

Mark Scheme (Results)

Summer 2018

Pearson Edexcel IAL
In Economics (WEC03)
Paper 01 Business Behaviour

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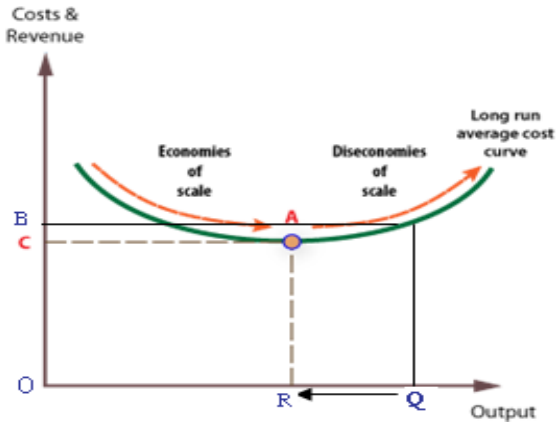
General Marking Guidance

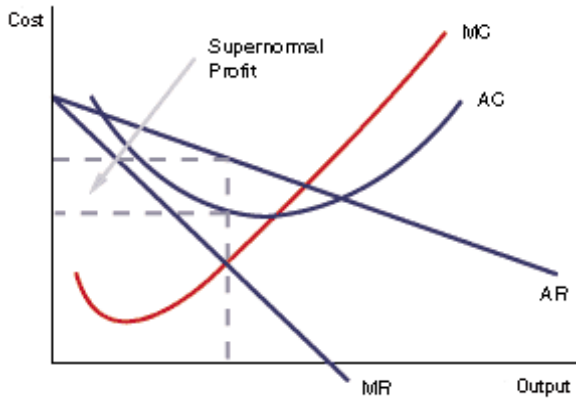
- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should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

Section A: Essay questions

NB: Use levels based mark scheme (20 marks) to mark this section.

Question Number	Answer	Mark
1	**Indicative content** • Explanation of the term 'demerger' – separation of one business into two or more independent businesses. This would apply to the dissolution of a previous merger Possible reasons for a demerger : • To achieve lower LRAC as the business was previously experiencing diseconomies of scale • Following a demerger the business becomes more efficient – less x-inefficiency • Expected synergies from the merger did not occur - hence the firm may reduce its LRAC by demerging • The business was experiencing cultural clashes - different leadership approaches, working practices - especially if sections of the business are operating in different economies e.g. Australia and New Zealand • Business expects to increase profit (or reduce loss) as a result of lower LRAC • The business has sold off parts which were higher risk - e.g. scaling down in countries which are economically or politically unstable • The business experiences an increase in funds through the sale of assets • The business may avoid intervention from competition authorities as it was becoming too dominant in certain markets	

	• Diagram to show impact of the decision The business is currently experiencing diseconomies of scale - output OQ on LRAC curve Following demerger output falls to OR – movement along LRAC and to the left Therefore a fall in LRAC – with a move towards MES LRAC falls from OB to OC  • Credit examples of demergers **Evaluation** • Raising of funds through the sale - the impact depends on how the funds are used – e.g. pay outstanding costs or debts (more short term) compared with used for further investment (more long term) • The business may regret decision (in long run) – if the demerged firm performs well under new ownership and/or was undervalued at the time of sale • The business may experience a rise in LRAC and a reduction in economies of scale - size of business now below point of MES (point A on diagram): e.g. due to the breaking up of a vertical integration (cheaper source of supply) • The impact on economies/diseconomies of scale – may be the most important factor as it affects the business in the long run • The cost of the demerger may outweigh the potential benefits e.g. legal fees, dispute in breaking up, possible redundancy costs, new It systems required etc.	**(20)**

Question Number	Answer	Mark
2	**Indicative content** • Definition of collusion – where firms co-operate in their pricing and output strategies. Applies particularly where the market is an oligopoly. Firms act as if they are a monopoly to consumers e.g. car parts suppliers dividing up the Chinese market between them and sharing information • Collusion provides firms with the ability to fix prices and limit output Collusion may be rational because: • Interdependence of firms in an oligopoly means that firms want to avoid price competition (price wars) • Each firm can protect its ability to gain supernormal profit Monopoly diagram to show SNP  • Barriers enable firms to restrict competition • It reduces unpredictability and uncertainty in the market for collusive firms e.g. prices are more stable and/or set by the firms themselves • Increased profits to firms and greater certainty may encourage firms to increase R and D leading to improved higher long run profits • Firms can avoid a potentially highly damaging price war e.g.in the car parts industry • Tacit collusion may be impossible to prove by competition authorities	

	Evaluation • Benefits to firms may be short-lived if one or more colluding firms break away from the agreement • Falling demand will create tension between firms e.g. during an economic downturn • The entry of new firms into the industry may break existing collusive agreements • It may have been more beneficial for firms to have competed by using non-price strategies • Exposure of anti-competitive behaviour by the government or other regulatory agencies is likely to cause agreement to end e.g. the Chinese regulators • There may be lengthy and costly legal procedures as a result of intervention by regulators • Exposure may mean firms face fines and/or other legal sanctions • May result in negative publicity which may lead to fall in consumer demand • Overall judgements e.g. it depends on whether the benefits from collusion to firms outweigh the costs of exposure of collusion **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	**(20)**

Question Number	Answer	Mark
3	**Indicative content** • Define monopsony power - where there is one buyer, (or one dominant buyer), and many sellers • Pressure group activity may be through the actions and campaigning of: for example; trade unions, suppliers (e.g. farmers), fair trade organisations, consumer organisations • Pressure groups may influence and persuade government to restrict or remove monopsony power. For example by: - Setting a minimum price for suppliers e.g. set price when selling to large UK supermarkets - Increasing the powers of the competition authorities e.g. tightening up competition laws to weaken powers of monopsonist - Regulating profits of monopsonist - Opening up the monopsony market to more competition EFFECTS ON MONOPSONIST • Higher purchasing costs to obtain goods from suppliers leading to lower profit margins • Reduced producer surplus, and lower profit for monopsonist **IMPACT ON BUSINESS BEHAVIOUR OF MONOPSONIST** • Monopsonist may look to become more efficient • Monopsonist may fear government intervention and may modify behaviour to avoid regulation • Lower profits of monopsonist (e.g. supermarkets), may lead to a fall in investment in R & D and a consequent reduction in quality and new product development • Monopsonist may look to cut costs in other ways - e.g. wages, overheads, downsizing	

	• Monopsonist may be able to pass on higher cost of production to consumers in the form of higher prices (especially if demand is price inelastic) • Monopsonist may prefer to use non-price strategies to retain or attract consumers **Evaluation:** • Depends on the effectiveness of pressure groups - size, power and influence over both government and monopsonist • Limits to the powers of pressure groups – if monopsonist is very powerful in the market. In this case there may be little impact on business behaviour • Monopsonist may choose alternative suppliers from other economies where pressure groups have less influence • Pressure group activity may harm the relationship built up between suppliers and monopsonist • Possibility of regulatory capture & government failure, so monopsonist is not adversely affected • Information failure - a government may not have access to relevant information/reluctance of firms to provide the government with relevant information • Short run/long run distinction – removing market power from monopsonist may take time to have any significant impact	**(20)**

Question Number	Answer	Mark
4	**Indicative content** • Definition of a TNC - an international firm which has facilities and other assets in at least one country other than its home country Forms of government intervention and **possible impact on TNC behaviour** • Action against TNC which break laws or conventions to avoid (evade) profits taxes -transfer pricing e.g. Netflix, Google and Amazon. Tightening up tax laws, enforcing fines and other forms of legal action **Impact**: TNC complies and this reduces profits for TNC. May encourage TNC to be more efficient/innovative to restore profits • Stronger legislation and regulation of other TNC activities - employment laws, job protection for employees, health & safety, minimum wages, price and profit regulation **Impact**: TNC may want to enhance its reputation both within the country and in a global sense. Improved living standards for employees and benefits for consumers results in enhanced business reputation for TNC • Competition policy- stronger controls over mergers and takeovers – to limit purchase of large businesses by foreign investors **Impact**: likely to dissuade TNC from attempting a foreign merger/takeover • For any of the above measures a TNC may decide to shift its assets to another economy where government laws and regulations are less stringent	

	Evaluation • A government may be concerned about the threat of TNCs pulling out of the economy – negative consequences on jobs, incomes etc. so measures to control TNCs are weak or not fully enforced • Difficulties of imposing *national* laws and regulations on *transnational* organisations - so have little major impact e.g. French Government may need to get other EU governments to apply the same legal standards • Depends upon the degree of competition in the market(s) in which the TNC operates • Distinction between short run and long run impact - e.g. in the short run TNC may comply but look to shift its resources to another economy in the long run	**(20)**

Section A Questions: Performance Criteria for Mark base 20		
Level 0	0	• No rewardable material
Level 1	1-4	• Displays knowledge presented as facts without awareness of other viewpoints • Demonstrates limited understanding with little or no analysis • Attempts at selecting and applying different economic ideas are unsuccessful • Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
Level 2	5-8	• Displays elementary knowledge of well learnt economic facts showing a generalised understanding together with limited analysis i.e. identification of points or a very limited discussion • Displays a limited ability to select and apply different economic ideas • Material presented has a basic relevance but lacks organisation, but is generally comprehensible. Frequent punctuation and/or grammar errors are likely to be present which affects the clarity and coherence of the writing overall.
Level 3	9-12	• Displays knowledge and understanding of economic principles, concepts and theories as well as some analysis of issues i.e. answer might lack sufficient breadth and depth to be worthy of a higher mark • Shows some ability to apply economic ideas and relate them to economic problems • Employs different approaches to reach conclusions • Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
Level 4	13-16	• Displays a good knowledge of economic principles, concepts and theories together with an analysis of the issues involved • Demonstrates an ability to select and apply economic ideas and to relate them to economic problems • Evidence of some evaluation of alternative approaches leading to conclusions • Material is presented in a generally relevant and logical way, but this may not be sustained throughout. Some punctuation and/or grammar errors may be found which cause some passages to lack clarity or coherence.

Level 5	17-20	• Displays a wide range of knowledge of economic principles, concepts and theories together with a rigorous analysis of issues • Demonstrates an outstanding ability to select and apply economic ideas to economic problems • Evaluation is well balanced and critical leading to valid conclusions • Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

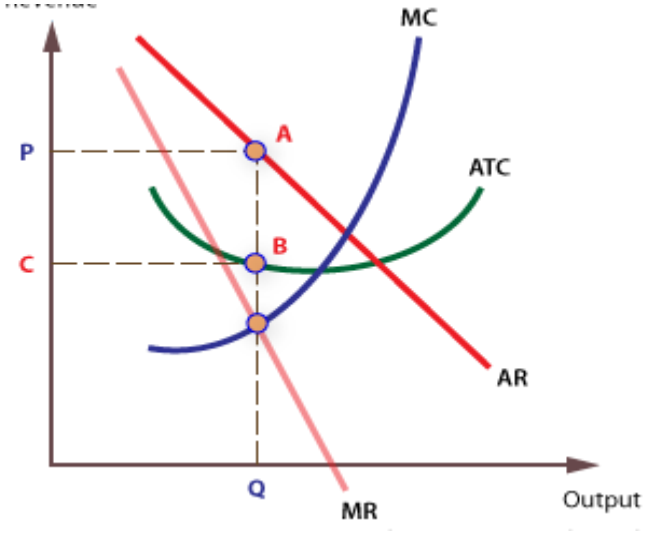
Section B: Data response

Question Number	Answer	Mark
5 (a)	**Knowledge and Application (up to 4 marks)** **Knowledge** – up to 2 marks: • Define price elasticity of demand – the response of QD to a change in price **(1)** • Formula for PED % change in QD/% change in P **(1)** • Define inelastic demand and/or elastic demand (**1** mark for each) **Application** – up to 2 marks: • Demand is price inelastic **(1)** • The price rise is 43% (30/70 x 100%)/ demand is expected to fall by 20% **(1)** • Value of PED is (-) 0.46 or 0.47 or 0.5 **(2)** • Reward accurate, annotated diagram showing inelastic demand curve **(2)**	**(4)**

Question Number		Mark
5 (b)		**(12)**
Knowledge, application and analysis – indicative content		

- Australia Post is government owned - in the public sector
- A business, such as postal services, may have social objectives as a priority - providing a service to the public where profit is unlikely or is a secondary consideration. Australia Post may be providing external benefits especially to more remote rural areas
- Public sector organisations can be financed through tax revenues and therefore may not have profit as a main objective
- A private sector firm e.g. DHL is likely to have profit as its major objective
- Diagram: e.g. Compare a private sector firm with an objective of profit maximisation with a public sector organisation where marginal cost pricing may be an objective (or sales maximisation or revenue maximisation)

Private sector

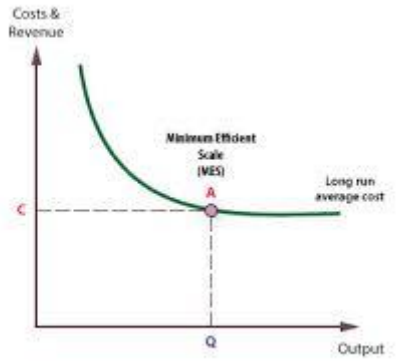


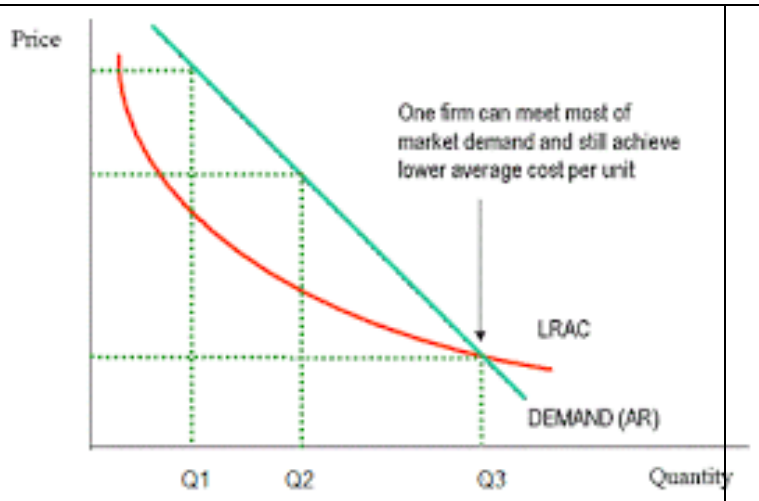
	• Public sector organisations e.g. Australia Post are likely to place a greater emphasis on meeting community needs Whereas shareholders in large private sector companies tend to want good returns in the form of dividend payments and a rising share price	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the differences in business objectives between firms in the public and private sector. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the impact of the differences in business objectives between firms in the public and private sector with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the impact of the differences in business objectives between firms in the public and private sector with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	• Social responsibility can apply to the not for profit part of the private sector and possibly to other parts of private sector e.g. where environmental factors are important • Commercially-based public sector organisations, such as Australia Post, often have a profit objective much the same as in the private sector. It is cross-subsidising in order to make parts of its business more profitable. • Australia Post is competing against private sector businesses in most parts of its organisation • Change in emphasis within the public sector over time e.g. the impact of privatisation and the diminishing importance of nationalisation - profit becoming more important • Differences in objectives may be in relation to priority of importance **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

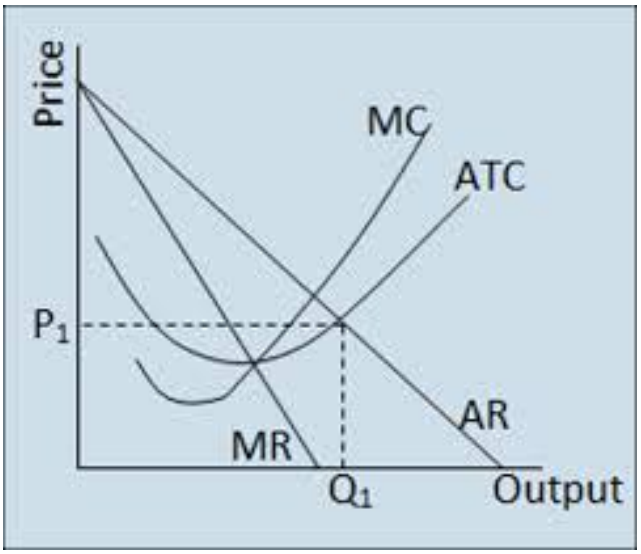
Question Number		Mark
5 (c)		**(12)**
Knowledge, application and analysis – indicative content		
	• Definitions of efficiency – productive (lowest point of AC), allocative (p=MC) and dynamic (technical) • Australia Post has a legal monopoly for letter delivery up to a certain postage size • A monopoly may achieve significant economies of scale and hence lower long run average costs • MES may occur at a high level of output and legal monopoly achieves productive efficiency  • Monopoly has greater potential for **dynamic efficiency** – financial resources for investment in R & D and product innovation for consumer benefit • According to Australia Post, the business exceeded its set target for letter deliveries in 2014 (94.8%) and it has consistently met its targets over 15 years • A monopoly, such as Australia Post, may need to operate efficiently to deter potential entrants, especially if the market is becoming more contestable (e.g. in the Australian postal market) • A monopoly may be created if long run average costs are falling -e.g. railways, water, postal services	

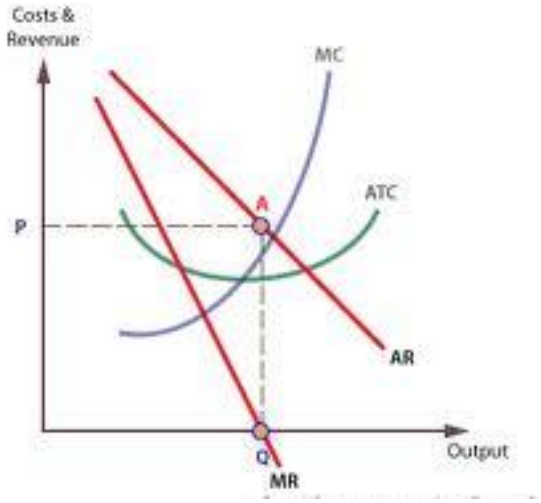


Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the relationship between a monopoly and the degree of efficiency. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the relationship between a monopoly and the degree of efficiency with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the relationship between a monopoly and the degree of efficiency with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	• A monopoly can protect inefficiencies as the firm is not subject to competition • Australia Post has had a range of complaints from angry customers - lost letters, parcel delivery failures etc. • Even though Australia Post has a monopoly for part of its business, the rest of its business is open to competition • Australia Post made a loss of AUD$381million on the monopoly part of its business - this may be a sign of inefficiencies **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question Number		Mark
5 (d)		**(12)**
Knowledge, application and analysis – indicative content		
	Entry of new firms potentially makes the market more competitive/contestable **EFFECTS ON EXISTING FIRMS' BEHAVIOUR** a more competitive market may cause existing firms to, for example: • Lower prices e.g. limit pricing, predatory pricing • Improve quality of products/services e.g. improved delivery times • Innovate (be more dynamically efficient) e.g. electronic bookings for deliveries • Diversify into other markets • Increase advertising and promotion to retain or attract consumers • Firms may aim for sales maximisation. Firms may decide to earn normal profits (AC = AR) rather than profit maximisation as a means of competing and deterring new entrants  Output at Q_1, price of P_1	

	Firms may decide to aim for revenue maximisation for the same reasons as above  Revenue maximisation where MR = 0 • Some existing firms may not be able to compete e.g. Australia Post may find it difficult if government support is removed or reduced • Possible loss of scale economies for existing firms due to new entrants to the market	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the impact of a more competitive market on the behaviour of existing firms. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the impact of a more competitive market on the behaviour of existing firms with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the impact of a more competitive market on the behaviour of existing firms with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	• Existing firms in the Australian post and parcels industry are large private sector companies (DHL etc.) so entry of new firms may have little impact • Depends on the relative size of new firms (e.g. Japan Post) and how much market share they can gain in the short run • Impact may vary according to new entrants' reputation (e.g. new entrants may already be established firms which may have diversified into a new market - so could pose more of a threat) • New entrants may apply hit and run tactics and leave the industry once high short run profits have been gained	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question Number	Answer	Mark
6 (a)	**Knowledge and Application (up to 4 marks)** **Knowledge** - up to 2 marks • A higher price is charged because <u>demand is higher</u> **(1)** • Reward accurate diagram showing initial equilibrium **(1)** • Taxi firms can <u>price discriminate according to time of day</u> **(1)** - They can charge different prices to different users for the same service/may be shown on diagram **(1)** • The higher price may <u>reduce/remove any excess demand</u> **(1)** • Price acts as a rationing device **(1)** • Any other valid point (up to 2 marks) **Application** - up to 2 marks • A rightward shift in the demand curve/may be shown on diagram **(1)** • Various peak times when demand for taxis is likely to be higher - time of day/night **(1)** • Demand for taxis will be more inelastic at peak times **(1)** • Price rise at peak times increases revenue **(1)** and may result in higher profits **(1)** • Higher price will cut back on queues and waiting times for taxis **(1)** • Any other valid point (up to 2 marks)	**(4)**

Question Number		Mark
6 (b)		**(12)**
Knowledge, application and analysis – indicative content		
	Product differentiation is typical of monopolistic competition and oligopoly It may be by: • product features – size of taxi (some may cater for larger groups); age of taxi (an option where consumers pay lower rates for using older taxis) • method of booking a taxi - telephone or hailing a cab in the street or using an app (with firms such as Uber and Safaricom) • Quality of service e.g. reliability (arriving on time, tracking progress of taxis by consumers using apps); safety and security; friendly service by taxi drivers **IMPACT ON PROFIT** If successful, profit should increase because of: • Increased demand by consumers (Diagram showing rightward shift in MR & AR curves and increased gap between AR and AC at profit maximisation) • Demand rises because of: - innovations in the market making it easier to book taxis through apps - the impact of instant customer reviews leading to improved customer service -higher price charged for better quality taxi/larger size etc.	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the impacts on profit of a product differentiation strategy. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the impacts on profit of a product differentiation strategy with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the impacts on profit of a product differentiation strategy with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	• Profit is the difference between revenue and cost. Some firms may gain revenue but costs may rise to a greater extent. This is because of the cost of innovations, providing modern and comfortable taxis etc. • Some taxi firms may lose market share because of the increased product differentiation taking place in the market. Hence profit falls • If the market structure is monopolistic competition any supernormal profits will only apply in the short run. In the long run normal profit is earned • If the market structure is oligopolistic all firms may be differentiating their products because of interdependence. Hence little or no change in profit • Some taxi firms may focus on price competition rather than product differentiation e.g. Mondo Cab to some extent **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question Number		Mark
6(c)		**(12)**
Knowledge, application and analysis – indicative content		
	Define contestable market - a market with few, if any, barriers to entry and exit. Evidence of contestability: • Low set up/sunk costs - relatively low costs involved in buying taxis • Large number of firms in the market - including unlicensed operators • Recent entrants into the market including Uber, Safaricom, Mondo Ride & Taxify • Innovations have opened up the market - the use of apps to order taxis • Predicted that more firms will enter the market	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of contestable markets. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of contestable markets with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of contestable markets with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	• Several competitive strategies currently being used by existing taxi firms. e.g: product differentiation, pricing strategies. These can act as barriers to new entrants • A contestable market depends on the absence of entry and exit barriers and not on the number of firms • The Kenyan Government may choose to restrict the number of taxi firms • Short run/long run distinction. The market currently appears to be highly contestable • In the long run the market may become dominated by the larger firms such as Uber, Mondo Ride & Safaricom • This may lead to increased monopoly power and result in entry barriers being applied - the use of advertising and promotion to create brand awareness and consumer loyalty - aggressive pricing policies to remove competitors e.g. predatory and limit pricing **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question Number		Mark
6(d)		**(12)**
Knowledge, application and analysis – indicative content		
	Regulation may be used to: • Set limits on price and/or profit levels • Set safety and quality standards • Reduce the external costs of production or consumption • More effectively license taxi operators **Reasons for *more* regulation** If it stays mainly unregulated Nairobi's taxi industry could result in: • Unsafe vehicles on the road • An increase in air pollution and congestion; both of which are already severe • A greater number of older taxis being used to keep prices down. These are likely to be less environmentally friendly • A rise in traffic accidents • Hence a rise in external costs and an example of market failure arising from externalities - credit diagram showing a divergence between market equilibrium and social optimum	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the case for government regulation. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the case for government regulation with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the case for government regulation with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – indicative content		
	More regulation is unnecessary as: • Demand for taxis reduces car use so acts as a substitute good • Using taxis may even lower car ownership • More competition may result in 'greener cars' e.g. electric taxis and hybrids • Customer reviews can act as a form of self-regulation- an incentive for taxi firms to improve efficiency • Risks of government failure • An unregulated market may be more innovative and dynamic **Candidates may take either perspective for KAA and the reverse perspective for evaluation.**	

Level	Marks	Descriptor
0	0	Nom evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

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