication is limited.

### Level 2 ([6]–[10])

Candidate provides some explanation of the term efficiency. There is a degree of economic analysis but this may be incomplete or contain errors. Quality of written communication is satisfactory.

### Level 3 ([11]–[15])

Candidate provides clear and comprehensive explanation of the term efficiency. There is accurate economic analysis and quality of written communication is of a high standard. [15]

(b) Traditional economic theory suggests that highly competitive industries are more likely to be economically efficient than those where there is less competition. Intense competition will force firms to charge a price which is equal to their marginal cost of production and hence allocative efficiency will occur. This pressure on price will, in turn, force firms to minimise the average cost of each unit produced and so productive efficiency will occur.

However, it could be argued that firms which operate in less competitive markets are more likely to invest in research and development and therefore these industries are more likely to achieve dynamic efficiency. It could also be argued that firms which face little competition can grow large enough to avail of economies of scale which would reduce average costs and so lead to greater productive efficiency.

Finally, it has been suggested that it is not the actual level of competition a firm faces which forces it to be efficient but the level of potential competition.

Issues for discussion and evaluation include:

- comparison of monopoly/oligopoly with perfect competition/monopolistic competition
- reference to minimum efficient scale of production
- reference to economies of scale
- reference to contestability
- different measures of efficiency
- reference to measures of concentration
- appropriate examples
- appropriate diagrams
- reference to dynamic efficiency and impact of expenditure on R and D.

#### **Level 1 ([1]–[7])**

Candidate shows little understanding of the view that economic efficiency is more likely to be achieved in a highly concentrated industry rather than a highly competitive industry. There is no significant analysis or evaluation, and quality of written communication is limited.

#### **Level 2 ([8]–[13])**

Candidate shows some understanding of the view that economic efficiency is more likely to be achieved in a highly concentrated industry rather than a highly competitive industry. There is some attempt at analysis and evaluation, and quality of written communication is satisfactory.

#### **Level 3 ([14]–[19])**

Candidate shows in-depth understanding of the view that economic efficiency is more likely to be achieved in a highly concentrated industry rather than a highly competitive industry. There is significant analysis and evaluation of the arguments, and quality of written communication is of a high standard.

#### **Level 4 ([20]–[25])**

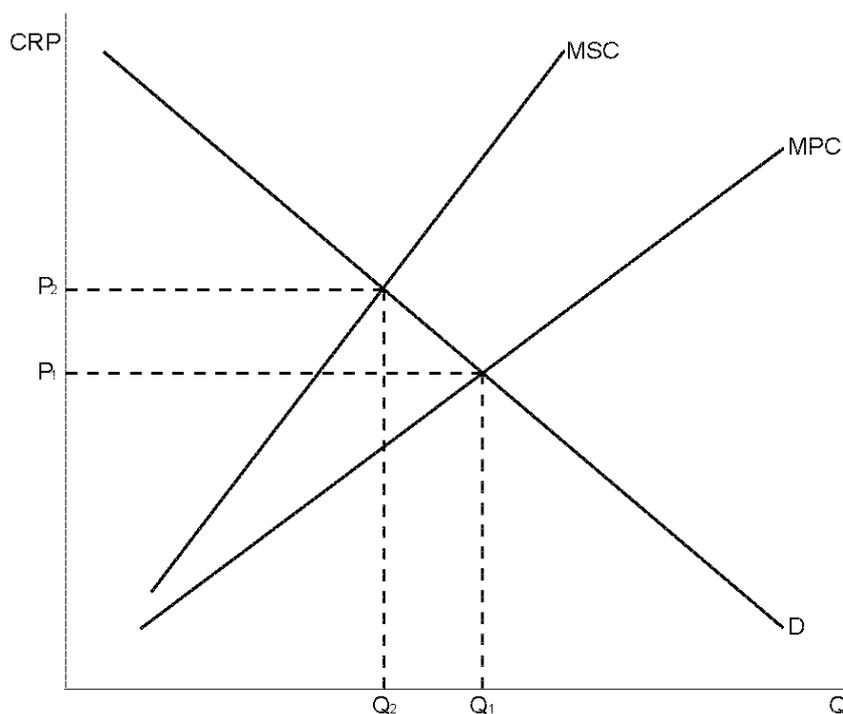
Candidate shows clear and comprehensive understanding of the view that economic efficiency is more likely to be achieved in a highly concentrated industry rather than a highly competitive industry. There is significant evaluation and judgment of the arguments, and quality of written communication is excellent.

[25]

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### 3 Concerns over food miles leads to calls for freight transport levy

- (a) The long distance transport of food has come in for huge criticism from environmentalists who argue that the price paid by consumers does not fully reflect the social cost of production. They argue that transporting food over long distance creates negative externalities in the form of pollution. Whenever production creates negative externalities the marginal social cost of production is greater than the marginal private cost. In a free market economy firms will produce up to the point where the marginal private cost of production (MPC) is equal to the demand curve ( $Q_1$ ). In the absence of externalities this would represent an efficient allocation of resources as price would equal marginal cost. However because externalities exist output  $Q_1$  represents an inefficient allocation of resources since price does not equal the full marginal social cost. When externalities exist the socially optimal allocation of resources occurs at  $Q_2$  where price equals marginal social cost. This is shown on the diagram below.



Areas for analysis and discussion include:

- explanation of externalities
- discussion of efficiency
- appropriate examples
- appropriate diagrams.

**Level 1 ([1]–[5])**

Candidate provides little explanation of why long-distance transport of fresh food might result in a misallocation of resources. There is no significant economic analysis and quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some explanation of why long-distance transport of fresh food might result in a misallocation of resources. There is a degree of economic analysis but this may be incomplete or contain errors. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate provides clear and comprehensive explanation of why long-distance transport of fresh food might result in a misallocation of resources. There is accurate economic analysis and quality of written communication is of a high standard. [15]

- (b) There are a range of policies open to government to deal with negative environmental externalities each of which have their own benefits and drawbacks.

These include:

- subsidising environmentally friendly forms of production
- environmental legislation
- environmental taxation
- tradable pollution permits
- extension of property rights.

Areas for analysis and discussion include:

- effectiveness of legislation
- cost of enforcement
- impact on price
- impact on efficiency
- impact on and use of tax revenues
- administration costs
- government failure
- opportunity cost of subsidy
- appropriate examples
- appropriate diagrams.

**Level 1 ([1]–[7])**

Candidate shows little understanding of the range of policies open to a government to deal with negative environmental externalities. There is no significant analysis or evaluation, and quality of written communication is limited.

**Level 2 ([8]–[13])**

Candidate shows some understanding of the range of policies open to a government to deal with negative environmental externalities. There is some attempt at analysis and evaluation, and quality of written communication is satisfactory.

**Level 3 ([14]–[19])**

Candidate shows in-depth understanding of the range of policies open to a government to deal with negative environmental externalities. There is significant analysis and evaluation of the arguments, and quality of written communication is of a high standard.

**Level 4 ([20]–[25])**

Candidate shows clear and comprehensive understanding of the range of policies open to a government to deal with negative environmental externalities. There is significant evaluation and judgment of the arguments, and quality of written communication is excellent. [25]

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**4 Globalisation creates opportunities and challenges for UK firms**

- (a) The short run is the period of time whenever the input of at least one factor is fixed. The short run average and marginal cost curves are U-shaped because of the law of diminishing returns. The law of diminishing returns states that as increasing quantities of a variable factor are added to a given quantity of a fixed factor, marginal product will at first increase but will eventually diminish. This, in turn, causes marginal and average costs to fall initially but to eventually increase. Hence these curves are normally U-shaped.

Areas for analysis and discussion include:

- distinction between short run and long run
- distinction between fixed and variable costs
- law of diminishing returns
- analysis of link between MC and AC
- link between marginal product and marginal cost
- numerical example
- appropriate diagrams.

**Level 1 ([1]–[5])**

Candidate provides little explanation of why a firm's short run average and marginal cost curves are likely to be U-shaped. There is no significant economic analysis and quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some explanation of why a firm's short run average and marginal cost curves are likely to be U-shaped. There is a degree of economic analysis but this may be incomplete or contain errors. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate provides clear and comprehensive explanation of why a firm's short run average and marginal cost curves are likely to be U-shaped. There is accurate economic analysis and quality of written communication is of a high standard. [15]

- (b) Globalisation refers to the way in which markets across the world have become increasingly integrated. Globalisation has brought benefits to UK businesses in that it has allowed them to access larger markets and has provided a cheap pool of labour and raw materials. In addition, it has made it easier for firms to access a cheap source of funds.

However, globalisation has also presented UK firms with a number of challenges. UK firms now face much greater levels of competition from low cost producers which has put pressure on revenue streams and profits. In addition, there are significant costs associated with conducting business on a global scale, not least in the areas of transportation, language differences and exchange rate uncertainty.

Areas for analysis and discussion include:

- access to larger potential markets
- potential for economies of scale
- access to cheap pool of labour either through the use of off-shoring or the use of migrant labour
- access to cheaper raw materials
- access to greater sources of finance
- impact on levels of competition
- impact on efficiency
- impact on revenue streams
- impact on profits
- increased cost of doing business on a global scale
- cultural and language barriers
- impact of anti-globalisation sentiment on brand image
- appropriate examples
- appropriate diagrams.

**Level 1 ([1]–[7])**

Candidate shows little understanding of the impact of globalisation upon the costs and revenues of UK firms. There is no significant analysis or evaluation, and quality of written communication is limited.

**Level 2 ([8]–[13])**

Candidate shows some understanding of the impact of globalisation upon the costs and revenues of UK firms. There is some attempt at analysis and evaluation, and quality of written communication is satisfactory.

**Level 3 ([14]–[19])**

Candidate shows in-depth understanding of the impact of globalisation upon the costs and revenues of UK firms. There is significant analysis and evaluation of the arguments, and quality of written communication is of a high standard.

**Level 4 ([20]–[25])**

Candidate shows clear and comprehensive understanding of the impact of globalisation upon the costs and revenues of UK firms. There is significant evaluation and judgment of the arguments, and quality of written communication is excellent.

[25]

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**Total****80**