Economics Questions By Topic:

Monopolistic Competition (3.4.3) Mark Scheme

A-Level Edexcel Theme 3

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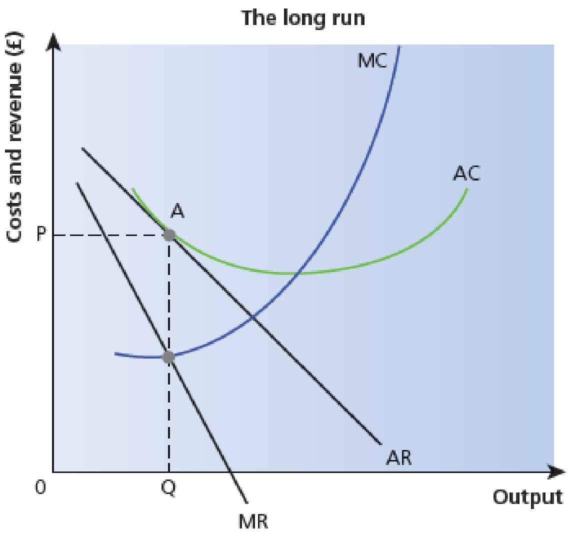
Table Of Contents

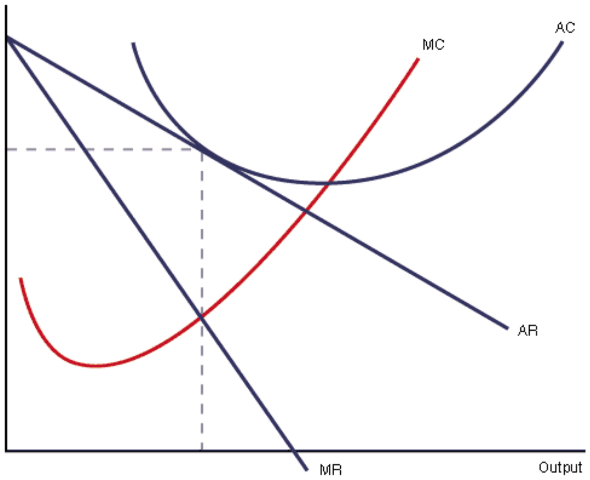
SECTION A

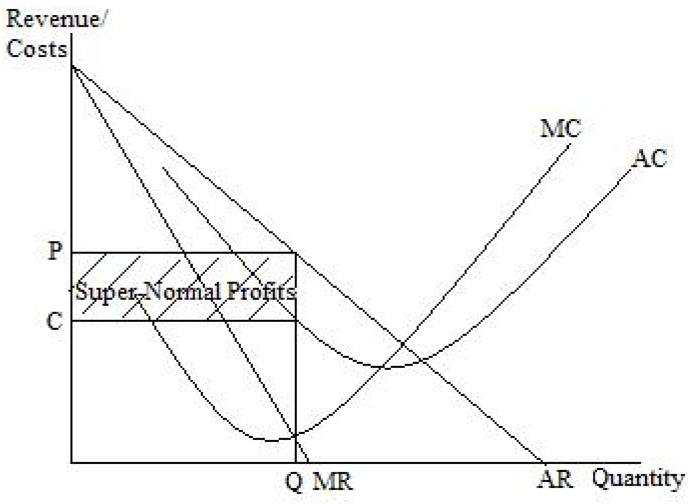
Question Number	Answer	Mark
1(a)	**Analysis 1** **The only correct answer is D** **A** is not correct because there is some differentiation in monopolistic competition aided by advertising and research **B** is not correct because there are many firms in a monopolistic competition market **C** is not correct because goods are not necessarily homogenous in monopolistic competition and some degree of products being heterogeneous is likely to be evident	**(1)**

Question Number	Answer	Mark
1(b)	**Knowledge 2 Application 2** AC shown tangential to downward sloping AR curve (2) followed by: Identification of the profit maximising equilibrium price and output where MC=MR (1) AC=AR shown at the profit maximising equilibrium (1)  	**(4)**

Question Number	Answer	Mark
2	Key: E	**(1)**
	Definition of normal profit (1) e.g. AR=AC or TR=TC or making just enough profit to keep factors in their current use. Award 1 mark for correct calculation of the columns and filled in up to at least 5 units, for TC (1) AR or MR (1) MC (1) or total profit if added (1). Observation that MC=MR is profit maximisation (1) The firm is a price taker, or faces perfectly elastic/horizontal demand (1) The firm makes normal profits where AR=AC in the long run (1) Defining characteristic of perfect competition, if not included above, e.g. very many firms in the industry, perfect knowledge, no barrier to entry or exit, homogeneous product (1) Diagram showing price taking firm, or perfect competition firm with industry diagram determining the price (1) Total revenue is increasing at a constant gradient indicating firm is a price taker (1) Knock out marks: e.g. it is not A because this is a price taker with horizontal demand curve whereas monopolistic competitor would have downward sloping demand curve due to differentiation (1) D is wrong because £3 loss is made at 3 units	**(3)**

Output per day	Total revenue (£)	Average revenue/Marginal revenue (£)	Total cost (£)	Average cost (£)	Marginal cost (£)
0	0	-	12	-	-
1	10	10	22	22	10
2	20	10	28	14	6
3	30	10	33	11	5
4	40	10	40	10	7
5	50	10	50	10	10
6	60	10	81	13.5	31

Question Number	Mark scheme	Mark
3	Key: D	1
	Definition or characteristics of monopolistic competition (1) *e.g. low or no barriers to entry or exit, slightly differentiated products, non-homogenous* Function of supernormal profits in terms of entry (1) e.g. profits attract new entrants Normal profits are made in the **long run** (1) e.g. supernormal profits are eroded or competed away Application to context (1) e.g. shoe repair services are very cheap to set up and very little equipment or training is required Explanation that **normal profits** are where AR=AC or TC=TR or 'just enough profits to keep resources in their current use' (1). Diagram showing AC=AR (1) (if not awarded above as a written definition of normal profits), where MC=MR and AR is downward sloping (1): Revenue or costs (£)  Also award normal profit as TC=TR (verbal or on TR/TC diagram). *Example of knock out marks: It is not C because in the short run, before other firms can enter or leave the industry, supernormal profits (or losses) can be made (1)*	3

Question Number	Answer	Mark
4	**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)**

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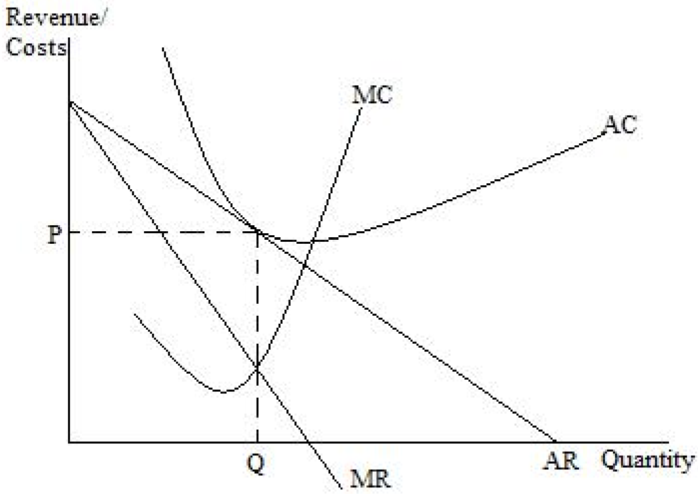 Example of elimination mark: Knock out of A because monopoly has high entry barriers Not D as only monopoly can make supernormal profit in the long run	

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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 ≠ MC and AC ≠ 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 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
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

SECTION B

Question Number	Answer	Mark
8	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
9	**Knowledge 2, Application 2, Analysis 1** **Knowledge and analysis** 3 marks for identifying market structure and relevant features. Points might include: • Monopolistic competition or highly competitive (1) • Many small sellers in the market (1) • Low price setting power (1) • Firms sell differentiated goods (1) • Normal profit/low profit margins as a sign (1) of low barriers to entry/exit (1) • Allow up to 2 marks for diagrammatic analysis **Application:** 2 marks for data (1+1 or 2): point might include: • there are many firms 10 000 to 20 000 (1) • cheap, low skill labour are possibly migrants (1) • low level of capital required (1) • everyone paying the same £5 (1) • some offering inside and out washes (1) / similar car washing at each provider (1) • Availability of cheap premises make market entry easier (1)	**(5)**

END OF SECTION B