EXPERT TUITION

Economics Questions By Topic:

Efficiency (3.4.1)
Mark Scheme

A-Level Edexcel Theme 3

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Question Number	Answer	Mark
1	**Correction Option B** Definition of allocative efficiency, e.g. the price is equal to the marginal cost (AR=MC or P=MC) (1) Explanation of monopoly – single firm dominates or 25%+ market share (1) Explanation that the price has been set at a point that maximises (consumer/producer) welfare (1); Monopoly may do this as marginal cost pricing has been imposed by the government (1) Annotation of diagram showing consumer/producer welfare(1) Example of knock outs (can also come from annotating the diagram) It's not C because M is not at the lowest point of AC It's not D because this is revenue maximisation (or the area KLMN represents SNP for a revenue maximising firm) It's not D as shown by a correctly annotated profit maximising area on their diagram (connecting AR and AC at output T – this will involve a new horizontal line meeting the AC curve)	(4)

Question Number	Answer	Mark
2	**B** Definition of **x-inefficiency**, e.g. when lack of competition means that costs are higher than they would be with competition (1); examples of x-inefficient behaviour: satisficing profits, organisational slack, rising average costs of labour as wages rise or over-manning, laziness, complexity, management with other aims such as luxury cars (1+1); Explanation of **patents**, e.g. legal barriers which prevent copying of names or concepts by rival firms these act as a barrier to entry (1) meaning that new firms cannot enter/force existing firms to cut their prices or costs – there is no need for existing firms to cut costs (1); Reasons why x-inefficiency exists: firms can become a monopoly, firms gain market power (1+1); Diagram showing two average costs curves, one AC higher than they would other be when x-efficient, or a point above AC (1); Example of knock out mark: it cannot be C as barriers to entry will be high (1).	(4)

Question Number	Answer	Mark
3	A Definition of productive efficiency, e.g. lowest point on the average cost (AC) curve, or MC=AC (1); MC=MR is profit maximisation (1); Explanation: firm is operating under **monopolistic competition** (1) in the long run (1); other characteristic of monopolistic competition (note this must be consistent with the model, and not be a defining characteristic of monopoly) e.g. similar but differentiated products, a large number of small firms, low barriers to entry or exit (1); There are only normal profits in the long run diagram shown, or AR=AC means there are no supernormal profits (1) prices cannot fall any lower because costs are not as productively efficient as possible (1); Annotation of diagram, e.g. to show productive efficiency at the lowest point of AC (1); Example of knock out mark: it cannot be B because the firm is making normal profits (1) (if this has not been awarded as part of the analysis). Example of knock out mark: not D because the AR and MR are downward sloping (1).	(4)

Question Number	Answer	Mark
4	**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
5	**D** Definition/characteristic of monopolistic competition, e.g. slightly differentiated products. (1) Explanation of *lack of* both types in efficiency (not just definitions) e.g. ' the firm is not operating at lowest cost per unit' and 'the firm is not operating to maximise welfare'. Accept formulae demonstrating $AR \neq MC$ and $AC \neq MC$ (1 + 1) Application to snack food, e.g. very similar food types (1) low ability to create strong market allegiances (1) Diagram showing long run equilibrium positions (1) with reference on diagram to $P=MC$ and/or Min AC not being achieved (1). Also credit short run diagram where this illustrates changes (2 marks)	**(4)**

Question Number	Answer	Mark
6	**A** • **Definition of profit maximisation MC=MR** • **Explanation of productive efficiency (lowest point on average cost curve) (1 mark) NB definitions are not sufficient for this mark. There must be some explanation** • **Explanation of allocative efficiency (P=MC) (1 mark)** • **Explanation of firms entering/leaving industry in long run, with no barriers to entry or exit (up to 3 marks)** • **Diagram illustrating long run equilibrium of a perfectly competitive firm (1 mark for horizontal AR, 1 mark for tangential AC)** Long-run equilibrium of industry and firm under perfect competition Industry Firm	(4)

Question Number	Answer	Mark
7	**C** Definition of monopolistic competition or at least one characteristic e.g. firms have differentiated products and therefore the demand is not perfectly elastic has low barriers to entry, many firms **(1 mark)** Explanation of lack of productive efficiency **(1 mark)** Explanation of lack of allocative efficiency **(1 mark)** Supernormal profits will be competed away in long run OR only normal profits in the long run **(1 mark)** Diagram to illustrate long run position showing allocative and productive inefficiency can rewarded up to **(2 marks)**	(4)

END OF SECTION A

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SECTION B

Question Number	Answer	Mark
8	KAA (4)	
	1 mark definition of **efficiency** (might be implicit) – lower costs per unit, or allocative efficiency, x-inefficiency etc. This might be shown on a diagram, for example by the minimum point on an AC curve (productive efficiency) or P=MC (allocative efficiency).	
	Award application marks for reasons from data for using national price, e.g. supermarket alleged 'price fixing', oil companies using price discrimination or 'dual pricing'	
	Efficiency might change owing to: • Direct controls could act as a surrogate for competition • Some firms are forced to cut prices, or reduce x-inefficiency • Some retailers might increase supply • Prevention of monopoly pricing • Change in incentives, e.g. firms will not want to invest/expand • Impact on costs for firms/cost push inflation • Reduced need for regulation, and the costs and problems of investigations • Reduced 'shoe leather costs' as people do not have to shop around for fuel	
	Allow answers based on the wholesale market for fuel, for example with reference to dual pricing by the major oil companies (Extract 2).	
	Evaluation (2): 2 x 2 marks or 3+1 or 4+0 *This could take the form of disadvantages of a national pricing scheme if advantages given for KAA, or vice versa.*	
	• Some consumers would pay a lower price if there were variable prices, e.g. non-London • Difficulty of enforcement • Loss of price competition might mean prices do not fall as much as they could where competition is effective • Regulatory failures, e.g. uniform price set at a level that is too high/low • Argument on the impact on incentives e.g. new firms could enter the market • Loss of quality of service as market becomes more aggressive	**(8)**

Question Number	Answer	Mark
9	KAA 6 marks Award 3 types/methods of regulation OR 3 types of efficiency for 2 marks each, or 2 x 3 marks, or a combination of the two: KAA marks are to be awarded for two/three reasoned **explanations**, either in terms of the **effects** of two/three different types of regulation on efficiency, or the **effect** of regulation on two/three types of efficiency, rather than for a simple **identification** of the types of either regulation or efficiency. • Possible examples of types of regulation include: monitoring; target setting; price capping (e.g. RPI-X); fines. • Possible types of efficiency include: productive; allocative; dynamic, x-inefficiency, with explanation (not just defined). These points may be illustrated by relevant diagrams, and KAA marks can be awarded for this. **Role** of competition authorities: to promote competition, to promote the public interest, to increase cost effectiveness (may be implicit) (1 mark) Examples of points might include: • How regulation affects costs and pricing e.g. likely to force banks to cut costs (more productive efficiency) by cutting bonuses, • likely to improve allocative efficiency as prices become lower, • increasing consumer surplus as regulators force prices down; • Impact on pay structure, Impact on banks' treatment of SMEs • Economies of scale, if linked to regulation N.b. answers might relate to OFT or Competition Commission, or other regulatory body such as the FSA or banking ombudsman, or direct intervention by government, e.g. punitive tax Evaluation 6 marks **Candidates can argue that the regulations are**	(12)

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advantageous or disadvantageous as evaluation marks

- Now that many banks are essentially owned by the taxpayer this might change the objectives of banks

- Small businesses are collectively the biggest employer in the UK, or other reasons to support SMEs

- Banks should be allowed to recompense their staff in a manner that improves and rewards effectiveness which justifies the higher bonuses

- Competition authorities do not have the power to address this issue

- Increased regulations will make the market less contestable/efficient

- Difficult to decide where P=MC

- How big should the fines be

- Regulatory capture

- Diseconomies of scale as firms have to expand credit to SMEs, separating functions of banks to retail/wholesale

- Conflict between quality of service (allocative efficiency) and reduction in costs (productive efficiency)

- Firms might lose their best managers if pay is capped

- Allow macro arguments if related to efficiency, e.g. banks might move abroad

- conflicts inherent in some types of regulation, e.g. rate of return and efficiency

- making mergers **easier** could be seen as decreasing regulation

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Question Number	Answer	Mark
10	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

(16)

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

END OF SECTION B

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