



# A Level Economics B

**Getting Started Guide**

**Issue 2**

---

**Pearson Edexcel Level 3 Advanced GCE in Economics B (9EB0)**

---

**Please note:** Information within this document relating to AS Level Economics B is no longer applicable because the qualification is no longer available

# Getting Started: A level in Economics B 2015

## Contents

<b>1. Introduction</b>	<b>1</b>
1.1 Research and key principles	1
1.2 Support for the new specifications	2
<b>2. What's changed?</b>	<b>4</b>
2.1 How have AS and A level changed?	4
Changes to AS and A level qualifications	4
Changes to subject criteria	4
Changes to Assessment Objectives	6
2.2 Changes to the Pearson Edexcel AS and A level Economics B specifications	7
Specification overview	7
Changes to specification content	9
Changes to assessment	11
<b>3. Planning</b>	<b>13</b>
3.1 Planning and delivering linear AS and A level courses	13
3.2 Delivery models	13
3.3 Co-teaching AS and A level	14
3.4 Suggested resources	14
<b>4. Content guidance</b>	<b>15</b>
Theme 1: Markets, consumers and firms	15
1.1.1 The economic problem	15
1.1.2 Business objectives	15
1.1.3 Stakeholders (economic agents) and their objectives	16
1.2.1 Role of an entrepreneur in the economy	17
1.2.2 Entrepreneurial motives	18
1.2.3 Factors of production	18
1.2.4 Specialisation	19
1.2.5 The wider economic environment	19
1.3.1 Demand	20
1.3.2 Supply	20
1.3.3 Price determination	21
1.3.4 Price mechanism	21
1.3.5 Understanding the consumer	22
1.3.6 The competition	22
1.4.1 Role of banks in the economy	23
1.4.2 Risk and liability	24

1.4.3 Types and sources of credit and the impact of credit within the economy	24
1.5.1 Market failure and externalities	25
1.5.2 Government intervention and failure	26
1.6.1 Revenue and costs	26
1.6.2 The relationship between revenue and costs	26
1.6.3 Profit and loss	27
1.6.4 Business survival and cash flow	27
Theme 2: The wider economic environment	28
2.1.1 Growth	28
2.1.2 Methods of growth	29
2.1.3 Research and development (R&D) and innovation	29
2.1.4 How the digital economy affects markets and firms	30
2.1.5 How small firms compete	31
2.2.2 Competing on price	32
2.2.3 Types of non-price competition	33
2.2.4 Income elasticity of demand (YED)	34
2.3.1 Productivity	34
2.3.2 Capacity utilisation	35
2.3.3 Efficiency and competitiveness using lean production	36
2.3.4 Impact on costs and sales revenue	37
2.4.1 Globalisation	37
2.4.2 Developed, emerging and developing economies	38
2.4.3 International trade	38
2.4.4 Exchange rates	39
2.5.1 The economic cycle	39
2.5.2 Circular flow of income, expenditure and output	40
2.5.3 Inflation	41
2.5.4 Employment and unemployment	41
2.6.1 Possible macroeconomic objectives	43
2.6.2 Policy instruments	43
2.6.3 Potential policy conflicts and trade-offs	44
Theme 3: The global economy	46
3.1.1 Growing economies	46
3.1.2 Trade and growth	46
3.1.3 Trading blocs	47
3.1.4 Trade policy and trade negotiations	47
3.1.5 Exchange rate changes	48
3.2.1 Conditions that prompt trade	48
3.2.2 Assessing the potential of different economies	49
3.3.1 Responding to global demand	49
3.3.2 Demand-side factors in global markets	50

3.4.1 The impact of multinational corporations (MNCs)	51
3.4.2 Ethical issues	52
3.4.3 Controlling MNCs	52
3.5.1 Employment patterns	53
3.5.2 Wage rates	53
3.5.3 Minimum wage legislation	54
3.6.1 Poverty and inequality	55
3.6.2 Reducing poverty	55
3.6.3 The impact of inequality on economic agents	56
3.6.4 Re-distribution of income and wealth	56
Theme 4: Making markets work	57
4.1.1 Spectrum of competition	57
4.1.2 Barriers to entry	58
4.1.3 Oligopoly	58
4.1.4 Business objectives and pricing decisions	59
4.1.5 Productive and allocative efficiency	59
4.2.1 Market failure	60
4.2.2 Business regulation	61
4.2.3 Arguments for and against regulation	62
4.3.1 Market failure in society	63
4.3.2 Externalities	64
4.3.3 Policies to deal with market failure	64
4.4.1 The AD/AS model	65
4.4.2 Demand-side policies	66
4.4.3 Supply-side policies	67
4.4.4 The impact of macroeconomic policies	68
4.5.1 Risks and uncertainty	68
4.5.2 The role of the financial sector	69
4.5.3 The role of the central bank	70
4.5.4 The Global Financial Crisis	71
<b>5. Assessment guidance</b>	<b>73</b>
5.1 Implications of linear assessment	73
5.2 AS level assessment	73
5.3 A level assessment	74
5.4 Pre-released context (A level Paper 3 only)	74
5.5 Question types	75
5.6 Taxonomy (command words)	75
5.7 Mark schemes	76

<b>6. Quantitative skills</b>	<b>78</b>
6.1 Application of quantitative skills	78
<b>7. Transferable skills</b>	<b>81</b>
7.1 The need for 21st century skills	81
7.2 Cognitive skills	81
7.3 Interpersonal skills	83
7.4 Intrapersonal skills	85
<b>8. Economics B and the EPQ</b>	<b>87</b>

# 1. Introduction

---

## 1.1 Research and key principles

Our new AS and A level Economics specifications are designed to support a range of student interests, learning styles and aspirations for progression.

The specifications have been developed in consultation with the teaching community, higher education, learned societies and subject associations. Teachers from a range of schools and colleges – in focus groups, surveys, phone interviews and face-to-face conversations – have provided feedback at each stage and have helped us to shape the specifications.

Academics in UK universities have helped us understand how to build on the strengths of the 2008 A level Economics and Economics & Business specifications, and advised on how progression to undergraduate study could be improved.

We have commissioned and conducted our own research projects, including international benchmarking. The specifications are also aligned with our World Class Qualification principles to ensure they are appropriate for a range of learners.

Drawing on feedback from all parts of the Economics subject community, the 2015 specifications have been designed to support students in developing the following skills that have been identified as key for progression in economics:

- Thinking like an economist.
- The application of economic concepts and theories to real-world contexts.
- The application of appropriate quantitative skills to relevant economic contexts.
- Engagement with economics through wider reading and an awareness of the current issues impacting on the subject.

The 2015 specifications have been built on the following key principles:

- **Clear specifications.** Clear guidance on what students need to learn, providing clarity for planning, teaching and assessments. The changes we have made to the structure of the specifications are explained in Section 2.2 (page 7).
- **Co-teachable AS and A level courses.** The AS level is embedded in the A level to allow co-teachability. The relationship between AS level and A level qualifications and considerations for co-teaching the qualifications are detailed in Section 3 (page 13).
- **A distinctly different approach.** The specifications promote a distinctly different teaching and learning approach, requiring the investigation of economic theory through real-world business contexts and the environment in which businesses operate. The specifications give students the opportunity to use economic theory to explain events while simultaneously developing an understanding of the practical strategies employed by businesses in responding to these events. Ideas and suggestions for teaching approaches are detailed in Section 4 (starting on page 15).
- **Reflect today's global economy.** Building on the strengths of the International Business unit in the 2008 Economics & Business course, the new specifications ensure students develop an understanding of the current global issues which impact on economies and businesses operating within them. An overview of the global theme can be found on page 9 and the changes made to this theme (compared with the 2008 specification) are summarised in the table on page 10.

- **Engaging and relevant content.** The specifications have been updated to reflect developments and current issues in the subject area. The introduction of the financial sector supports student understanding of recent economic events and the 2008 Global Financial Crisis. The investigation of consumer behaviour, business decisions, and government objectives and policies ensures students explore current issues in the subject area. A summary of these changes compared with the 2008 specification are summarised in the table on page 10. Ideas and suggestions for teaching approaches are detailed in Section 4, and further support for the new areas of the specification are available on the Economics B pages of the Edexcel website.
- **Clear assessments.** Clear and consistent use of command words across assessments and between series. Our approach to the assessments, definitions for the command words and details of how the command words relate to the assessments are explained in Section 5, starting on page 73.
- **Real-world focus.** All of the assessments are based on real businesses, real data and real issues. This helps provide stimulating assessment materials to cover a wide range of economic issues and business contexts for students to engage with. This is further supported by a pre-released context. (See Section 5, starting on page 73.)
- **Clear mark schemes.** The new mark schemes provide a consistent understanding of the skills and connections between these skills required for each question type. Clear wording reflects how teachers and examiners describe the qualities of student work, so the expectations are clear for teachers and for markers. Our approach to skills-based mark schemes is explained in Section 5.7 on page 76.
- **Skills for progression.** The pre-released context will encourage students to develop transferable research skills to support study in a wide range of subjects at university and the transition to employment. These skills include numeracy, communication, critical thinking, an understanding of the business environment and commercial awareness. Our approach to skills development is detailed in Section 5 (pre-release), Section 6 (quantitative skills), Section 7 (transferable skills) and Section 8 (Economics B and the Extended Project Qualification).

### 1.2 Support for the new specifications

This *Getting Started* guide provides an overview of the new AS and A level specifications to help you get to grips with the changes to content and assessment, and to help you understand what these changes mean for you and your students.

We will be providing a package of support to help you plan and implement the new specifications:

- **Planning.** In addition to the relevant section in this guide, we will be providing a course planner and schemes of work that you can adapt to suit your department. We will also be providing mapping documents to highlight key differences between the new and 2008 specifications.
- **Teaching and learning.** To support you with delivering the new specifications, we will be providing suggested resource lists, regular case studies and suggested activities, a student guide and materials for options evenings.
- **Understanding the standard.** Exemplar student work with examiner commentaries for the sample assessment materials will be provided.
- **Tracking learner progress.** Our ResultsPlus service provides the most detailed analysis available of your students' exam performance. It can help you identify topics and skills where students could benefit from further learning. Extra assessment materials for A level will also be available to support formative assessment.

## 1. Introduction

- **Support.** Our subject advisor service, led by Colin Leith, and our online community will ensure you receive help and guidance from us, as well as sharing ideas and information with each other. You can sign up to receive e-newsletters from Colin to keep up-to-date with qualification updates, and product and service news.

These support documents will be available on the Economics B pages of the Edexcel website.



## 2. What's changed?

### 2.1 How have AS and A level changed?

#### Changes to AS and A level qualifications

From September 2015, A level Economics B will be a linear qualification. This means that all examinations must be sat at the end of the course. More information about the implications of the move to linear assessment is given on page 13.

From September 2015, AS level Economics B will be a standalone qualification. This means that it cannot be used to contribute towards an A level Economics B grade. More information about the relationship between AS and A level is given on page 13.

#### Changes to subject criteria

The subject content requirements for AS and A level Economics have been revised. All awarding organisations' specifications must meet these criteria. The full subject content document can be found on the Department for Education's website, but the boxes below highlight the key requirements.

The following requirements apply to both AS and A level Economics specifications:

**AS and A level** specifications must require students to:

- develop an understanding of economic concepts and theories through a critical consideration of current economic issues, problems and institutions that affect everyday life
- develop analytical and quantitative skills in selecting, interpreting and using appropriate data from a range of sources
- explain, analyse and evaluate the strengths and weaknesses of the market economy and the role of government within it
- develop a critical approach to economic models of enquiry, recognising the limitations of economic models
- understand microeconomic and macroeconomic market models; use the models to explore current economic behaviour; make causal connections; and develop an understanding of how the models shed light on the economy as a whole
- be aware of the assumptions of the model of supply and demand; explain the way it works using a range of techniques; and use the model to describe, predict and analyse economic behaviour
- develop an understanding of the benefits of markets and the reasons why they may fail; understand the implications of market failure for individuals, firms and government; and recognise the possibility of government failure
- use the aggregate demand/aggregate supply (AD/AS) model and data to understand why supply-side and/or demand-side policies may be seen as appropriate ways of managing an economy
- consider the possible impact of macroeconomic policies; recognise the issues governments face in managing the macroeconomy; argue for different approaches; and identify criteria for success and evaluate effectiveness
- develop the ability to apply and evaluate economic models as represented in written, numerical and graphical forms; interpret and evaluate different types of data from multiple sources; and propose and justify possible responses to economic issues.

## 2. What's changed?

All **AS** and **A level** specifications must cover the following core knowledge, understanding and skills:

### **Economic choices and markets**

- Scarcity and choice: the basic economic problem, opportunity cost, specialisation and trade.
- How competitive markets work: allocation of resources, the objectives of economic agents, supply and demand, elasticity.
- Market failure and government intervention: externalities, alternative methods of government intervention, government failure.

### **The national and global economy**

- The determination of output, employment and prices: circular flow of income, expenditure and output, aggregate demand and aggregate supply.
- Economic policy objectives and indicators of macroeconomic performance: for example, economic growth, employment, inflation, the balance of payments; potential policy conflicts and trade-offs.
- The global context: international trade, exchange rate changes.
- The application of policy instruments: the nature and impact of fiscal, monetary, exchange rate and supply-side policies.

The following requirements also apply to A level Economics specifications:

**A level** specifications must require students to:

- develop an understanding of the role and impact of the financial sector
- recognise the assumptions, relationships and linkages of the possible impacts of macroeconomic policies
- apply and evaluate economic concepts, theories, methods and models to a wider range of contexts.

**A level** specifications must also cover the following core knowledge, understanding and skills:

### **Economic choices and markets**

- Scarcity and choice: the margin.
- How competitive markets work: productive and allocative efficiency, the interaction of markets.
- Competition and market power: business objectives, market structures and their implications for the way resources are allocated, interdependence of firms.
- Labour market: wage determination, labour market issues, government intervention.
- Market failure and government intervention: market power, information asymmetries.

### **The national and global economy**

- Financial sector: the role of the financial sector and its impact on the real economy, financial regulation, role of central banks.
- Economic policy objectives and indicators of macroeconomic performance: income distribution and welfare.
- The global context: globalisation, trade policies and negotiations.

The main changes in the revised subject content are:

- the core content requirements (outlined in the tables above) must constitute 60% of the AS and A level specification content
- there is now defined core content for AS level
- the financial sector and labour markets are included within the core content
- there is greater emphasis on the application of appropriate quantitative skills in a range of economic contexts. The assessment of these skills will include at least Level 2 mathematical skills as a minimum of 15% of the overall AS and 20% of the overall A level marks.

Students are expected to accomplish the following quantitative skills as part of their AS and A level study:

- calculate, use and understand ratios and fractions
- calculate, use and understand percentages and percentage changes
- understand and use the terms mean, median **and relevant quantiles**
- construct and interpret a range of standard graphical forms
- **calculate** and interpret index numbers
- **calculate cost, revenue and profit (marginal, average, totals)**
- **make calculations to convert from money to real terms**
- make calculations of elasticity and interpret the result
- interpret, apply and analyse information in written, graphical and numerical forms.

*Note: emboldened skills are not a requirement in the AS level.*

More information about the application of quantitative skills is given in Section 6 on page 78.

### Changes to Assessment Objectives

The AS and A level Economics Assessment Objectives have been revised. The objectives have been made more explicit to exemplify the skills developed through the AS and A level specifications. The Assessment Objectives are the same for both AS and A level but the weightings are different.

<b>A01</b> AS 25–35% A level 20–30%	Demonstrate knowledge of terms/concepts and theories/models to show an understanding of the behaviour of economic agents and how they are affected by and respond to economic issues
<b>A02</b> AS 25–35% A level 20–30%	Apply knowledge and understanding to various economic contexts to show how economic agents are affected by and respond to issues
<b>A03</b> AS 15–25% A level 20–30%	Analyse issues within economics, showing an understanding of their impact on economic agents
<b>A04</b> AS 15–25% A level 20–30%	Evaluate economic arguments and use qualitative and quantitative evidence to support informed judgements relating to economic issues

## 2. What's changed?

### 2.2 Changes to the Pearson Edexcel AS and A level Economics B specifications

Economics B is a new qualification and would be a suitable successor to our Economics & Business qualification.

Students apply economic theory to real-life business contexts to help them understand the complexities of the world around them. Students also use data to help them analyse markets and economies, and how governments try to influence both. Students use economic theory to explain events and develop an understanding of the strategies employed by businesses in responding to these events.

The A level specification is structured into four themes. In this structure students are introduced to core economic concepts and develop a broad understanding of economic issues and how these relate to business contexts, before building on this core knowledge and understanding to consider more complex issues and wider contexts. In this thematic approach, progression is continuous as students develop their knowledge and understanding throughout the course.

In developing the 2015 specifications we have retained the strengths of the 2008 specification:

- integrated approach
- engaging and updated content
- real-world contexts
- global focus
- pre-released context in A level
- AS and A level courses designed to allow co-teachability.

Changes have been made to the specification content and the assessments to ensure the revised subject content and assessment requirements for economics are met, and to bring the specifications up-to-date.

The layout of the new specification ensures that the required content is clear and comprehensive. Section 4 of this guide gives further examples and guidance for each topic area.

#### Specification overview

The specification content is organised into a coherent and logical structure to enable students to build breadth and depth of knowledge throughout the course. Theme 1 and Theme 2 focus on how markets work and introduce students to economics through building knowledge and understanding of core microeconomic and macroeconomic concepts and how these relate to business contexts. Breadth and depth of knowledge and understanding with applications to more complex concepts and models is developed through Theme 3 and Theme 4 content, which focus on the dynamic nature of the economy in terms of influences and changes.

The charts on page 8 provide an overview of the AS and A level specifications, indicating the relationship between the two. (Further guidance on the relationship between AS and A level is provided in Section 3, starting on page 13.)

The A level is structured into four themes with three externally assessed exams:

<p><b>Theme 1</b> <b>Markets, consumers and firms</b></p> <p>1.1 Scarcity, choice and potential conflicts 1.2 Enterprise, business and the economy 1.3 Introducing the market 1.4 The role of credit in the economy 1.5 Market failure and government intervention 1.6 Revenue, costs, profits and cash</p>	<p><b>Theme 2</b> <b>The wider economic environment</b></p> <p>2.1 Business growth and competitive advantage 2.2 Firms, consumers and elasticities of demand 2.3 Productive efficiency 2.4 Life in a global economy 2.5 The economic cycle 2.6 Introduction to macroeconomic policy</p>
<p><b>Theme 4</b> <b>Making markets work</b></p> <p>4.1 Competition and market power 4.2 Market power and market failure 4.3 Market failure across the economy 4.4 Macroeconomic policies and impact on firms and individuals 4.5 Risk and the financial sector</p>	<p><b>Theme 3</b> <b>The global economy</b></p> <p>3.1 Globalisation 3.2 Economic factors in business expansion 3.3 Impact of globalisation on global companies 3.4 Impact of globalisation on local and national economies 3.5 Global labour markets 3.6 Inequality and redistribution</p>
<p><b>Paper 1</b> <b>Markets and how they work</b> Assessing Theme 1 and Theme 4</p>	<p><b>Paper 2</b> <b>Competing in the global economy</b> Assessing Theme 2 and Theme 3</p>
<p><b>Paper 3</b> <b>The economic environment and business</b> Assessing all themes</p>	

The AS level is embedded in the A level: Theme 1 and Theme 2 comprise the same content for both the AS and A level specifications. There are two exams:

<p><b>Theme 1</b> <b>Markets, consumers and firms</b></p> <p>1.1 Scarcity, choice and potential conflicts 1.2 Enterprise, business and the economy 1.3 Introducing the market 1.4 The role of credit in the economy 1.5 Market failure and government intervention 1.6 Revenue, costs, profits and cash</p>	<p><b>Theme 2</b> <b>The wider economic environment</b></p> <p>2.1 Business growth and competitive advantage 2.2 Firms, consumers and elasticities of demand 2.3 Productive efficiency 2.4 Life in a global economy 2.5 The economic cycle 2.6 Introduction to macroeconomic policy</p>
<p><b>Paper 1</b> <b>Markets, consumers and firms</b> Assessing Theme 1</p>	<p><b>Paper 2</b> <b>The wider economic environment</b> Assessing Theme 2</p>

### Changes to specification content

Changes have been made to the specification content, both to ensure the revised subject content requirements for economics are met and to refresh the specifications to bring them more up-to-date in response to our research findings; for example, by incorporating current issues such as the digital economy.

The following content has been included in addition to the core content specified in the DfE subject criteria (outlined on pages 4 to 6). The content outlined in the table below has been included for contextualisation and for developing depth. This is achieved through integrating economic theory with business contexts. This allows students to explore the complexities of real-world problems and develop an appreciation of a range of differing perspectives.

Specification content	Rationale for inclusion
Business contexts	<p>Business contexts are integrated throughout the course to provide a contextualised approach to economics, with less emphasis on abstract models and more emphasis on real-world case studies. This demonstrates how economics can be used to understand the business world, and how the business world provides relevance and engagement to the study of economics.</p> <p>The inclusion of business contexts supports key stakeholder findings, supports progression to university study and supports students in making sense of the world in which they live. This approach was pioneered by the Nuffield Foundation.</p>
Global focus	<p>Theme 3 focuses on global economies and the global context. This demonstrates how economic concepts and theories can be applied in different and real-world contexts. This supports student appreciation of the contribution of economics to the wider social and economic environment, and broadens their knowledge and understanding beyond the UK context.</p>

The table on page 10 is an overview of the specification content. Economics B would be a suitable successor to the 2008 Economics & Business specification; detailed mapping of individual topics from the 2015 specification to the 2008 Economics and 2008 Economics & Business specifications can be found on the Economics B pages of the Edexcel website.

2015 specification content	Highlights
<p><b>Theme 1</b> <b>Markets, consumers and firms</b></p> <p>1.1 Scarcity, choice and potential conflicts</p> <p>1.2 Enterprise, business and the economy</p> <p>1.3 Introducing the market</p> <p>1.4 The role of credit in the economy</p> <p>1.5 Market failure and government intervention</p> <p>1.6 Revenue, costs, profits and cash</p>	<p>This theme introduces students to the economic problem, market failure and government intervention.</p> <p>Highlights include:</p> <ul style="list-style-type: none"> <li>• consumer choices and enterprise in the economy</li> <li>• the market economy and how market forces shape the way in which firms meet consumer demand</li> <li>• the role of banks in the economy.</li> </ul>
<p><b>Theme 2</b> <b>The wider economic environment</b></p> <p>2.1 Business growth and competitive advantage</p> <p>2.2 Firms, consumers and elasticities of demand</p> <p>2.3 Productive efficiency</p> <p>2.4 Life in a global economy</p> <p>2.5 The economic cycle</p> <p>2.6 Introduction to macroeconomic policy</p>	<p>Macroeconomic policy is introduced in this theme, and students are introduced to the economic cycle and the global economy.</p> <p>Highlights include:</p> <ul style="list-style-type: none"> <li>• how consumers are influenced by and respond to changes in prices and incomes</li> <li>• small firm survival in competitive markets</li> <li>• an introduction to developed, emerging and developing economies.</li> </ul>
<p><b>Theme 3</b> <b>The global economy</b></p> <p>3.1 Globalisation</p> <p>3.2 Economic factors in business expansion</p> <p>3.3 Impact of globalisation on global companies</p> <p>3.4 Impact of globalisation on local and national economies</p> <p>3.5 Global labour markets</p> <p>3.6 Inequality and redistribution</p>	<p>Building on Theme 2 content, students develop their understanding of the global context. The content has broadened to developing economies such as Africa. Students are also introduced to global labour markets and inequality and redistribution.</p> <p>Highlights include:</p> <ul style="list-style-type: none"> <li>• the impact of globalisation and expansion into new markets</li> <li>• global employment</li> <li>• poverty and inequality.</li> </ul>
<p><b>Theme 4</b> <b>Making markets work</b></p> <p>4.1 Competition and market power</p> <p>4.2 Market power and market failure</p> <p>4.3 Market failure across the economy</p> <p>4.4 Macroeconomic policies and impact on firms and individuals</p> <p>4.5 Risk and the financial sector</p>	<p>This theme has a greater focus on market failure and macroeconomic policies, building on knowledge and understanding from Theme 1. Students are also introduced to risk and the financial sector.</p> <p>Highlights include:</p> <ul style="list-style-type: none"> <li>• market power</li> <li>• market failure and macroeconomic policies</li> <li>• the Global Financial Crisis.</li> </ul>



## 2. What's changed?

### Changes to assessment

The assessment structure for AS and A level Economics B is outlined in the charts below and on page 12. More detail on the assessment for each component is given in Section 5, starting on page 73.

There are three **A level** papers, each comprising 100 marks and 2 hours in duration.

<p><b>Paper 1</b> <b>Markets and how they work</b></p> <p>Total marks: <b>100</b> Weighting: <b>35%</b> Exam time: <b>2hrs</b></p> <p>Questions drawn from Theme 1 and Theme 4 content.</p>	<p><b>Section A:</b> Based on stimulus material. One data-response question comprising a number of parts.</p>
	<p><b>Section B:</b> Based on stimulus material. One extended open-response question.</p>
	<p><b>Section C:</b> Based on stimulus material. One extended open-response question.</p>
<p><b>Paper 2</b> <b>Competing in the global economy</b></p> <p>Total marks: <b>100</b> Weighting: <b>35%</b> Exam time: <b>2hrs</b></p> <p>Questions drawn from Theme 2 and Theme 3 content.</p>	<p><b>Section A:</b> Based on stimulus material. One data-response question comprising a number of parts.</p>
	<p><b>Section B:</b> Based on stimulus material. One extended open-response question.</p>
	<p><b>Section C:</b> Based on stimulus material. One extended open-response question.</p>
<p><b>Paper 3</b> <b>The economic environment and business</b></p> <p>Total marks: <b>100</b> Weighting: <b>30%</b> Exam time: <b>2hrs</b></p> <p>A broad context will be issued in November of the previous year. Questions drawn from all themes.</p>	<p><b>Section A:</b> Based on stimulus material. This section will focus on the broad pre-released context. One data-response question comprising a number of parts, including one extended open-response question.</p>
	<p><b>Section B:</b> Based on stimulus material. This section will focus on a strand within the broad pre-released context. One data-response question comprising a number of parts, including one extended open-response question.</p>



There are two **AS** papers, each comprising 80 marks and 1.5 hours in duration.

<p><b>Paper 1</b> <b>Markets, consumers and firms</b></p> <p>Total marks: <b>80</b> Weighting: <b>50%</b> Exam time: <b>1hr 30</b></p> <p>Questions drawn from Theme 1 content.</p>	<p><b>Section A:</b> Based on stimulus material. One data-response question comprising a number of parts.</p>
	<p><b>Section B:</b> Based on stimulus material. One data-response question comprising a number of parts.</p>
	<p><b>Section C:</b> Based on stimulus material. One extended open-response question.</p>
<p><b>Paper 2</b> <b>The wider economic environment</b></p> <p>Total marks: <b>80</b> Weighting: <b>50%</b> Exam time: <b>1hr 30</b></p> <p>Questions drawn from Theme 2 content.</p>	<p><b>Section A:</b> Based on stimulus material. One data-response question comprising a number of parts.</p>
	<p><b>Section B:</b> Based on stimulus material. One data-response question comprising a number of parts.</p>
	<p><b>Section C:</b> Based on stimulus material. One extended open-response question.</p>

Changes have been made to the approach of the AS level and A level papers to ensure the assessments are clear and consistent, enabling students to understand the skills they are required to demonstrate without overly focusing on exam technique. The changes summarised below are explained in detail in Section 5 starting on page 73:

- A reduction in the variety of **command words** used, careful definition of the skills that comprise each command word, and consistent application of the command words within and across assessments.
- **Skills-based mark schemes** that focus on the qualities students are required to demonstrate in their answers, rather than the quantity of points within responses. Clarity of the skills comprising each command word reflects how teachers and examiners describe the qualities of student work, so the expectations are clear for teachers and for markers, reducing subjectivity.
- **Short-answer questions** that focus on knowledge, understanding and application. These ensure the integration of assessment objectives within questions so they are not considered in isolation, support the application of knowledge to real-business contexts, and require students to demonstrate a holistic understanding of economics through making connections between their knowledge of economic theories and concepts and business contexts.
- A focus on the skills required for progression to university and employment within the **pre-released context**.

## 3. Planning

---

### 3.1 Planning and delivering linear AS and A level courses

Both the AS and the A level qualifications are linear, with assessments taken at the end of the course. There will be no January assessment window.

For AS, therefore, centres can decide whether to teach Theme 1 and Theme 2 in parallel or sequentially, based on their timetabling and staffing situation.

For A level, centres will need to decide whether they are delivering the A level on its own or co-teaching AS and A level students together, as this may impact on the approach to teaching in the first year. See Sections 3.2 and 3.3 below for further guidance on this.

With a linear A level, consideration will need to be given to leaving sufficient time for revision in the second year, particularly to revisit topics studied in the first year. The structure of the course supports continuous revision as students develop knowledge and understanding from Theme 1 and Theme 2 to Theme 3 and Theme 4.

### 3.2 Delivery models

One of the first decisions centres will need to make is the approach to offering AS and A level. The benefits of a linear A level course include more flexibility in structuring the course, more time for teaching in the first year, greater student maturity when completing assessments and more opportunity for students to make links between different elements of the course. On the other hand, it means that all students must embark on a two-year course; any student who leaves the course after one year, for whatever reason, will leave with no qualification.

Centres wishing to offer the AS alongside the A level will need to decide whether they can run separate AS and A level classes, or whether AS and A level students will need to be taught in the same class. Co-teaching means that students may be able to delay their decision on whether to take the full A level until they have experience of the subject content; many students are learning Economics for the first time at this level. Those who do go on to the full A level would still have to be examined on all the A level content at the end of the second year and their AS grade would not count towards their A level grade.

Centres are advised to check the funding implications of students delaying AS and A level decisions.

Centres co-teaching the AS will follow a thematic approach, delivering Theme 1 and Theme 2 in the first year. The themes could be run in parallel or taught sequentially, depending on what is most appropriate for staffing and timetabling within each centre. Centres offering only the A level may also start with Theme 1 and Theme 2 in the first year, but could decide to structure the course differently and adopt an integrated approach, for example by bringing aspects from Theme 4 into the course earlier. Suggested different approaches to structuring the course are given in the separate course planner documents (available on the Economics B subject pages of the Edexcel website). The chart on page 14 illustrates the different options described above.

	<b>Sept 2015</b>	<b>Jan 2016</b>	<b>June 2016</b>	<b>Sept 2016</b>	<b>Jan 2017</b>	<b>June 2017</b>
<b>AS level only</b>	Theme 1	Theme 2	Enter for AS level qualification			
<b>Co-teaching AS and A level</b>	Theme 1	Theme 2	Enter for AS level qualification	Theme 3	Theme 4	Enter for A level qualification
<b>Thematic approach to A level</b>	Theme 1	Theme 2	Mock for Themes 1 and 2	Theme 3	Theme 4	Enter for A level qualification
<b>Integrated approach to A level</b>	Themes 1, 2, 3 and 4 (integrated approach)					Enter for A level qualification

### 3.3 Co-teaching AS and A level

The AS level is embedded in the A level: Theme 1 and Theme 2 have the same content for the AS and A level specifications. This means that Theme 1 and Theme 2 can be co-taught for AS and A level.

The AS and A level assessments are differentiated. Content in Theme 1 and Theme 2 may be assessed at both AS and A level, but the style of questions may be differentiated. For example, students may be asked to define a concept from Theme 1 in the AS level assessments but may be asked to explain the impact of this concept in the A level assessments. Students may be required to perform a calculation at AS level but may be asked to complete an additional step (such as interpret the result of this calculation) at A level.

### 3.4 Suggested resources

To support in the teaching and learning of the new specifications, we will provide a comprehensive suggested resources list to capture a range of sources you may find useful. The list will be regularly updated and can be viewed on the Economics B pages of the Edexcel website.

## 4. Content guidance

**This section provides ideas and suggestions for teaching approaches and is not intended to be prescriptive. The specification should be referred to as the authoritative source of information.**

### Theme 1: Markets, consumers and firms

This section provides ideas and suggestions for teaching approaches for Theme 1 and is not intended to be prescriptive. The specification should be referred to as the authoritative source of information.

#### 1.1 Scarcity, choice and potential conflicts

This section introduces the basic economic concepts and what the study of economics entails. These are the fundamental concepts which will reoccur throughout all the themes, and students will be expected to be able to use these concepts in both economic and business contexts. Scarcity and choice should be taught from a theoretical viewpoint but students should be able to apply these to the choices made by individuals, businesses and governments on a day-to-day basis.

Examples of conflicts which arise from scarce resources should be developed, and students will be expected to evaluate the strategies used and the impact on economic agents such as consumers, producers and the government.

The objectives of firms should be considered for different sizes of businesses ranging from small sole traders to large multinationals. Students should develop an appreciation that not all firms aim to maximise profit and that there may be ethical considerations for social enterprises such as One Water. Economic agents (stakeholders) are integral to the course, and the different stakeholders and how the actions of different economic agents impact on them should be examined.

##### 1.1.1 The economic problem

- a Students should develop an understanding of the economic problem, understanding that there are unlimited wants but a finite amount of resources. Factors of production (in 1.2.3) should be introduced here, including capital, land, labour and enterprise. These can be introduced with examples of different types of businesses.
- b Economics is the 'science of choice' and students need to be aware of the choices which have to be made at local, national and international level. The concept of a trade-off and how this applies to the different economic agents should be investigated.
- c Opportunity cost is fundamental to the study of economics and business. Students need to have a theoretical understanding of this concept and be able to apply the concept to unseen contexts in terms of decision making by the different economic agents, for example the opportunity cost to an individual of remaining in higher education or more complex scenarios such as the impact of changes in government spending.

##### 1.1.2 Business objectives

- a The financial objectives of profit maximisation, sales maximisation and satisficing should be explored. The different financial motives as firms expand can be investigated, and students can explore the difference between profit maximisation and profit satisficing for different local, national and international businesses.

- b Many small businesses are set up with the intention of survival in the first year and sole traders can be examined to explore this objective. For example, students could investigate the reasons for the sole trader's existence in the local economy. The likelihood of failure within the first two years can be investigated.

It is essential that other objectives are also considered for different types of businesses. As the business grows, market share and cost efficiency may become more important than survival. More ethical considerations, such as the impact on other stakeholders, and why some businesses have differing objectives should also be examined. Social objectives and non-financial objectives, such as employee welfare and customer satisfaction, are becoming just as important for many firms, especially in very competitive markets.

### 1.1.3 Stakeholders (economic agents) and their objectives

- a Businesses have different types of internal and external stakeholders, with different interests and priorities. An economic agent, or stakeholder, is defined as any individual or group with an interest in the business and economy. Stakeholders are individuals, groups or organisations that are affected by the activity of the business. Understanding internal and external stakeholders (economic agents) is essential to the course and students should explore a range of stakeholders, including owners/shareholders, employees (directors, managers, employees), customers, suppliers, the local community, the government, banks and other financial lenders, pressure groups and the environment.
- b Owners have a significant say in how the objectives of the business are decided but other groups also have an influence over decision making. For example, the directors who manage the day-to-day affairs of a company may decide to make higher sales a top priority rather than profits. Businesses that ignore the concerns of customers find themselves losing sales to rivals. In a small business, the most important or primary stakeholders are the owners, staff and customers. In a large company, shareholders are the primary stakeholders as they can vote out directors if they believe they are running the business badly.
- c It is impossible for any business to meet the demands of all its stakeholders – they invariably conflict. A firm must find a way of prioritising stakeholder demands and therefore balancing out these competing requirements, which involves judgement. It can be argued that there is no scientific way of doing this; someone in the organisation has to make a decision and this decision may be based on a wide range of information they have been provided with. Different stakeholders have different objectives. The interests of different stakeholder groups can conflict. For example, owners generally seek high profits and so may be reluctant to see the business pay high wages to staff. A business decision to move production overseas may reduce staff costs. It will therefore benefit owners but work against the interests of existing staff, who will lose their jobs. Customers also suffer if they receive a poor service.
- d Corporate social responsibility (CSR) has become an important consideration for many large multinational corporations. It is often part of a business's strategic objectives, and many businesses report on their CSR activities and use it as a source of positive public relations (PR). It would be useful to look at a range of businesses that have CSR policies to compare and contrast them, for example BP, BAT, Disney, Tesco and The Body Shop.

## 1.2 Enterprise, business and the economy

This section considers the role and importance of the entrepreneur in the economy. Entrepreneurs create businesses by combining the factors of production: land, labour and capital. Students will need to understand this process, and that the quality and amount of these resources can determine the success of an economy. The impact of the division of labour and of specialisation on businesses and individuals is considered, before a first look at the wider economy.

This section is an introduction to what these terms mean and a consideration of their impact on businesses. Deeper understanding of their causes and policy solutions is explored in Theme 4.

### 1.2.1 Role of an entrepreneur in the economy

- a Many small businesses are formed by entrepreneurs and there are many examples of local businesses which have been set up by sole traders or partnerships. The initial idea has come from the entrepreneur. One of the many roles of the entrepreneur is to organise the factors of production (land, labour and capital, and enterprise) into a form of business ownership. This may be from using existing factors of production, such as taking over an already-established business, or starting from scratch and producing a completely innovative idea. There are many examples which illustrate both paths – *Dragon's Den* is a good example of both types of creative destruction.

Innovation and creative ideas can come from within a larger business organisation rather than just from an entrepreneur running their own business. Creativity and enterprise are encouraged by many small and large organisations. Examples of this include 3M and Google.

In 3M (considered one of the most innovative companies in the world), employees are allowed to spend up to 15% of their time working on ideas that they think might benefit the company. If an idea is proven viable, the company officially funds it. One such funding programme is called the Genesis Grant, which offers researchers up to \$85,000 to carry their projects past the idea stage.

Similarly, Google has set up a formal process for encouraging internal entrepreneurship. Several years ago, Google implemented its concept of Innovation Time Off to encourage creativity among its employees and support continuous innovation. Around 20% of an employee's time was to be spent on company-related work that was of personal interest. Almost half of Google's new product launches – including Gmail, Google News and AdSense – are said to have originated from the Innovation Time Off programme.

- b Once the business has been established, the entrepreneur has the responsibility for all aspects of the business from finance to marketing. The established business will then look to expand to new locations or develop the business in new ways.
- c Adding value is essential for the success of any entrepreneurial activity and there are many examples of how different types of businesses add value from selling their output for more than the cost of the inputs. Students could consider basic examples, such as how a manufacturing firm like Rolls Royce can charge such high final prices for their cars, and service sector businesses such as Toni & Guy in hairdressing. The ways of adding value should be examined and evaluated for their effectiveness in the marketplace.

### 1.2.2 Entrepreneurial motives

This section can be taught with objectives and different business objectives in 1.1.2.

- a The reasons why entrepreneurs set up businesses should be examined: what drives a person to take risks and run their own business as opposed to being an employee within a business? Students should recognise that motives can be divided into two types: financial and non-financial. Many students will be able to identify the main financial reasons for running a business and will be able to give examples of successful entrepreneurs who have become wealthy from their business, such as Peter Jones and Deborah Meaden.

For many firms, large and small, profit acts as an incentive. This could be the only income for sole traders, compared with large multinational corporations who have shareholders and investors to satisfy in terms of dividends and retained profits. Money and profit are great incentives to entrepreneurs and profit can act as a signal to enter a marketplace.

- b Non-financial motives are equally important and students should be encouraged to identify the many different non-financial motives which drive many entrepreneurs. There are many businesses which highlight these types of motives. A good starting point is looking at The Body Shop and Innocent Drinks, which have much more of an ethical/social motive but which did also both start off with financial motives. Students could also look at local businesses and their main reason for existence, and whether any have been set up for independence and the ability to work from home or juggle family commitments.

### 1.2.3 Factors of production

- a The factors of production are another fundamental economic concept which can be applied to either a product or a service and helps to support the theory of the allocation of scarce resources. Enterprise is the creative idea or risk taken by an entrepreneur. The quality of the idea often affects the success or failure of a business. The entrepreneur has to organise the other three factors of production in order to produce goods and services and, if successful, receives profit.
- b Capital can be divided into two types: financial and physical capital. Financial capital is used to purchase physical capital that goes into making other things. Physical capital consists of premises, machinery, equipment, tools, etc. Providers of capital receive interest.

Land is classified as the natural resources needed for the production of goods and services. Resources include timber, land, fisheries, farms and other similar natural resources. Land is usually a limited resource and, although some natural resources – such as timber, food and animals – are renewable, the physical land is usually a fixed resource. Some countries have many natural resources while others are limited in what they can use. Iceland has a plentiful supply of geothermic energy. Geothermal power facilities currently generate 25% of the country's total electricity production.

Labour represents the human capital available to transform raw or national resources into consumer goods. Human capital includes all able-bodied individuals capable of working in the nation's economy and providing various services to other individuals or businesses. This factor of production is a flexible resource as workers can be allocated to different areas of the economy for producing consumer goods or services. Human capital can also be improved through training or educating workers to complete technical functions or business tasks when working with other economic resources.



### 1.2.4 Specialisation

- a The economic theory of specialisation goes back to Adam Smith in his book *The Wealth of Nations* and the making of pins. In the famous example of a pin factory, Smith explained how co-operation between workers in the factory to divide tasks between them raised their combined output. He went on to explain how, by trading with others, both at home and abroad, we could specialise our own production, and society as a whole would benefit from higher incomes and standards of living. The concept of division of labour is the assignment of different parts of a manufacturing process or task to different people in order to improve efficiency. This then enables the worker to exchange their services for other goods and services. A simple starting point can be the different departments within a school in terms of subject specialists, or a simple manufacturing process such as in a car plant. Students should be able to assess the advantages and disadvantages to employers and employees.
- b A modern economy is based on specialisation, trade and exchange. The division of labour is a form of specialisation. Employees specialise in given occupations and machines specialise in certain tasks. Regions and countries specialise in producing goods and services. If people and other resources concentrate on things which they do relatively well, then output increases and economic growth occurs.

### 1.2.5 The wider economic environment

- a This topic introduces the wider business environment in which all businesses operate. This is to give students an understanding of the factors which impact on businesses and their decisions. These will be examined in much more detail in Theme 4. Students do not need to know what causes these changes; the focus here is on how they will affect a business.

Interest rates are vital for many businesses in terms of the cost of borrowing as well as the impact on demand of changes in interest rates. Students will need an understanding of how changes in interest rates may affect consumer demand within an economy and, in turn, how this will affect businesses. Changes in interest rates will also affect the level of borrowing and investment a business is willing to undertake.

Exchange rates can be a confusing topic for many students. The acronym 'SPICED' (Strong Pound: Imports Cheap, Exports Dear) may help students to remember and understand. They will need to know how a change (appreciation/depreciation) in exchange rates will affect both importers and exporters.

Students should understand the difference between direct and indirect taxation and know the main examples of each, such as income tax, corporation tax, VAT and excise duty. They do not need to know the reasons for taxation or any further detail other than to understand how changes in the level of taxation will affect a business. An increase in taxation on consumers will reduce their disposable income and so alter demand for goods and services; an increase in corporation tax will affect levels of retained profit and may even discourage investment or location within a region or country.

Unemployment will have an impact on a wide range of businesses in terms of demand and availability of labour. If unemployment increases this is likely to lead to a fall in consumer incomes and consumer confidence, which will reduce demand for many goods and services. On the other hand, those businesses that are looking to recruit should have a wider pool of labour to choose from and there will be less upwards pressure on wages.



Inflation causes problems within an economy for a number of reasons. For individual businesses it can mean uncertainty, rising costs and falling demand as consumers' real incomes decrease. Many workers react by striving to gain wage increases which increase production costs and reduce profitability unless the business can increase prices. Inflation has redistributive effects and therefore alters patterns of consumer spending, which affects the demand for many goods and services. For the whole economy, it reduces competitiveness with other countries.

### 1.3 Introducing the market

This section covers all aspects of the market, from basic definitions, through the forces that allocate resources, to an understanding of how to use market information to improve the prospects of the firm.

This is an important section as much of what follows in this theme and Themes 2, 3 and 4 rely on a sound understanding of the workings of the market. Students need not just the theoretical background of the market but must also be able to apply it to real-life situations. They may be required to use suitably labelled demand and supply diagrams to show the impact of changing market conditions.

#### 1.3.1 Demand

- a This section introduces the idea of demand and that it comes from consumers who make decisions about where to use their income in order to maximise satisfaction. This leads to an inverse relationship between price and quantity that gives rise to the downward sloping demand curve.
- b Measuring the relationship between price and quantity demanded provides information that is used to create a demand schedule, from which a demand curve can be derived. Once a demand curve has been created, other determinants can be added to the model. Factors affecting demand include price and non-price factors such as changes in income, preferences, price of substitutes, price of complements and expectations.
- c Students need to be clear about the distinction between the movement along a demand curve caused by a change in price and a shift of the demand curve caused by a change in one of the factors of demand.
- d Students are required to illustrate the impact of changes in a range of factors on a diagram, showing the relevant inward/outward shift of the curve. They should also be able to explain why it has happened.

#### 1.3.2 Supply

- a This section introduces the idea of supply and that it comes from producers who make decisions about how much to produce based on price and their own costs. This leads to a positive relationship between price and quantity that gives rise to the upward sloping supply curve.
- b Supply can be measured for a single factor of production, for a single firm, for an industry and for a whole economy. Once a supply curve has been created, other determinants can be added to the model. Factors affecting supply include price and non-price factors such as the availability of factors of production, new firms entering the market, weather and other natural factors, taxes on products and subsidies.
- c Students need to be clear of the distinction between the movement along a supply curve caused by a change in price and a shift of the supply curve caused by a change in one of the factors of supply.

- d Students are required to illustrate the impact of changes in these factors on a diagram showing the relevant inward/outward shift of the curve. They should also be able to explain why it has happened. (Note that although students may need to show in a diagram the impact of indirect taxes and subsidies, they will not need to consider the impact of tax incidence.)

### 1.3.3 Price determination

- a Students need to be able to combine the demand and supply curves, understand equilibrium and be able to produce a fully labelled diagram.
- b Students will need to be able to produce diagrams showing the impact on price and quantity of excess supply and excess demand.
- c Students will need to understand the nature of equilibrium and how the market will clear to restore equilibrium following situations where there has been excess supply or demand.
- d Students will need to be able to illustrate the impact on a market of a change in the factors of demand or supply, showing the resulting inward/outward shift of the demand/supply curve and the impact on equilibrium price and quantity. Students will also be required to explain what has happened.
- e Students should understand that the demand and supply model of the market is just that: a model that simplifies complex situations to aid understanding. Only one variable is examined at a time and the model is analysed under conditions of *ceteris paribus* (assuming other variables remain constant). It is also only a representation of one particular moment in time and likely to change.

### 1.3.4 Price mechanism

- a A market answers three basic questions. What do we produce? How do we produce it? And for whom do we produce it? The price mechanism plays a crucial role in answering these questions and in allocating resources. High prices and profits attract resources to increase market supply and satisfy high demand. In doing so, prices fall and consumer satisfaction increases. In a reverse process, it is the presence of low prices and losses that drive resources out of areas that are no longer demanded towards more profitable uses. Markets also have a rationing function in that scarcity is reflected in high prices, effectively rationing consumption.
- b Markets respond to changes in demand by changes in price, caused by a shift of the demand curve and a movement along the supply curve. This will alter profitability for producers and they respond by increasing/decreasing production.
- c The price mechanism fulfils the same function in local, national and global markets, but the results can vary as each market will reflect different conditions of demand and supply, leading to different outcomes. This can be illustrated by the housing market where, for example, house prices in London far exceed those in the rest of the country. Students will need to know the differences between a mass market and a niche market, and how these differ in terms of products/services, customers and their marketing strategies. Students should have an understanding that price may be more crucial in a mass market and that a niche market may set higher prices.
- d Students should be introduced to the idea that markets have the potential to grow and expand. Students could be asked to examine a range of markets and then comment on which ones are more likely to grow, suggesting reasons why.

### 1.3.5 Understanding the consumer

- a Students should be aware of the nature and purpose of market research in understanding the consumer, the difference between primary and secondary research, the advantages and disadvantages of each, and when they are most likely to be used. The same applies to quantitative and qualitative research.  
It may be worth using Steve Jobs' famous quote about Apple here: 'A lot of times, people don't know what they want until you show it to them.'
- b Market research has limitations. Care must be taken with the questions used in order to yield the right information. Sampling techniques need to be carefully considered to avoid error and bias. Students should be able to assess the value of market research to a business.
- c Students need to understand the role of market segmentation in categorising consumers, considering how and why it is used. Different ways of segmenting the market should be explored and students should appreciate that segmentation can be done on a global or local scale. Segmentation should also be linked to mass/niche markets.

### 1.3.6 The competition

- a Market positioning is how individual products or brands are seen in relation to their competitors by the consumers. Finding and achieving the right market position can be crucial to the success of a business. Some businesses successfully re-position themselves to boost declining sales, such as Skoda and Lucozade.  
Market mapping is the use of a grid showing two features of a market, such as price and consumer age. Individual brands or businesses are added to the grid to show products in relation to each other. It can also show potential niches or gaps in the market. Students should be aware of its usefulness and limitations.
- b Competitive advantage is any feature of a business that enables it to compete effectively with rival products. An advantage may be based on price, quality, service, reputation or innovation. In competitive markets, all businesses must strive for competitive advantage in order to avoid falling sales and rising losses. Students could explore a range of businesses and identify the source of their competitive advantage.
- c Product differentiation may be used to achieve a competitive advantage. This can be based on features of the product such as price, innovation or quality or consumers' perceptions such as brand image and style. Successful differentiation can mean the ability to charge a higher price and increase profitability.
- d Students need to understand the concept of added value and how it can help increase sales. As well as the technical definition, they should be able to link it to differentiation and competitive advantage, and to recognise it from real-life examples.
- e Pricing decisions are a crucial part of marketing and students should know the advantages and disadvantages of different pricing methods. These should include: competitive pricing, cost-plus pricing, penetration pricing, premium pricing, price skimming and predatory/destroyer pricing.
- f The concept of changing markets can be developed here with a more detailed look at markets that are dynamic, are static, or may even shrink and disappear. Once again, practical illustrations would be useful here.

### 1.4 The role of credit in the economy

Firms need finance for a number of different reasons: to cover start-up costs, to ensure adequate cash to operate or for day-to-day costs, and to invest in expanding the business. Although firms need to borrow for capital investment and working capital, borrowing can be both costly and risky. Students will develop an understanding of the role of banks in the economy and the importance of liability.

Starting a new business involves numerous costs. Some of these will be large one-off payments for things like premises and equipment and can be considerable. The business may also need finance to keep paying costs such as wages and raw materials until enough income comes in from its sales.

If all goes well, the business will be successful and make a profit. However, this does not mean that the business will have enough cash on a day-to-day basis to pay its bills. It may well need additional finance to provide sufficient working capital to cope with any cash-flow problems.

There may come a time when the business will want to expand. This may involve extra finance to pay for it. Firms must decide between different types of credit and finance, and be aware of the challenge of obtaining credit.

#### 1.4.1 Role of banks in the economy

- a Banks have traditionally been intermediaries that provided an indirect link between savers who want a secure haven for their money and businesses that need finance for a variety of reasons. This role, although still important, has been complemented by other sources of finance.
- b Considering what credit is, the different ways banks provide it, and why it is essential for the economy is a good starting point for examining the role of banks in providing credit. There are several ways in which credit helps the UK economy. Loans provide businesses with expansion capital. A secured loan is one that is guaranteed by some form of asset, such as buildings and property. An unsecured loan is not backed in the same way.

Business account services enable a business to transact its day-to-day affairs, for example paying wages into employee's accounts, paying bills and taking up periods of credit when applicable. Businesses are able to use bank services such as standing orders and direct debits to pay water, electricity, business rates and other regular bills. Overdraft facilities enable a business to have a short period of credit to smooth out cash-flow difficulties. The business arranges an overdraft limit with its bank and is permitted to borrow up to the arranged overdraft ceiling. Cheques, credit cards and bank drafts enable a business to smoothly manage its day-to-day payments and transactions. Bank statements enable the business to keep a regular check on its accounting position.

The bank will also provide systematic and ongoing advice, particularly to small businesses and start-ups. For example, the bank will provide detailed advice on how to construct and organise a business plan. Banks also provide long-term finance in the form of mortgages for the purchase of land and property. Merchant banks and issuing houses also support companies in the management of share issues, for example by arranging for financial institutions to underwrite a new share issue.

- c Students should explore what interest rates are and what is meant by collateral in terms of deciding the best source of credit for a business that needs additional capital or funds. Students should also consider how banks charge interest on different forms of credit. For example, a bank will lend a business a given sum for a specified period of time, such as £6,000 for 2 years. The business will then repay the capital sum in instalments with interest added, such as £360 per month. The rate of interest on unsecured loans is higher than for secured loans. For overdrafts, interest is charged only on the amount overdrawn each day. For example, if the business was only overdrawn by £100 for 1 day of the year it would pay 1/365th of the annual interest rate for £100.

### 1.4.2 Risk and liability

- a Running a business will involve taking calculated risks. There will be degrees of risk that entrepreneurs will need to take over the course of the business. This could be giving up a well-paid, secure job to run a business or could be linked to the risk from credit and capital borrowing to fund expansion.
- b Students should develop a basic understanding of the legal consequences of why some businesses choose to become a limited company as opposed to remaining as a sole trader. Advantages and disadvantages of the different types of liability should be covered. Students should understand that a wider range of sources of finance are available to limited companies compared with smaller unlimited enterprises.

### 1.4.3 Types and sources of credit and the impact of credit within the economy

Students need to understand the types and sources of credit and the type and sources of finance; understand when these sources of credit and finance might be the most appropriate to use; and any advantages/disadvantages in doing so.

- a Credit is available through different methods:
- Loans involve the use of someone else's money for a period of time, with regular repayments including additional interest.
  - An overdraft is a facility from the bank that allows a firm to spend more than it has in its account up to an agreed limit.
  - Trade credit is the period of time allowed by a business after supplying another business with goods or services before payment is due.
- b High street and commercial banks are some of the main sources of credit available to firms. A report by venture capital group Albion Ventures shows that other lending methods – including mortgages (7%), cash loans from friends (5%) and equity investments from venture capital and angels investors (6%) – have a long way to go before they catch up.
- c Other types of finance are available:
- Venture capital is funding provided by specialist firms or individuals in return for a proportion of the company's shares.
  - Share capital is finance raised by selling shares in the company and can apply to both a private and public limited company.
  - Leasing is a long-term rental agreement that allows businesses to use assets without having to pay for them outright.

## 4. Content guidance

- d Other sources of finance includes the following:
- Owner's capital or equity is the money that the owner(s) have available to put into the business.
  - Retained profit is all the money that is left after all deductions (including tax, interest and any dividends paid to shareholders) have been taken away from total sales revenue. It can then be re-invested into the business.
  - Sale of assets refers to when the business sells assets (things of value such as buildings, land and vehicles) in order to raise money. The business will often lease the assets back again.
  - Individual investors such as friends and family may form part of the finance required for a business. There are many advantages and disadvantages of using this source of finance which should be investigated, and this may lead to conflict within the stakeholder groups depending on the type of business organisation.
  - Online collaborative funding, also referred to as crowdfunding, has become a new source of finance for both business start-ups and expansion for existing businesses. Crowdfunding is the practice of funding a project or venture by raising monetary contributions from a large number of people, typically via the internet. There are many examples on the internet of successful online collaborative funding, and the advantages and disadvantages can be considered.
- e The Institute of Directors has reported that obtaining credit is one of the biggest challenges faced by small and medium businesses and that having a good credit rating is often one of the most difficult things to obtain. Most businesses experience some problems getting paid on time by their customers and, with debt recovery, good credit control helps to prevent this becoming a serious problem. Six out of ten of small firms have a poor credit rating, according to credit reference agency Graydon UK. Having a good credit score is not only important to enable a business to borrow funds, but it also affects the ability to secure good terms on trade credit.

### 1.5 Market failure and government intervention

Theme 1 has already explored the workings of the market in a mostly theoretical manner; for example, that the free market allocates resources in response to consumer demand and that free markets work efficiently. This section introduces the idea that markets often do not produce the required results and actually create problems that need to be addressed.

The first topic covers what these problems are and how markets fail. In order to correct these market failures, some form of government intervention is needed.

The second topic considers how governments can and do intervene. Government intervention does not always solve the problems and can make them worse or create problems elsewhere. This is the concept of market failure.

This section should refer to real-life examples wherever possible.

#### 1.5.1 Market failure and externalities

- a Students need to know and understand the terms private costs, external costs and social costs, and have a practical grasp of real-life examples.
- b Students need to know and understand the terms private benefits, external benefits and social benefits, and have a practical grasp of real-life examples.
- c Once students understand the theory, they could be asked to apply these terms to the production and consumption of something such as cars or alcohol, and to identify examples of cost and benefit for each.



- d The market economy has a number of strengths and students should appreciate the benefits that it can bring in terms of competition, innovation, lower costs, lower prices, service, quality and the efficient allocation of resources.
- e It can also have weaknesses which can be seen as market failure. Market failure occurs when there is an inefficient allocation of resources: the market fails to produce enough of something that we do need or produces too much of something that we do not need. Although merit and public goods are not required here, a discussion of these would be useful.

### 1.5.2 Government intervention and failure

- a When markets fail, the government intervenes to try to correct it. Students could look at various case studies to appreciate the range and scope of intervention in various contexts, such as the labour market and the minimum wage, agricultural subsidies, healthcare and pollution.
- b Governments have several options when it comes to correcting market failure. They can regulate or control the production of externalities; they can pass laws and impose penalties for failure to comply. Taxes and subsidies act as disincentives and incentives to alter consumption/production levels. They can create voluntary codes of conduct and encourage compliance. Students should be familiar with how these would correct market failure and with examples of each.
- c In reality, intervention often leads to government failure. Again, students will need to understand why this can happen and use real-life examples. Interfering with the workings of a market can lead to a misallocation of resources or, while the failure is corrected, other problems/failures being created. For example, the 'help to buy' scheme designed to make it easier for first-time house buyers to purchase a home has arguably led to sharply rising house prices.
- d Students should explore various contexts to understand government failure in various markets. Subsidies can lead to over-production of agricultural products; the minimum wage can cause costs of production to rise; regulation and/or legislation can be costly and time-consuming; and taxation on price inelastic products has little impact other than to increase government revenue.

### 1.6 Revenue, costs, profits and cash

This section introduces students to financial techniques for measuring the way a business is performing. Businesses need to be able to measure their performance and know when to take remedial action. Students will be expected to know how to make a range of calculations, apply them and interpret them. They will need to know what the results show and be able to make comparisons and draw conclusions.

#### 1.6.1 Revenue and costs

- a–c Students need to be familiar with these calculations. Students will be required to make the calculations and use the calculations to interpret data.

#### 1.6.2 The relationship between revenue and costs

- a–d Students need to be familiar with these calculations. Students will be required to make the calculations and use the calculations to interpret data.
- e Students should understand the assumptions that are made when using break-even analysis and how this limits the usefulness of the analysis.

### 1.6.3 Profit and loss

- a The profit signalling mechanism can act as an incentive to enter and exit a market. If a market is seen as profitable, then this is a flag to other producers to enter the market in order to seek profits. The ease of entry and exit depends on the barriers to entry for each individual market.
- b–e In this section, students need to be familiar with the statement of comprehensive income (profit and loss account) and how all of its components are arrived at. They will also need to be able to calculate profit margins and comment on their significance. The final section is about how firms increase profit; students should be able to suggest and evaluate different strategies for doing this, such as increasing price or reducing costs.

### 1.6.4 Business survival and cash flow

- a Many otherwise profitable businesses cease trading because their cash flow has dried up. Students must be able to understand the difference between profit and cash flow and why cash-flow management is a crucial business skill.
- b The importance of cash flow for business survival cannot be underestimated and the difference between profit and cash can be explored here. Cash is the lifeblood of any business and a profitable business can still go into liquidation due to poor cash flow. Many businesses may continue to trade in the short to medium term even if they are making a loss. This is possible if they can delay paying creditors and/or have enough money to pay variable costs. However, no business can survive long without enough cash to meet its immediate needs. The phrase 'cash is king' is often quoted for the importance of business survival. The emphasis here is on simple cash-flow forecasts; complex spreadsheets are not required. However, students are required to interpret cash flow: they should understand the components of cash inflow and cash outflow, and be able to calculate net cash flow and move balances forward.
- c Students are required to use a forecast to recognise when a problem might occur and know what to do about it; it is a tool in identifying credit requirements and minimising risk.



## Theme 2: The wider economic environment

This section provides ideas and suggestions for teaching approaches for Theme 2 and is not intended to be prescriptive. The specification should be referred to as the authoritative source of information.

### 2.1 Business growth and competitive advantage

This section focuses on the motivations for the growth of firms and the methods firms may use to achieve growth. The objectives of firms, including profit maximisation are explored, along with how to increase brand awareness, market share and market power. Research and development (R&D) is examined in the context of establishing and maintaining competitive advantage. The increasing importance of buying and selling online is explored and the section ends with a look at the reasons why small firms continue to thrive despite the advantages accruing to large firms.

#### 2.1.1 Growth

- a Economies of scale build on the work on revenues and costs explored at the end of Theme 1. They lead to a reduction in average costs and the various reasons for this should be explained, including technical, managerial, financial, risk bearing, purchasing and marketing economies of scale. Internal and external economies of scale also need to be defined along with minimum efficient scale of production (MES). A range of examples will make understanding easier.

When considering why firms grow it is important to recognise that there is, in most cases, a desire to increase their market power. Market power is about the extent to which one business can affect what happens in the market, this is about being able to have more control over what goes on rather than having to 'catch-up' with other firms. This includes pricing and marketing.

The impact of increasing market share can be explored through examples such as Kraft's takeover of Cadbury in 2009, where there has been an increased product range, exploitation of brand recognition and evidence of reduced competition.

Links should be made between growth and achieving or increasing competitive advantage, for example how lower costs may lead to higher profits if prices remain the same or lower prices set which may lead to increased demand and higher revenues, both of which can lead to increased profitability.

- b Diseconomies of scale can be explored through case study materials and examples. These might include famous cases such as General Motors. Internal communication becomes more difficult as the size of the organisation grows; mistakes may be made, causing loss of output or orders. A simple game of 'Chinese whispers' can reinforce this point!

Skills shortages have an impact on the productivity, wage costs and the international competitiveness of firms. The impact of skills shortages is to drive up wages, as firms compete to attract scarce employees. In other words, demand for labour exceeds supply.

- c Corporate culture includes: shared values of a firm or workplace; the implicit beliefs and norms that influence all aspects of working life within a firm; and the day-to-day behaviour of employees – ‘the way we do things round here’. Corporate culture can be extremely important for determining the long-term success or failure of a firm and is often influenced by the leadership of the firm and the strength of teamwork. Google is a good example of a dynamic corporate culture.

### 2.1.2 Methods of growth

- a Organic (internal) growth should be compared with inorganic (external) growth and the processes of both explored. The advantages and disadvantages of each should be looked at as well as the distinction between a merger and a takeover. Examples might include Pfizer and AstraZeneca, Disney and Pixar for inorganic, and JCB, Poundland and Subway for organic growth.
- b Horizontal, vertical and conglomerate integration need to be explained and the differences and advantages discussed. Examples are useful here and might include Morrisons and Sainsbury for horizontal integration, oil companies such as BP and Shell for vertical integration and Tata for conglomerate integration.

### 2.1.3 Research and development (R&D) and innovation

R&D is investment in technical and/or scientific research undertaken with a view to introducing new or improved products and services or improving methods of production.

- a The most successful firms systematically pursue innovation (Apple, Samsung) and it becomes part of their corporate culture (Google). Many large multinational corporations are outsourcing and/or offshoring their R&D expenditure to cheaper locations where they benefit from tax concessions, external economies of scale and lower labour costs.
- b R&D is another way of increasing market power. R&D can serve to differentiate the product from that of rival firms, potentially increasing brand loyalty and revenues. Good examples include the smartphone industry, where the dynamic market is characterised by rapid product development.
- c Product innovation is usually associated with relatively small, often subtle changes to the characteristics and performance of a product. Process innovation involves changes to the way in which production takes place to become more efficient. It can also cover business logistics; for example the huge investment by supermarkets in stock control and distribution systems and innovation in the management of employees.
- d R&D leads to economic growth and from the state’s point of view this has clear benefits such as rising GDP and real incomes and falling unemployment. The problem is that R&D can be expensive and not enough is undertaken (there are links here with Theme 1, section 1.5) so the state provides funding. A knowledge of the many grants and government support schemes available is not required, it is the reasons for, and the effects of, state funding that are important. However students may find it helpful to look at some examples on a regional, national and EU level.
- e The product life cycle and the impact of each stage – development, introduction, growth, maturity and decline – on costs, revenues and profits should be covered; the traditional diagram is useful here.  
  
Extension strategies are intended to prolong the useful life of a product before it goes into decline and firms use marketing techniques to improve sales. Examples include: advertising, price changes, adding value, entering new markets at home or overseas and new packaging and branding.

### 2.1.4 How the digital economy affects markets and firms

- a The impact of the internet, including web-based technologies, on firms and consumers has been, and continues to be, significant. The selling and buying of goods and services electronically has changed the nature of many markets in a variety of ways. One of the most significant has been the increase in consumer knowledge, as the widespread use of price comparison sites and consumer reviews has, to some extent, served to reduce the asymmetrical relationship between supplier and consumer.

Viral marketing is a strategy by which a firm, creates a campaign focused on causing viewers of that promotion to spread it by sending it to friends by e-mail, text or social media. Some famous viral marketing campaigns include Touch of Gold (Nike), the Threshers 40% Off Voucher and 'Real Beauty Sketches' (Dove).

Platforms such as Facebook and Twitter provide businesses with not only a way of promoting their business to increase sales and awareness, but also a way of getting valuable feedback from customers. Businesses can also benefit from sites such as LinkedIn which enables professionals to make useful contacts all over the globe. Social media marketing is the process of gaining customer information through social media sites such as Facebook or Twitter with promotions or more targeted micromarketing messages.

- b Micromarketing is usually associated with e-commerce and can be contrasted with mass marketing. Many students will be familiar with micromarketing through their use of social networking and other web media, where they are the target of individualised marketing such as special offers and voucher codes.

The digital economy has affected some retail sectors more than others. Amazon, eBay, Asos and Ocado are obvious examples here. The success of firms such as Vente-privee and SportPursuit and their online 'flash sales' of branded, surplus stock could be examined as a case study.

The rise of the digital economy has also seen a rise in the demand for staff with digital skills, which may be a problem for some businesses as they either struggle to find suitable staff or have to face increased labour costs to recruit and retain them. (There is a link here to the first section on growth and skills shortages.)

- c The long tail theory suggests that consumer choice is widened through online retailing. Firms can maintain and increase sales revenue by selling 'fewer of more products' as opposed to the mass market model of 'selling more of fewer products'. The advantage to a firm of online retailing is that it gives access to a potential worldwide market and the consumer has a worldwide market to choose from.

The ways in which small firms, perhaps supplying niche products, are able to exploit wider geographical markets through online selling can be explored by case studies such as The Cambridge Satchel Company.

- d The digital economy has caused major changes to the way we access and consume products and services. It has affected prices and choice for the consumer; whether the outcomes are positive or negative for all parts of society in both the short and long term is a useful discussion to have. The disappearances of famous names such as Virgin, Blockbuster, Peacocks and Comet have all been blamed to some extent on the digital economy.

For businesses the issues are about profit and loss and survival, the digital economy has opened up markets to more competition. For some this has meant new opportunities, increased sales and profitability but for others it has meant falling profit margins, a struggle to compete and even failure. In many ways, it could be argued that the impact on markets and firms has been to accelerate the process of 'creative destruction'.

Those 'traditional businesses' that have survived and even increased profitability, have done so by embracing features of the digital economy with a multi-channel approach including online stores and phone apps. Examples include Starbucks and its rewards app and UK fashion retailer Oasis with its ecommerce site, mobile app, and brick-and-mortar locations.

### 2.1.5 How small firms compete

- a Students should investigate how and why small firms continue to survive and thrive given the cost advantages enjoyed by large firms. Small businesses are able to exploit their size to offer a more individualised product and better customer experience. This can lead to increased customer loyalty and higher revenues.

There are links here with the previous section on the digital economy which has enabled the creation of many new small firms. The reasons for the survival of small firms in competitive markets could be explored with case studies and examples.

## 2.2 Firms, consumers and elasticities of demand

The focus of this section is on the relationship between the firm and the consumer. Activities that firms engage in to maximise demand for goods and services, as well as the factors which impact on the consumers' willingness and ability to purchase those goods and services, are explored. Pricing strategies are considered, as is the idea of non-price competition.

The concept of price elasticity of demand is used to help students understand and analyse the relationship between price level, demand and sales revenue. The concept of income elasticity of demand is used to help students understand and analyse the relationship between income level, demand and sales revenue.

Much of this section builds upon the work on demand curves covered in Theme 1, it may be useful to remind students of the basics before starting this section. Diagrams should be used to help explain the effects of the variables discussed.

### 2.2.1 Price elasticity of demand (PED)

- a The price of a product or service can be a key part of a marketing strategy; a firm needs to know what will happen to quantity demanded if it changes the price. PED measures the responsiveness of quantity demanded to changes in price. The extent of this responsiveness depends upon the circumstances of the firm. In a mass market where there is a lot of competition demand is much more sensitive to a price change. In a niche market where factors other than price take precedence this responsiveness is likely to be limited or of little importance.
- b There needs to be a basic understanding of how PED is calculated. This should always be to one decimal place and shown as a negative number (this shows that there is an inverse relationship between price and quantity demanded.)

The formula is:

$$\frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}$$

Students may need some basic revision on percentage change and should be given plenty of practice with this calculation.

- c If  $PED = 0$  then demand is said to be perfectly price inelastic. This means that demand does not change at all when the price changes.  
If  $PED$  is between 0 and 1 (i.e. the percentage change in demand is smaller than the percentage change in price), then demand is price inelastic.  
If  $PED = 1$  (i.e. the percentage change in demand is exactly the same as the percentage change in price), then demand is said to be of unitary price elasticity.  
If  $PED > 1$ , then demand responds more than proportionately to a change in price and is price elastic.
- d Factors influencing  $PED$  include: the number and closeness of substitutes; the degree of necessity of consumption or whether the good is a luxury; the percentage of a consumer's income allocated to spending on the good; the time period allowed following a price change; whether the good is subject to habitual consumption. Care should be taken to distinguish between the  $PED$  for an individual good and the  $PED$  for the whole market.
- e In general, firms selling price inelastic goods or services can increase sales revenue by increasing price. By contrast, firms selling price elastic goods or services can increase revenue by decreasing price. This can best be illustrated through a normal supply and demand diagram showing the relative change in revenue ( $P \times Q$ ) when there is a movement along a relatively steep and a relatively flat demand curve.

### 2.2.2 Competing on price

- a Pricing strategies are key marketing tools and students need to know the different types, when they are the most suitable to use and the implications for the business.
  - Cost-plus or 'mark-up' pricing is widely used in retailing, where the retailer wants to know in advance what the gross profit margin of each sale will be. This reduces uncertainty as the firm will know that its costs will be covered if the good is sold. This approach can lead to pricing that is uncompetitive and firms may see a loss of market share, revenues and profits. A simple example can be used to illustrate the calculation required.
  - Price skimming involves setting a high price before other competitors enter the market. It is most commonly used when a new product is launched and faces little or no competition, usually due to technology changes or extremely distinctive product design or branding. Price skimming is usually a short-term strategy as the profit signalling mechanism attracts new entrants to the market and increases competition.
  - Penetration pricing sets a low initial entry price, usually lower than the intended established price or existing competition, to attract new customers. The strategy aims to encourage customers to switch to the new product because of the lower price and then to increase price when customer loyalty is established.
  - Destroyer or predatory pricing (in theory illegal in the UK) is when a dominant firm in a sector deliberately sets prices very low in order to restrict, prevent or eliminate competition. The price set might even be free, or lead to losses by the predator.
  - Competitive pricing is where firms set prices based on those of their competitors. This is often done where the competing products are similar in nature.
  - Psychological pricing is a pricing tactic designed to appeal to customers' emotional rather than rational responses to the pricing of goods and services. Pricing at £12.99 or £99.99 is often an indication of such a tactic.

- b Students should be aware of the various factors that will determine the way that price is set.
  - Number of USPs/amount of differentiation: The more unique the product or the higher the degree of differentiation, the higher the price (premium pricing) is likely to be in relation to the competition. Products that have little in the way of USPs or differentiation may have to rely on low prices to beat their rivals.
  - Price elasticity of demand: Low PED will see higher prices set and high PED will see competitive based pricing or even undercutting to increase sales.
  - Strength of brand: Strong brands have a low PED and therefore premium pricing is likely.
  - Stage in the product life cycle: In the introductory stage penetration pricing could be used if the product has a lot of competition or price skimming if it is a new innovative product and likely to face high initial demand. In the growth and maturity it is more likely to be competitive based. In the decline stage pricing is likely to become lower to keep sales going and to sell off existing stock.
  - Costs and the need to make a profit: If profit is important then price may be set to increase profitability; this may well take the form of cost-plus pricing
- c The impact of social trends is considered in 2.1.4 and should be applied to changes in pricing in this section.

### 2.2.3 Types of non-price competition

- a Product differentiation involves anything from branding and packaging, to advertising and product placement. It is anything which makes the product in some way different to that of a competitor. Successful product differentiation may shift the demand curve outwards (right) increasing demand at all price levels or make the demand curve steeper (more price inelastic) or do both.  
Advertising can be informative and/or persuasive. The impact of advertising and other promotional methods upon the demand curve can be summarised as follows:
  - To increase demand at all price levels, shifting the demand curve outward (right) and increasing equilibrium price and quantity, *ceteris paribus*.
  - To make demand more price inelastic, allowing firms to charge a premium price to maximise revenue and profit or pass on increased costs in the form of higher prices without seeing a fall in revenues. In this case the demand curve will be steep and a change in price will have a proportionately smaller impact upon quantity demanded.

Distribution methods are changing rapidly and there is a link here to the digital economy in the previous section. Amazon can be used here, particularly their Prime service and planned one hour service. Effective distribution can be a crucial competitive advantage and a form of product differentiation.
- b Marketing involves a range of approaches including those detailed above. Which ones are used or take precedence over the others depends on the nature of the product or service, the potential consumer and the market the firm operates in. It may be that the pricing strategy used is the most important element, perhaps the product itself is the most important with its differentiation or USP being a key element, it may be that the way in which it is promoted or advertised becomes crucial and even the distribution method may be important. Students need to be able understand why a particular approach or mix of approaches may be the most appropriate for a particular good or service.



### 2.2.4 Income elasticity of demand (YED)

- a YED measures the responsiveness of quantity demanded to changes in income. Individual incomes changing will have little effect on YED. It is when incomes change for sections of the population that it begins to affect a business. Businesses may need to react to changes in incomes and plan accordingly. The usual cause of this is a change in the economy or government policy. A recession, for example, may witness increasing demand for budget or value products and decreasing demand for luxury or expensive products. A cut in income tax may have the opposite effects.
- b There needs to be an understanding of how YED is calculated (this should always be to one decimal place).

The formula is:

$$\frac{\% \text{ change in quantity demanded}}{\% \text{ change in income}}$$

- c The magnitude of the coefficient and whether the coefficient of income elasticity is negative or positive is very important.  
Inferior goods have a negative YED: demand falls as income rises. This does not mean poor quality (which is a common source of misunderstanding).  
Normal goods have a positive YED: as consumers' income rises, more is demanded at each price level.  
If YED is 0, demand does not change when income rises. This is zero income elasticity.  
If YED is between 0 and 1, demand rises by a smaller proportion than income. This is income inelastic.  
If YED = 1, demand changes proportionately with income. This is unit income elasticity.  
If YED > 1, demand changes by a greater proportion than income. This is positive income elasticity.
- d Normal necessities have an income elasticity of demand of between 0 and +1. Normal luxuries have an income elasticity of demand > +1, meaning demand rises more than proportionate to a change in income.  
A crucial determinant of YED is whether the good is a luxury or a necessity; luxuries are income elastic and have high positive values e.g. exotic holidays, designer goods, necessities are income inelastic and have a low positive value e.g. public transport, petrol.

## 2.3 Productive efficiency

The section focuses on the ways in which firms can reduce their costs in order to become more competitive. Productivity is examined and the strategies and procedures available to firms to improve productivity are explored. The impact of relative efficiency on sales revenue and costs is also considered.

### 2.3.1 Productivity

- a Productivity measures the efficiency with which inputs are converted into outputs. As inputs represent costs, productivity is important for individual firms and for the international competitiveness of the economy as whole. Costs are an important variable in the establishment of prices and in the calculation of profit.

The most common measure of productivity is labour productivity. This is simply the output per person (worker) in a fixed time period. Simple numerical examples can be used to illustrate this point: if Susan produced 20 sandwiches an hour and Jayne 30 sandwiches an hour, then Jayne is said to have higher labour productivity than Susan. Labour productivity is often used to compare the relative efficiency (or otherwise) of different countries or companies (usually in the same sector). Improved productivity can lead to:

- lower average costs: cost savings might be passed on to consumers as lower prices, which leads to rising demand and output, and an increase in employment
- improved international competitiveness: productivity growth can lead to increased competitiveness of firms in global markets
- higher profits: efficiency increases can lead to higher profits for firms which may in turn be reinvested to support the long-term growth of the firm
- higher wages: firms can afford higher wages when their workers are more efficient and this may lead to a higher standard of living
- economic growth: if an economy can raise the rate of growth of productivity then the trend growth of national output (GDP) can increase.

Due to the relationship between productivity and costs, firms work to increase productivity in a variety of ways.

Physical capital refers to a factor of production (or inputs into the process of production) such as machinery, buildings or computers – any physical asset that is not used up in the production of a product. A growth in physical capital stock leads to a rise in capital per employee which may, in the long term, lead to increasing productivity.

Human capital is the people employed and trained by the firm to produce output. Human capital is developed and increased through investment in the human agent, the idea being that investment in training increases the stock of human capital. Access to finance is an important variable in determining the level of investment available to firms and therefore has a significant impact upon productivity.

Technology and technological changes may be related to physical capital but are often associated with increasing productivity. Process innovation may also increase productivity as resources (both physical and human) are allocated more efficiently to produce goods and deliver services.

- b Labour intensive production uses more people than machines. Labour intensive production usually takes place where there is a plentiful supply of appropriately skilled labour, minimising production costs. Services tend to be characteristically labour intensive.

Capital intensive production uses more machines than people. Capital intensive production usually takes place where there is relatively cheap and easy access to capital for investment, minimising production costs.

### 2.3.2 Capacity utilisation

- a Capacity utilisation is the amount of goods and/or services that can be produced by a firm (or an economy – industrial capacity) in a given time period, if current factors are used to their fullest extent. The percentage of capacity in use is often expressed as the capacity utilisation rate.

A firm can be said to be operating at full capacity if all the resources available to a firm are being used to the fullest extent all of the time.

Spare capacity means that for some of the time some resources are not being used and therefore there is a loss of potential output.



- b Investment and technological change can increase the capacity of a firm. It can also increase the capacity of the economy as a whole. Capacity utilisation measures what proportion or percentage of the maximum possible output of a firm is actually produced.

$$\frac{\text{Current output}}{\text{Full potential output}} \times 100$$

- c Under-utilisation of capacity means fixed costs will be shared across a lower level of output. This means average fixed costs (fixed costs per unit of production) are likely to increase. This increase in unit costs either reduces profitability or results in higher prices (to cover the increased unit costs) and a loss of competitiveness. On the other hand some under-utilisation can be beneficial. It gives the business flexibility; special orders from customers can be quickly accommodated and there is time to service and repair machinery and plant without having to stop production.

Over utilisation of capacity means that the business is trying to produce more than its capital equipment was designed for. This too can result in an increase in average costs as bottlenecks, breakdowns and overcrowding reduce efficiency. Once again this means that the business is not as competitive as it could be.

- d Improving capacity utilisation is linked to increasing productivity. Various options are open to a firm, including: extending the product range; finding new markets; increasing demand by promotion; or producing goods from other businesses (e.g. own brand products).

### 2.3.3 Efficiency and competitiveness using lean production

Lean production is about minimising waste at every stage of production or service delivery to minimise costs. Various strategies are used in lean production, most of which are now commonly used in manufacturing.

- a Quality control refers to the traditional method of checking that products are of a good enough standard. Inspection of products takes place during and at the end of the operations process. This approach can be useful for firms that rely on unskilled or temporary staff but it has several drawbacks; for example, it accepts that mistakes are inevitable and does not solve the problem of what has caused the mistake in the first place

Quality assurance (QA) implies a commitment to collaboration between the people responsible for design, production and marketing. They will work together towards increased quality and reliability. Everyone in the business has to become more aware of the need for quality. Instead of monitoring output, a QA department will be drawn into the design process and the setting up of the production system: quality becomes central to the basic organisation of production and is checked at every stage.

Total Quality Management (TQM) is a philosophy that tries to generate both an individual and a collective responsibility for quality at every level. Each department or team is seen as having responsibility for quality in both products and services. It is expected to regard the department handling the next stage of production as its customer, whose needs must be satisfied.

- b Kaizen is a Japanese word meaning 'continuous improvement' and it emphasises getting things right first time. In practice, it seeks to make every worker responsible for quality control, encouraging all workers to make suggestions for improvements. It is based on the idea that lots of relatively small, cheap changes can have a huge effect in terms of minimising waste and costs, and increasing productivity.

- c Just in time (JIT) is simply an application of lean production to stock control. The JIT process focuses on frequent reordering of relatively small quantities of stock thus reducing the costs of holding stock and relies on a strong working relationship between a firm and its suppliers.
- d Competitive advantages from lean production are:
  - A reduction in costs, which may allow firms to spend more on product development or marketing or can allow the firm to reduce prices which, depending on PED for the product, could increase market share and sales revenue for the firm.
  - Improved quality and therefore greater customer satisfaction.
  - Labour becomes more involved, therefore more motivation and less staff turnover.

### 2.3.4 Impact on costs and sales revenue

- a Any steps a firm takes to increase productivity can serve to reduce average unit costs. This can result in higher profits which may be re-invested to further improve efficiency or in product development. It may also mean the company can reduce prices in relation to competitors and increase market share or sales revenue.
- b Linked to the above is the likelihood that minimising waste and improving efficiency may develop a growing reputation for quality, developing and enhancing brand loyalty (making PED more inelastic) and increasing market share.
- c Reduced lead times (the time delay between making a decision and implementing the decision) may make a firm more market orientated. This is most important in dynamic markets where firms have to be able to respond quickly to changes in consumer demand. For example, the high-street fashion industry has to be able to respond quickly to changes in consumer tastes and it is vital that firms are able to keep lead times short in order to maintain competitive advantage.

## 2.4 Life in a global economy

Globalisation is the ongoing integration of countries on a political, economic and social level. A definition from Peter Jay, the former BBC Economics Editor, is:

'The ability to produce any good (or service) anywhere in the world, using raw materials, components, capital and technology from anywhere, sell the resulting output anywhere, and place the profits anywhere.'

Although it is not in itself new, the last three decades have seen a huge increase in globalisation, leading to increasing trade and rising prosperity across the globe, with the growing power of transnational corporations producing and selling in developing economies and emerging markets. China and India, for example, have become significant economic powers, and other countries are growing rapidly. Allied with rapid technological change and improved transport and communications, the global economy has seen a major structural change which is continuing to affect individuals, firms and economies.

### 2.4.1 Globalisation

- a Globalisation can be examined in terms of three dimensions that effectively relate to and support each other: increased investment flows between developed and, more recently, developing economies; the increasing importance of trade as a proportion of global trade; and the increasing movement of people within and between trading blocs and national boundaries.

- b Trade liberalisation is characterised by the removal of many restrictions on the movement of goods and services between nations and trading blocs.

Capital market liberalisation is seen as a means of stimulating economic growth in developing countries by removing regulations and restrictions on capital flows between countries. The idea was to encourage more foreign investment which would stimulate economic growth.

In the aftermath of the break-up of the Soviet Union and important political and economic reforms in China, the economic map of the world is being redrawn. Detailed knowledge of these events is not required but the implications of this for other economies should be explored.

The 'death of distance', characterised by developments in telecommunications and transportation, has contributed to the growth of offshoring and outsourcing and, in turn, to the increased importance of transnational corporations.

It is always interesting to examine data on the GDP of countries and the sales revenue of transnational corporations.

### 2.4.2 Developed, emerging and developing economies

- a Rapid GDP growth in developing economies can be compared with the relatively low growth rates in developed economies, such as the UK. The validity of using GDP as a measure of economic development can also be introduced here.
- b GDP per capita can be compared with other measures of economic development and discussed in terms of living standards. Students should be aware of how the Human Development Index (HDI) has changed over time – it is currently a composite statistic of life expectancy, education and income indices.
- c The characteristics of developed economies can be compared with those of developing economies. The concept of emerging markets can also be explored from the perspective of opportunities for trade.
- d The mean and median incomes of developed and developing economies can be compared, and the measures themselves evaluated in terms of their strength as indicators of development and living standards for populations.

### 2.4.3 International trade

- a Classical theories of absolute and comparative advantage can provide a neat way into discussions about specialisation and trade. Students will not be expected to know about these for the exam but they should understand the underlying principle that by specialising in what they do best (or least badly) and then trade, there will be gains. The advantages and disadvantages of specialisation should be covered with practical examples.
- b The different types of trading blocs and their impact on member countries and those outside should be covered. These include an alliance of countries that want free trade between themselves, free trade areas, common markets and the single market. The potential impact of future enlargement or the creation of new trade blocs should also be considered.
- c The importance of trade in terms of creating economic growth for nations and globally could be discussed. Historical data on the relationship between global economic growth and GDP can be examined. After 2008 there was a sudden decline in international trade and a rise in protectionism, as well as changing patterns of FDI.
- d The distinction between visibles and invisibles needs to be made so there is some understanding of the meaning of trade deficits and surpluses which can be developed in section 2.6.1.

- e The availability of cheap imports on consumer choice and living standards should be discussed, as well as the implications of dependence on imported goods (including the impact on domestic producers and employment).

### 2.4.4 Exchange rates

- a The exchange rate is the value of one currency expressed in terms of another; for example €1 = US\$1.42. Depreciation and appreciation of currency over time, caused by changes in the demand for and supply of a currency, should be explored and can be represented in diagrammatic form. Simple numerical examples need to be worked through.
- b Students may be asked to assess the impact of changing exchange rates on different firms in different markets both directly and indirectly. This should include any potential impact on sales, output, costs and competitiveness in both domestic and international markets.
- c–d Students should be able to understand and interpret exchange rate data in the form of tables or graphs and appreciate its significance or otherwise.

Effective Exchange Rate (EER) index is a weighted index of a currency's value against a basket of currencies. The weights are based on the importance of trade between the one country and its trading partners so may vary over time with changing patterns of trade.

## 2.5 The economic cycle

This section extends 2.4 to look at the macroeconomic environment within which firms operate. Established macroeconomic concepts are defined and developed to encourage students to understand that firms do not operate in isolation from broader national and international economic forces and trends.

### 2.5.1 The economic cycle

- a The theory is that real output in the national and global economy does not rise or fall at a uniform rate. Economies experience a more or less regular trade cycle where the rate of growth of production, incomes and expenditure fluctuates over time. Students need to understand a simple diagrammatic representation of the economic cycle and be aware of how it changes over time and the different stages involved.
- b A boom is when real national output is rising strongly at a rate faster than the trend or long term rate of growth. In boom conditions, real output and employment increase and the level of aggregate demand (AD) for goods and services is rising.

Characteristics of an economic boom include: strong and rising level of aggregate demand, usually driven by consumption; rising employment and real wages; rising demand for imports; rising government tax revenues; increasing profits, share prices, dividends and investment; and increased capacity utilisation (economy close to full capacity) with resultant demand-pull and/or cost-push inflation ('overheating').
- c A recession means a fall in the level of real national output, a period of negative economic growth (technically defined as two consecutive quarters of negative GDP growth). In a recession, national output declines leading to a contraction in employment, incomes and profits.

Characteristics of an economic recession include: declining aggregate demand (AD); rising unemployment; a fall in business confidence, profits and a decrease in private investment expenditure; de-stocking and heavy price discounting by firms in order to maintain cash flow; reduced inflationary pressure and a fall in demand for imports; increased government borrowing due to lower tax receipts and increased spending on welfare payments; and lower interest rates from the central bank as a policy response to declining output.

- d The impact on firms will depend on the good or service, as well as the type of market and the extent of fluctuations in output, income and prices. Firms supplying income elastic goods are likely to see significant changes in demand and revenues during a recession or a boom. Firms supplying income inelastic goods may see less change in demand. Firms selling inferior goods may see demand increase during recession and decrease during a boom period.

### 2.5.2 Circular flow of income, expenditure and output

- a Definitions and explanations of the circular flow of income would include the basic description that households provide the factors of production and receive income. They buy the goods and services produced by firms which use the income received. In this way, the income circulates throughout the economy.

Often the best way to understand the circular flow of income is in diagrammatic form and there are many simple representations of the circular flow of income available online.

- b The withdrawals (leakages) from the system are savings, taxes and imports. The injections are investment, government spending and exports. In theory, the economy is described as being in equilibrium when leakages are equal to injections. By altering the relative levels of injections and/or withdrawals the level of economic activity can be influenced.
- c Aggregate demand (AD) is defined as the total spending on goods and services in an economy, in a given period of time at a given price level. It is made up of consumption (C), investment (I), government spending (G) and net export expenditure ( $X - M$ ).

Consumption (C) is the total spending by consumers on domestic goods and services. Investment (I) is the addition of capital stock to the economy by firms and government. Government spending (G) is spending on goods and services. Net exports ( $X - M$ ) are the value of export revenues minus import expenditure over a period of time.

- d Aggregate supply (AS) is the total amount of goods and services that all industries in the economy will produce at every given price level.

Any changes in the cost of inputs and resources such as wage rates, the cost of raw materials or the price of imports will alter the amount firms are willing and able to supply, alterations in the supply of individual firms affects AS.

Changes in productivity will alter the AS of goods and services as more can now be produced using the same amount of resources. Anything that can improve productivity such as improvements in human and physical capital, technological advances and process innovation will therefore influence AS.

### 2.5.3 Inflation

- a Inflation is a sustained rise in the average price level (usually retail prices) and a fall in the value of money. Deflation is a sustained fall in the average price level (usually retail prices) and a rise in the value of money. Disinflation is a fall in the rate of inflation – a decrease in the rate at which the average price level is rising. A common area of misunderstanding arises here: disinflation does not mean a fall in the average price level, it is a decline in the rate at which average prices are rising.

- b Students should be aware of the difference between the RPI and CPI; for example, RPI includes housing costs whereas CPI does not. They will also need to be able to interpret price indices including the RPI and CPI and hence the rate of inflation.

- c Students need to know the distinction between real and nominal values, constant and current prices, and be aware of their significance when using data or discussing economic events.

The nominal value of something is its money value at different points in time. Real values adjust for differences in the average price level over time. In other words, real values are nominal values but with inflation taken into account.

Constant and current prices apply the methods of real and nominal values to data. As such constant prices take into account inflation and current prices are not adjusted for inflation.

- d Demand-pull inflation occurs as a result of increasing AD in an economy, resulting in prices rising as consumers try to buy increasingly scarce goods.

Cost-push inflation occurs as a result of an increase in the costs of production in an economy, resulting in rising prices as firms try to maintain profitability. The rising price of oil and other imported commodities can cause cost-push inflation.

- e Inflation affects firms in many ways, causing uncertainty among the business community with the resulting tendency not to invest. Interest rates tend to be forced up so that the 'real' rate remains positive, increasing the cost of borrowing for firms and making return on investments less certain.

Inflation within the UK pushes up the prices of domestically produced goods, this means that UK goods and services may be less competitive than those of other nations. This may lead to a fall in demand (depending on PED) and a resultant fall in sales, output and profit.

- f Inflation tends to harm those on fixed incomes or those who lack bargaining power and so their pay rises do not keep up with the inflation rate, their real income falls. Inflation harms those who save and benefits those who borrow.

Inflation redistributes wealth to those with assets. For example, property owners see a rise in value during periods of inflation. In general, inflation impacts negatively on the lower income and wealth groups more than it does on the higher income and wealth groups.

### 2.5.4 Employment and unemployment

- a Employment, unemployment and underemployment need to be explained, students need to appreciate the differences between the terms and how they are defined.



- b Students should be aware of the differences between the measures of unemployment and how they are arrived at. The claimant count is a measure of unemployment and counts only those people who are eligible to claim the Job Seeker's Allowance (JSA). One significant problem with the claimant count is that it omits many people who are interested in finding work but do not meet all of the criteria for claiming.

The ILO measure is designed to include all persons above a specified age who are, without work, currently available for work and seeking work.

- c Unemployment has various causes and students should be able to distinguish between them and why they happen. These have implications for which policy to use in correcting it (the policies come later).
- Structural unemployment is where unemployment occurs because the structure of the economy has changed; for example, the decline of whole industries such as coal mining.
  - Occupational immobility is when an unemployed person does not have the right skills or abilities to take up the employment on offer, this is often linked with structural change.
  - Geographical immobility is similar in that an unemployed person is prevented from taking a job because they cannot move to where the job is, perhaps because of family or the cost of moving.
  - Technological unemployment is caused by technological change. As technology improves it is often the case that fewer employees are needed, they can be replaced with machinery or computers.
  - Demand-deficient unemployment also known as cyclical unemployment is where unemployment occurs because AD in the economy has fallen (in a recession), leading to a fall in the demand for labour.
- d Students may well be asked to assess the impact of unemployment and need to appreciate that much will depend on the firm or individual in question.

Unemployment can be a problem for the firm, rising unemployment means less disposable income and falling demand for many firms. Those that sell luxuries may be particularly badly affected whilst those who sell inferior goods may see improving sales. There is an obvious link here with the earlier work on YED.

On the other hand, unemployment can mean that a firm has a wider pool of labour from which to recruit, making it easier to find well qualified and skilled staff. There may also be less upward pressure on wages, reducing potential costs.

For the individual unemployment is not positive; rising unemployment will usually make it harder to find a job. There is also a direct financial cost measured as the difference between their previous income and any unemployment benefit received. The longer people remain unemployed, the more de-skilled they become. There are also personal costs for the unemployed in terms of stress-related illness and family problems caused by the strain of being unemployed.



## 2.6 Introduction to macroeconomic policy

A government's economic policy choices will be determined by their own short- and long-term political interests. The aim of this section is to explore the reasoning behind policy decisions and the likely conflicts between policy objectives.

There are commonly four main economic aims for government: steady and sustainable rate of increase of national output (economic growth); low level of unemployment; low and stable rate of inflation; and favourable balance of payments position.

The emphasis a government places on each of these areas will largely determine their fiscal and monetary policy.

### 2.6.1 Possible macroeconomic objectives

- a Economic growth is all about achieving a sustainable rate of growth in real GDP. If the economy grows too fast, inflation may accelerate because demand is growing and supply cannot keep up. Economic growth leads to higher living standards.
- b Low levels of unemployment are needed to maximise output and help achieve economic growth. It is also seen as a desirable social and political goal.
- c Low and relatively stable rates of inflation contribute to economic and political stability. Too high a rate is damaging to the economy because it is unpredictable and makes planning and investment more difficult, once again clashing with the objective of economic growth.
- d The current account is the sum of the balance of trade (goods and services exports less imports), net income from abroad and net current transfers. A positive balance of payments means that the money we earn from selling exports is greater than the money we pay for imports. If imports exceed exports a trade deficit develops; this will need to be financed by borrowing and may not be sustainable.

### 2.6.2 Policy instruments

Students need to know what these policies entail, how they work and how they impact on the economy, firms and economic agents.

- a Fiscal policy is where governments alter their own expenditure and taxation to affect the economy. To expand the economy, the government could reduce direct and indirect taxes and increase its expenditure. AD may increase and this could help to solve demand-deficient unemployment but could cause demand-pull inflation. To contract the economy, the government could increase direct taxes and decrease its expenditure. AD may decrease and this would help to solve demand-pull inflation but could cause disequilibrium demand-deficient unemployment.
- b Monetary policy is where governments or central banks alter the interest rate to affect the economy. To expand the economy, the government could reduce interest rates making borrowing cheaper for firms and individuals who are then more likely to consume and invest thus increasing AD. This could help to solve demand-deficient unemployment but could cause demand-pull inflation. A contractionary monetary policy works to reduce inflation by increasing interest rates to have the opposite effect and reduce AD.

- c Supply-side policies are designed to increase AS rather than AD. They allow the economy to grow without building up inflationary pressures. Students should be aware that there are numerous measures of different types but they are all intended to increase productivity. They include anything that is designed to help the economy produce more and use existing resources more efficiently, such as education and training, incentives to encourage investment, developing a flexible labour force, reducing structural unemployment and encouraging R&D. Some taxes such as the working family tax credit act as an incentive to seek employment rather than stay on benefits. The government may also reduce benefits and reduce taxes on low incomes in an attempt to get people back into employment (the poverty trap).
- d The exchange rate affects the economy through its effect on the prices of exports and imports. The UK has a floating exchange rate and as such can be deliberately manipulated by monetary policy.

With a floating exchange rate the price (exchange rate) of the currency is determined by the market forces of demand and supply. It behaves just like any good or service. The demand for, and supply of a currency are created by trade and investment flows. Higher interest rates tend to make the pound appreciate because investment in sterling assets becomes more attractive compared to other currencies, which increases the demand for pounds. Lower interest rates have the opposite effect.

The Bank of England does not specifically target the exchange rate but the Monetary Policy Committee (MPC) will take exchange rates into account.

### 2.6.3 Potential policy conflicts and trade-offs

All governments face potential policy conflicts and trade-offs. Solving one problem by using a particular policy can cause another problem to appear in its place.

- a Governments often find it difficult to achieve both a low inflation rate and a low unemployment level. This is because attempts to control inflation use a contractionary fiscal or monetary policy which reduces AD and hence output, meaning less labour is needed and so unemployment rises. To reduce unemployment the government may use an expansionary fiscal or monetary policy which increases AD and reduces unemployment but may cause unsustainable growth and inflation.
- b In a similar way to the trade-off between inflation and unemployment, government policies directed towards maximising economic growth may conflict with policies intended to ensure that growth is sustainable and that the pursuit of growth does not harm individuals not directly involved in production and consumption (third parties) or to the environment.

Expanding economies require increasing amounts of energy, generating this power can lead to direct negative externalities in the form of pollution and also the long term external costs of the depletion of non-renewable resources.

- c Issues governments face in managing the macro-economy are complex and often characterised by contradiction, as macroeconomic objectives are sometimes incompatible.

Certain policies and objectives can be unpopular such as tax rises and spending cuts and may face strong opposition. Policies, particularly supply-side ones can take a long time to show results. Changes in taxation have an almost immediate impact whereas changes to spending take time to work through.

There are also events that are beyond the effective control of government; external shocks such as the banking crisis or the recent Eurozone problems can affect policy outcomes. So too can fluctuating oil and commodity prices, high oil and food prices caused inflation in the UK despite low growth.

- d The extent to which macroeconomic perspectives and theories influence policy decisions is the subject of some debate. Students should be aware that there are differences of opinion over how to best manage the economy; this is often manifested in debate between political parties.

Students should understand the arguments between those who favour a more active interventionist role in the economy because the free market is inefficient and those who believe that the free market should be left alone to work in a more efficient manner. Similarly there are those that want to see greater taxation and spending and those who believe taxes should be cut and the public sector reduced. Again, there are those who want to see greater involvement in Europe and those that want to see the UK break free from the EU.

From a teaching perspective it is useful to examine the ways in which different macroeconomic perspectives have influenced political debate surrounding austerity measures in the UK.

- e Policy instruments can often be extremely logical, based on sound economic theory and very well intentioned. However, it is often the case that policies have unintended consequences. The case of the so-called 'fat tax', for example, promoted with the intention of reducing obesity, can have the unintended consequence of increasing inequality as those in the lowest income groups are more likely to consume food high in fat, salt and sugar. Such groups are also likely to spend a higher proportion of their income on such food and therefore see an increase in their tax burden. In a similar way, raising minimum wage levels may have a negative impact on employment, tax receipts and inflation. Links between the various fiscal and monetary policies need to be considered in the short and long run, and students should be encouraged to speculate as to the possible unintended consequences of policy instruments.

## Theme 3: The global economy

This section provides ideas and suggestions for teaching approaches for Theme 3 and is not intended to be prescriptive. The specification should be referred to as the authoritative source of information.

### 3.1 Globalisation

Globalisation is the ongoing integration of countries on a political, economic and social level. Although it is nothing new, the last three decades have seen a huge increase in its extent, leading to increasing trade and rising prosperity across the globe, particularly in emerging markets. China and India have become formidable economic powers and other countries are growing rapidly. Allied with rapid technological progress, the global economy has seen major structural change which is continuing to affect individuals, businesses and economies.

This section focuses on the connection between trade and growth and the various factors that have contributed to it, as well as the consequences arising from it.

#### 3.1.1 Growing economies

- a The rise and growth of the BRIC countries is well documented and students should be aware of this. In addition, other areas are developing rapidly and having an increasing impact on the global economy. Examples might include Nigeria, which is now Africa's largest economy, Mexico, which is attracting increasing levels of foreign direct investment (FDI), and Mongolia, which is beginning to exploit its minerals and resources. By contrast, China is beginning to slow and is perhaps losing its previous advantages as its economy develops. Students will not need to study these areas in depth or memorise statistics; rather, a broad overview is required.
- b Economic growth should lead to rising incomes and increased employment opportunities for individuals, as well as more choice and better living standards. Businesses should see an increase in sales and profitability with further opportunities for growth and investment. In reality, consumer incomes will not all increase and income inequality may rise. Not all businesses will flourish and some may suffer (for example suppliers of inferior goods and services). Structural change goes with economic growth, meaning some areas of an economy expand at the expense of others.
- c Rising incomes will affect individuals in different ways. In developing economies it can mean that many escape poverty; for example, China's average growth rate of 10% is thought to have lifted more than 500 million people out of poverty. In reality, consumer incomes will not all increase and income inequality may rise.
- d The differences between real and nominal values, and why and when they are used, should be explored.
- e Students will be expected to be able to calculate and interpret index numbers and understand why they are used.

#### 3.1.2 Trade and growth

- a Students should be aware that trade liberalisation has been an increasing phenomenon in recent years. This has been brought about by several factors, including political and social change, expansion of trading blocs and the role of the World Trade Organisation (WTO).

- b By specialising, countries can gain a competitive advantage in terms of lower average costs and reputation. Examples might include: Brazil and commodities such as soya, iron ore and sugar; India and IT services; Russia and energy supply; and the UK and financial services. Students need to be aware of both the advantages and disadvantages of specialisation.
- c Trade liberalisation can lead to reduced costs of trade, greater choice, lower prices, a rise in disposable income for consumers and an expansion of potential markets for businesses. All of these should lead to economic growth.
- d Students should understand the nature and trends of FDI, particularly that it is not just something that happens to developing nations. The impacts of FDI may include increases in employment, income and tax revenue, and subsequent economic growth. The multiplier concept is useful here.

Students are not required to study the theory of comparative advantage. However, they should have an understanding that, if countries specialise in what they do best or least badly and then trade, economic growth is likely.

### 3.1.3 Trading blocs

- a Students need to understand and apply the terms trade creation and trade diversion to real-life examples, and understand the positive and negative impacts of each of them.
- b The expansion of trade blocs has gone hand-in-hand with globalisation and the growth of trade. This process is ongoing and some trade blocs, such as the EU, are committed to further expansion. Although detailed knowledge of the workings of these blocs is not required, students should be aware of their impact on trade, businesses and individuals, and that new trade blocs, such as the RCEP, are in the process of being created.
- c Trading blocs affect businesses in different ways, both positively and negatively. Students should be able to assess the impact on a range of different businesses of being in a trade bloc, joining a trade bloc or of a trade bloc expanding.
- d Trade blocs create interdependence and reduce real independence and unilateralism. Economies in trade blocs need to consider the impact of their decisions on other economies in the bloc if they are to accept/continue membership.

### 3.1.4 Trade policy and trade negotiations

- a Students should explore what protectionism is and why countries use it, including protecting existing/infant industries, raising revenue, political pressure and retaliation. Diagrams should include a shift of the supply curve following the imposition of a tariff and a partly vertical supply curve following the imposition of a quota. Other trade barriers might include bureaucracy, rules and regulations, and the subsidising of domestic industry. Students should also be aware that protectionism can and does exist despite an apparent commitment to free trade.
- b Students should be able to give examples of trade negotiations and be aware of the role that these bodies play in the process of trade liberalisation and resolving disputes. They should also appreciate the limiting factors and to what extent these bodies and groups are effective.

### 3.1.5 Exchange rate changes

- a The emphasis here is on the *possible* effects, as they can vary widely depending on other factors, not least of which is the size and duration of any changes in the exchange rate in the first place. Students will be expected to apply concepts from other sections of the course and are likely to have to use evaluative skills. For example, the impact of a change can depend on the PED of exports and imports, whether the economy is in a boom or recession, what is happening in other economies, and the impact on inflation, which in turn affects these variables and the short- versus long-run situations.
- b Students need to be aware of the Eurozone and its impact on the EU, as well as on those countries such as the UK that do not share the Euro.

### 3.2 Economic factors in business expansion

This section explores businesses that want to trade overseas and the reasons for wanting to do so. Some may be forced to seek out new markets because of problems in existing domestic markets. Others will be tempted by the possibilities for growth and profit that new trading areas offer. Often, it will be a mix of reasons. Students will need to understand the reasons why this happens and why the reasons will vary for different businesses.

This section also covers the issues of which country to choose, either for a potential market in which to sell a product or service or as a location for production. Students will not be expected to have in-depth knowledge of potential markets and locations but rather an appreciation of the various influencing factors involved and how they will differ in importance for different businesses.

#### 3.2.1 Conditions that prompt trade

- a Poor trading conditions in domestic markets can 'push' a business into seeking new markets. For many western businesses the poor economic climate since 2008 has made it difficult to grow and even survive; many western markets are very crowded and it can be very difficult and costly to remain competitive. Domestic expansion can be slow and problematic.
- b There are a number of factors that can 'pull' a business into a new market. Many of the developing markets are growing in terms of size and wealth; they are relatively unsaturated and hold out the potential for increased sales, stability and profit.
- c Students should be aware of the difference between the terms offshoring and outsourcing. Offshoring is a type of outsourcing and means having the outsourced business functions in another country. Frequently, work is offshored in order to reduce labour costs, such as to China. Other reasons for offshoring are strategic: to enter new markets, to find labour or resources currently unavailable domestically or to overcome domestic regulations that prevent specific activities. (Although not a requirement, students may come across the terms nearshoring and onshoring, which refer to outsourcing close to a country and returning outsourced production back to the country of origin.)
- d Trading overseas can be seen as an extension strategy of the product life cycle. New markets add to total sales and boost profitability, prolonging the maturity stage. A declining or obsolete product at home may be new to the overseas market and enjoy a fresh lease of life.
- e Spare capacity can be used to increase production; this extra production may not be able to be sold domestically due to lack of demand but can find a market overseas. This improves capacity utilisation and helps to lower average costs, improving competitiveness and profitability.



### 3.2.2 Assessing the potential of different economies

- a Students should understand that there will be a range of factors that will influence which country (or countries) may be best suited as a potential market. These factors will vary depending on the product or service involved. One factor may be a paramount requirement or it may be a combination of all of them. Even if the ideal market is found, success is not guaranteed. Students should explore examples, such as Tesco in the US and eBay in China.
- b Students should understand that there will be a range of factors that will influence which country (or countries) may be best suited as a production location. These factors will vary depending on the product or service involved. One factor may be a paramount requirement or it may be a combination of all of them. Even if low labour costs are important, there is still a range of countries that can provide this. The traditional location of China is no longer as attractive as wage levels rise. Many automobile manufacturers are scaling down production in China and investing in Mexico, which has slightly higher wage costs than China but transport costs to the lucrative North American markets are much lower and it is also in NAFTA.

### 3.3 Impact of globalisation on global companies

This topic shows how firms have adapted marketing strategies in response to global demand. As businesses expand and international sales take place, a firm has to consider the needs of both domestic and international customers. For most businesses there is no such thing as a single global market: global sales are made up from many national markets. Despite modern technology and communications and the ongoing process of globalisation, there can still be considerable differences between these markets. Global businesses need to be able to recognise these differences and adapt their marketing strategies accordingly if they are to survive and prosper. Some businesses may need to do little in the way of adaptation, while others will go to great lengths to adapt each aspect of their marketing strategy to suit the requirements of each individual market.

Students will need to recognise the different approaches that businesses will use and their advantages and disadvantages. There are many excellent case studies and examples that will help do this. This section also looks at the rise of global niche markets and then at some of the cultural and social factors that businesses must take into account if they are to be successful and avoid costly marketing errors.

#### 3.3.1 Responding to global demand

- a Some businesses succeed by having a common global marketing strategy that applies to all of their operations worldwide. This global approach works well when their markets have similar expectations wherever they are. Where markets differ, and they frequently do, businesses need to plan differing marketing strategies that will fit local market preferences. Localisation means that the business may adapt or change its products and marketing plans to suit individual countries or market segments. Which approach a business takes will depend greatly on the product or service involved and how varied consumer needs and tastes are in different markets.



- b Domestic/ethnocentric, mixed/geocentric and international/polycentric are terms used to describe the different marketing approaches that reflect the degree of globalisation or localisation. Students need to understand the advantages and disadvantages of each approach and to recognise examples of each, such as Apple and Ferrari, which sell mostly standardised products everywhere, McDonald's, which maintains a global brand but adapts its menus in each country, and Unilever, which adapts many of its products to each individual market. For example, Unilever's Rexona deodorant brand had 30 different package designs and 48 different formulations. In reality, most businesses use elements of global and local strategies.
- c Students need to be familiar with price and non-price competition in global markets and understand that this will vary according to the global marketing approach adopted. The level of economic development may not permit standard western pricing tactics. Promotion may need to be adapted to be culturally relevant or avoid offence. Products may need to be changed to meet differing needs or cultural sensibilities. In many countries conventional distribution may not be possible and other means are developed, such as the Unilever Shakti programme.
- d 'Global brands' develops the idea of a brand and looks at what it means to be recognised as a brand on a worldwide basis. The strength of a global brand is not always linked to its current financial performance. For example, despite a string of recalls and bad publicity Toyota continues to be the top auto brand. Global brands are important if a business is to sustain a global presence and add value to its products. The current top global brand is Apple and the top 100 brands together are worth an estimated \$2.6 trillion.

### 3.3.2 Demand-side factors in global markets

- a There are numerous difficulties facing businesses when entering foreign markets and marketing their products. Students may already be aware of some of the problems that may arise from cultural and social factors such as religious and/or dietary differences and preferences, and the need for adaptations to the marketing strategy. Fast food chains such as McDonald's can provide good examples here. Western standards of dress, behaviour and morality can all cause problems. Students should be aware of the importance of adjusting the marketing approach to cater for cultural and social factors, and how potential difficulties can be minimised or avoided.
- b Information and communication factors include language, unintended meanings and inappropriate or inaccurate translations. There are many examples of marketing mistakes on the internet that can be both amusing and informative for students.
- c Away from the mass markets, there are many smaller but potentially lucrative niche markets based on the widely differing needs of many small groups of consumers. These niche markets may be based on a wide range of factors, such as cultural and social, artistic and aesthetic, or leisure and sporting. Some of these groupings will be found globally; others will be unique to one area or culture.

Global niche markets can transform business prospects because they create opportunities where national niche markets are very small. They are smaller, more specialised parts of a global market where customers in more than one country have particular needs that are not fully met by the global mass market. The product or service is likely to be differentiated from that of the mass market.

Global niche markets will still use the marketing strategies but a different emphasis may be placed on these. Price is likely to be higher, the product more specialised or perhaps of higher quality, promotion may be more specialist and more specifically targeted, and place may be of greater importance.

### 3.4 Impact of globalisation on local and national economies

Multinational corporations (MNCs) are businesses that operate or have assets in more than one country. They can be very large organisations with turnover exceeding the GDP of many countries. Inevitably, this gives them great power and influence. Many MNCs have been accused of abusing their position and have attracted great criticism of their actions. On the other hand, MNCs are often welcomed in overseas countries as they can bring many benefits to a range of stakeholders and economic agents, including the people, the government, other businesses and the economy as a whole. It is very likely that some of the biggest MNCs of the future will be Chinese or Indian and that they will have an increasing impact on the global economy.

Students will need to be able to assess the relative benefits and drawbacks that MNCs bring to an economy and to understand the controversies that can surround them. It is important that they understand both sides of the argument and present a balanced answer with examples.

Students will also be required to consider whether the activities of MNCs should be controlled and to what extent such attempts will be successful. It is also important to realise that MNCs operate in all types of economy and that most FDI still goes to developed economies.

Examples and case studies should be used to illustrate the various topics in this section.

#### 3.4.1 The impact of multinational corporations (MNCs)

This section considers the impact MNCs can have on both the local and national economy. This means that students will need to consider both positive and negative aspects and to make evaluative judgements.

- a The initial investment for location in a host country creates employment. Buildings and equipment may be needed, creating work for local people. Once operations commence, a workforce will be needed. Local businesses may be involved in supplying or servicing the MNC and see an increase in business, taking on more workers. All of the local people who have found new employment will spend some of their income with local businesses. This increases local demand and, in turn, creates more jobs. There is a positive local multiplier effect. The local community and environment may benefit from CSR programmes.  
However, some MNCs may exploit the local labour force with poor wages and conditions. Local labour may only be used for menial tasks, with MNCs bringing in their own personnel. Local businesses may be exploited or driven out by competition from the MNC, and there can be considerable damage to the local community and environment from pollution and despoliation – this is particularly common for the oil, mining and extractive industries.
- b MNCs also affect the national economy. Employment and growth at a local level contributes to overall economic growth and increased tax revenues that aid government spending and development. Production that is exported improves the balance of payments. Other MNCs may be attracted to follow suit and the flow of FDI increases, thus a growing business culture is created. MNCs bring skills and technology that can be passed on to the host country for future benefit.  
However, MNCs can be adept at avoiding tax liabilities by such practices as transfer pricing. Profits can be repatriated and have little impact on the host economy. R&D facilities may be kept in the home country, reducing opportunities to develop skills and for technology transfer. Many MNCs enter another country simply to access a new market, so only sales and marketing facilities are established. MNCs are likely to take whatever incentives are on offer, stay for a while and then move to the newest low-cost location in another country, leaving behind unemployed workers and a weakened economy. They encourage a so-called 'race to the bottom'.

### 3.4.2 Ethical issues

- a There is a great deal of potential for stakeholder conflict with MNCs. Shareholders may question the cost of ethical behaviour in the short run even though it may give the business a competitive advantage – the consumer's need for cheaper energy can cause damage to the environment and local communities.
- b Although many MNCs do pay above-average wages and have strong CSR policies in place, others may exploit workers in terms of pay, child labour, sweatshops and dangerous conditions. The collapse of the factory in Dhaka, Bangladesh, in 2013 killed over 100 people.
- c MNCs can cause great damage to the environment by their processes and the transportation of their products. This damage can be short or long term and the resulting situation may be unsustainable. Examples include the impact on areas such as the Amazon rainforest.
- d Many MNCs have long supply chains that are difficult to control in terms of ethical working practices. Cheap clothing chains have been involved in controversy on several occasions over the exploitation of labour.
- e MNCs need to take into account how they promote and package their products to avoid controversy. This covers not just the need to be sensitive (as in section 3.3.3) but also more controversial practices such as tobacco companies targeting youngsters in developing economies.

### 3.4.3 Controlling MNCs

- a Students need to be aware of the various ways in which the activities of MNCs might be regulated, influenced or controlled. They should explore how effective these factors might be and what will make them more or less effective depending on the situation. For example, the US or China is likely to have much greater influence over MNCs than Mozambique or Ethiopia. Developing nations may be reluctant to confront powerful MNCs that can bring much needed FDI. Legal systems are more likely to be robust in developed nations and public opinion is likely to be more influential over businesses that sell directly to the public, rather than over a mining business.
- b There have been many attempts to encourage self-regulation, either from within the industry itself or by outside bodies. Examples include OECD Guidelines on Multinational Enterprises, UNCTAD's Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, and the UN's Global Compact. Students are not required to know the details of these agreements but they should be able to assess the merits or limitations of self-regulation.

### 3.5 Global labour markets

The global labour market encompasses all types of labour that are available to work on a global basis. Like the domestic labour market, it is made up of all those who supply labour and those who demand it.

In recent decades it has both increased and changed dramatically. As developing economies have industrialised and started to compete in world markets, the global labour market has grown. As more than one billion people entered the labour force, a massive movement from the land to the city has accelerated the growth of productivity and per capita GDP in China and other traditionally rural nations, bringing hundreds of millions of people out of poverty. Developed economies have invested in labour-saving technologies and used global sources of low-cost labour in order to increase efficiency and competitiveness.

This topic explores how and why the global labour force has grown, how its composition has changed and the factors that have influenced this change. It also examines the workings of the labour market and how market imperfections, such as unions, professional bodies and minimum wage legislation, have an effect on labour, wage rates and economies.

#### 3.5.1 Employment patterns

- a It is estimated that, by 2030, the global labour force will reach 3.5 billion. Much of this increase will be contributed to by developing economies industrialising, the spread of globalisation and the reduction in trade barriers. Although this has led to improved standards of living for many people, it is also true that for others poverty remains a reality and young people have a disproportionately high level of unemployment (the ILO estimate 900 million and 75 million, respectively).
- b In 1980, the global labour force was just 1.7 billion. By 2010 it was 2.9 billion workers, with the emerging world responsible for most of the increase: it added 900 million new non-farm workers, of which 400 million live in China and India alone. The addition of China's and India's workers lifted many out of poverty. This structural change has powered rapid growth. China's non-farm workers are seven times more productive than farm workers. At the same time, structural change has been taking place in developed economies with less need for low skilled labour and the development of the knowledge economy. Students should understand that this is an ongoing process and be aware of current trends.
- c The global labour market is interdependent in that it is affected by events in individual labour markets. For example, it is claimed that the expansion of low-cost labour in developing markets has depressed wage rates in the more developed economies. India has developed a specialisation of workers in IT and software development; this has reduced the demand for similar personnel in western labour markets. Students need to understand the nature of this interdependence and its impact both historically and how it is likely to develop in the future.

#### 3.5.2 Wage rates

- a In a free labour market, wage rates are determined by the interaction of the supply of and demand for labour. Students need to know what the factors are and how they might influence wage rates. Supply is mainly determined by the number of workers available and with the right skills/education/requirements. Demand is a derived demand and depends on the demand for the particular product/service or industry. As such this is likely to be influenced by structural change, changes in the income/economic cycle, tastes and fashions, and the amount of capital available.

- b The importance of skills, training and education has long been recognised both as a means of growth for the economy and for the betterment of the individual. With mass labour becoming ever more abundant, it is even more vital for labour to have skills that are in demand and also transferable.
- c All of these will tend to reduce (or restrict increases in) wage rates in labour markets. The examples in 3.5.1c also apply here. A recession reduces the demand for labour and subsequent redundancies not only reflect a fall in demand but also increase the surplus supply of labour.
- d Trade unions and professional bodies have a distorting effect on wage rates: because they interfere with the free workings of the market, they can be seen as market imperfections. Students need to understand how the market responds to this in terms of the impact on the supply of labour and wage rates, and to understand the implications for business and the economy. (Although a diagram is not necessary here, it may well aid understanding in the classroom.)

### 3.5.3 Minimum wage legislation

- a Minimum wages also have a distorting impact on labour markets and wage rates. Students need to understand how the market responds to this in terms of the impact on the supply of labour and on wage rates, and to understand the implications for business and the economy. (Although a diagram is not necessary here, it may well aid understanding in the classroom.) Students should be aware of the arguments for and against minimum wages and to what extent they have had an impact. Developing economies such as China have just started to introduce minimum wages in some regions and, again, students need to understand why.
- b Structural change brings about skills shortages as new industries and businesses develop faster than the relevant supply of labour can. This has an impact on wage rates and the ability of countries/businesses to compete effectively.
- c When shortages appear in labour markets, one solution is to attract more labour to solve the problem. Relying on the internal or national supply of labour can be a problem due to the immobility of labour. However, accessing labour from international sources – migration – can be a solution and the UK has benefited from this in the past. Students should be aware of the advantages and disadvantages of migration and to what extent it is a solution given existing economic, political and social barriers.
- d Inequality is dealt with in more detail in 3.6 but students should be aware that labour market incentives such as the minimum wage can help to reduce inequality.

### 3.6 Inequality and re-distribution

This section examines inequality and poverty, and covers what these terms mean, how they are measured, and how and why governments attempt to deal with them. Inequality and poverty are features of every economy and the global economy as a whole, and although they are linked, they are not the same thing. In many economies poverty is being reduced but at the same time inequality is increasing.

Inequality itself is not necessarily a negative phenomenon: too much can mean hardship for many and restrict growth, too little may mean excessive government intervention and limit innovation and enterprise. Poverty is closely linked to economic growth in that it can restrict economic development. However, economic growth is a means of reducing poverty. For example, there has been a significant reduction in poverty in recent decades as countries such as China and India have developed in economic terms, but for many, poverty and absolute poverty remain.

Students need to be familiar with these concepts and how they affect individuals, businesses and the economy as a whole. They should understand how inequality and poverty are measured and be able to interpret the results and trends over time. They should be aware of how these problems have been tackled and be able to evaluate their effectiveness.

#### 3.6.1 Poverty and inequality

- a Students should be able to distinguish between relative and absolute poverty. Absolute poverty means that a person does not have adequate access to basic human needs such as food, safe water, shelter, sanitation and healthcare. It is likely to cause suffering and premature death.  
Relative poverty means not having the means or resources to adequately participate in the economic and social life of an economy. This level of poverty will vary depending on the level of development of the economy.
- b Students should also understand how poverty is measured. For example, the main measure for relative poverty used in the OECD and the EU is based on a level of income usually set at 60% of the median household income. They should also have an understanding of how levels of poverty have changed over time.
- c To measure inequality, students need to understand the Gini coefficient and the Lorenz curve – how they are arrived at, what they mean and how to interpret them.

#### 3.6.2 Reducing poverty

- a Economic development is about how an economy expands not just in terms of income and investment but also in socioeconomic terms. It is a way of measuring progress in the quality of life in developing and developed nations. Economic growth is more specific and refers to an increase in the real output of goods and services in the country expressed in terms of GDP. Students need to know how both can lead to a reduction in poverty.
- b International aid is often seen as a way of helping development and reducing poverty. Students should appreciate that this is not always a straightforward topic. While it can be seen as a means of helping alleviate poverty in the short term, it may not be the best long-term solution. The term NGO covers many different bodies but here students need to know about their role in aiding development; detailed knowledge is not required.



- c Poverty reduction policies are designed to reduce poverty and narrow the income gap. They cover a vast range in terms of type, size and scope. (The UN alone has over 4,000 different projects.) Students should be aware of one or two examples and understand how they might lead to poverty reduction.

### 3.6.3 The impact of inequality on economic agents

- a The impact of inequality can be a controversial area depending on political viewpoint. Nevertheless there does seem to be a growing consensus that excessive income inequality is harmful. The work of Professor Richard Wilkinson could be a useful example here.

Many social problems that affect the individual, such as crime, infant mortality, educational attainment and life span, are now thought to be related to the degree of inequality rather than that of poverty alone. Inequality makes it harder for the individual to progress and can cause social tensions and unrest. The US could be used as an example.

- b If inequality is responsible for the problems outlined above, then it is likely that low-income workers will be less productive than those on higher incomes in a more egalitarian society. Low-income workers who lack educational attainment or feel less involved are likely to be both less able and productive as a workforce.
- c Inequality may have a general slowing effect on economic growth; the rich consume a smaller proportion of their income than the poor. Those on higher incomes save money which people on lower incomes would spend. This leads to a fall in aggregate demand which, in turn, leads to lower growth and unemployment. It may also cause instability; some economists have argued that inequality in advanced countries contributed to the Global Financial Crisis.

### 3.6.4 Re-distribution of income and wealth

- a Income is a specific flow of money, usually in the form of wages or a salary, and measured over a specific time period. Wealth is a stock and is measured by the total monetary worth of assets at a particular time.
- b Students should appreciate the importance of incentives as a means of influencing certain behaviours. This can be in a positive manner and also in a negative way, such as the poverty trap. They should understand the nature of the poverty trap, why it is difficult to eradicate, how the government has tried to do so with the Working Families Tax Credit scheme, and the extent to which it has been successful.
- c A detailed knowledge of the tax system is not required but students should know the general purpose of taxation, its role in the redistribution of income and wealth, and as a source of government revenue for the provision of services. Students should understand that the level of taxation is an incentive/disincentive for individuals and businesses. It is also an area of political debate, with some economies favouring high levels of taxation, redistribution and services, and others that try to minimise government intervention.



## Theme 4: Making markets work

This section provides ideas and suggestions for teaching approaches for Theme 4 and is not intended to be prescriptive. The specification should be referred to as the authoritative source of information.

### 4.1 Competition and market power

This section covers market structures, and its focus is on market power and the nature of competition in a range of situations. The content builds on earlier work on competition, marketing, pricing strategies, costs of production, innovation and productivity. Revision of relevant topics will be important in helping students to progress towards a more sophisticated analysis of the issues involved. Productive and allocative efficiency are introduced and these topics encourage a synoptic approach. Overall, the objective should be to draw together students' understanding and prior knowledge, developing awareness of the links and relationships between concepts, events and policies. Taken together with the additional content, this section gives the student powerful tools of application, analysis and evaluation.

A wide range of case studies and examples will be required to illustrate the terminology employed. Markets and businesses vary hugely in terms of the strength the nature of the competition that prevails. The diagrams that are associated with the theory of the firm are not required but students should develop a thorough understanding of the range of real-world scenarios that can occur and the ways in which they can be categorised.

#### 4.1.1 Spectrum of competition

- a The spectrum of competition can be used as a way of defining the differences between the main market structures, helping students to understand the variations seen within each category. The specific features of perfect competition, oligopoly and monopoly can be taught using a wide range of examples. Within the umbrella term of imperfect competition, it may be useful to identify monopolistic competition, stressing product differentiation, because there will be so many examples within students' own experiences, for example hairdressers, florists, restaurants or estate agents.
- b Perfect competition should be taught as a yardstick, a way of evaluating the relative competitiveness of different markets. Commodity markets provide reasonably realistic examples of perfect competition. Most commodities come in different types or grades but within each category there is usually a homogeneous product. Wheat, sugar and tea are useful and can be contrasted with those commodities where global businesses and some governments have become very powerful, for example diamonds and oil.
- c Pricing strategies were covered in section 2.2 and these should be revised so that students can understand and analyse the connections between pricing strategies and market structures. For example, highly competitive markets will usually lead to many businesses pricing competitively, even though differentiation may sometimes create opportunities to charge higher prices. A business that has a degree of monopoly power may choose to use predatory pricing as a way to destabilise competing producers. Case study material will be needed to cover a wide range of scenarios.
- d Non-price competition occurs in all situations of imperfect competition. Products will not be homogeneous although some may be very similar. Businesses may focus on quality, design, reliability or any other product feature or marketing plan. Sometimes the objective will be to give perceived value for money, charging a relatively high price but incorporating desirable product features that give the product a competitive edge.

- e The limitations of the model of perfect competition should be discussed. Students should understand that the model shows how market systems can deliver allocative efficiency but that all kinds of market imperfections have potential to distort prices and the ultimate allocation of resources.

#### 4.1.2 Barriers to entry

- f In some sectors entrepreneurs can create a start-up really easily. In others it may be practically impossible to start from scratch. In the former case, the market is said to be contestable, because competitors can easily break into it. In the latter case, barriers to entry make it both difficult and expensive to start a new business. Easy entry means that a relatively small investment will be sufficient to start a business. Someone with a good idea and appropriate skills will have costs of production that can be covered at a reasonably competitive price. Entry may be easy for small new businesses, but also large businesses seeking to diversify their product range may have the necessary resources to enter the market. Examples might include bed and breakfast or accountancy services.
- g Barriers to entry can range from modest to highly significant. High start-up costs can make entry almost impossible. Many kinds of manufacturing processes require major investment in capital equipment, training and research, making entry very difficult. Brand loyalty may make it difficult to market a competing product. Creating a distinctive new product may require extensive R&D.
- h High barriers to entry make it likely that there will be relatively few competitors in the market, so markets for manufactured goods tend to be oligopolistic. Successful businesses will be big enough to afford the initial investment and the costs of innovation. Analysis of market structure will usually require extended consideration of barriers to entry.
- i Economies of scale were studied in section 2.1.1. Revision of each type of internal economy is required with particular reference to technical, marketing and risk-bearing economies. They account for the ease with which bigger businesses can cut costs; if there is sufficient competition they can lead to price cuts. They can create significant barriers to entry.

#### 4.1.3 Oligopoly

- a Concentration ratios show the percentage of the market accounted for by a given number of businesses, usually the biggest five or three firms in the market. They can be calculated from market share data.
- a Competition in an oligopoly may range from quite muted to very fierce. There is almost always strong non-price competition, using product differentiation and extensive advertising. One business may feel very confident and reduce prices in order to increase market share – supermarkets do this. Another may charge a premium price – think of Apple and the iPhone. Always, businesses within an oligopoly will watch each other closely: they are said to be interdependent. Any action by one is likely to produce a market response in others. Samsung sought to produce an equally attractive phone and sell it at a lower price. Markets with less technological change may keep prices stable in order to avoid the losses that may be associated with a price war.
- b Tacit agreement results when competing producers don't make big changes. They don't actually communicate with one another but they avoid active competition. Keeping prices steady makes it possible for all the businesses in the market to stay reliably profitable.

- c Price discrimination means charging different prices for the same product in different markets. Rail operators are most likely to do this, charging commuters more than they charge off-peak travellers. It is easy to keep the markets separate because commuters all travel at the same time of day. Price discrimination works by exploiting variations in price elasticity of demand in different market segments.

### 4.1.4 Business objectives and pricing decisions

- a Average cost, average revenue and profit are covered in section 1.6 and this work should be revised. This is a good time to explore the impact of economies of scale (section 2.1.1) on average total costs; it would be worth looking at the U-shaped average total cost curve and whether in fact it may have a long flat bottom. This can have an effect on business strategies for growth and objectives generally.
- b Economic decision making usually relates to what happens at the margin. Typically, firms might be deciding to produce a little more or a little less in response to market changes. Costs will increase or decrease by small amounts as output changes. It pays the business to produce more so long as the extra revenue is greater than the extra cost. Profit will be maximised when marginal cost is exactly equal to marginal revenue. Marginal costs and revenues can be found by calculating the change in total costs and total revenues when output increases/decreases by a certain amount.
- c Contribution decisions illustrate the significance of the margin. Students should revise section 1.6.2 and look at an example of how a reduced price can increase profit provided that it makes a contribution to fixed costs. Essentially, they are looking at the marginal cost and the marginal revenue of a small increase in output.
- d For some businesses, growth is an important objective. If their market is not growing, then they must look for a way of increasing market share and pricing may be made more competitive. For others, profitability may be more important and this may involve quite different strategies, possibly concentrating on specific market segments and charging premium prices. Reputation may be a significant objective and the response will be different again. Varied case study material is required.

### 4.1.5 Productive and allocative efficiency

- e Productive efficiency is all about getting the best possible standard of living from the resources available. It involves minimising production costs, strategies such as lean production and/or more effective management techniques. Allocative efficiency is completely different, referring to the extent to which resources are allocated in a way that best meets consumers' preferences. If businesses respond effectively to changes in consumer demand, there is allocative efficiency.
- f Decisions usually have an opportunity cost (section 1.1.1); there may be trade-offs. At the margin, consumers may decide whether to buy more meat or more fish. If there is increased demand for meat, prices will rise and farmers may respond by increasing the size of their herds. Governments may be forced to choose between spending more on care of the elderly or more on education of the very young. Resources are finite and, for allocative efficiency, the choice made must be the one that most closely matches consumer preferences.
- g Productive efficiency leads to higher productivity (section 2.3). Technological change, training, education and more efficient management can all lead to significant reductions in production costs. The quality of the product may improve too, giving it more value.

- h The market system creates incentives for businesses to create products that maximise consumer satisfaction. The more successfully they meet their customers' preferences, the more profit they will be able to make. Markets that function well in this way enhance allocative efficiency. Market-orientated businesses help to make this outcome more likely.
- i Many of the inputs used in a production process will be bought in from other firms. So if a maker of vehicle components becomes more efficient, prices may become more competitive and that will help the vehicle manufacturer to cut costs too. Markets also interact where there are changes in costs and prices of substitute and complementary products.

### 4.2 Market power and market failure

Markets are usually seen as providing an efficient way of allocating resources. Competition between providers ensures that businesses will strive to keep costs and prices down. The price mechanism ensures that businesses will produce the kinds of products that customers are seeking. The whole process will create an allocation of resources that gives society the best deal that can be obtained with the available resources.

However, vested interests may intervene and create the conditions for market failure. Businesses find competition difficult to live with: they are constantly struggling to hold on to their customers and stop them from choosing other firms' products. But to the extent that they successfully reduce the power of the competition, they may be charging the customer more than the true costs of production. This makes many people worse off than they need be. The key factor is power in the marketplace: businesses will try to achieve it but, in so doing, they may lose the efficiency which can improve standards of living.

Business regulation seeks to prevent market failure in ways that protect the interests of both consumers and employees. Students are not expected to learn the details in each major piece of legislation but they do need to know why regulation is important, how it works and what disadvantages it may have. Throughout, students should be examining case study material that provides good examples. Investigating current issues is particularly helpful, especially when students can follow the progress of a particular case which is concluded during their course.

Before starting this section, students should revise relevant earlier work, in particular: business and stakeholder objectives (1.1); markets and the price mechanism (1.4); market failure (1.5); business growth (2.1); and marketing and elasticities (2.2). They must also keep in mind the content of the previous section (4.1).

#### 4.2.1 Market failure

- a Businesses have many ways of acquiring and reinforcing their market power. Product differentiation, branding and some pricing strategies can help them to increase their market share and may play a part in enhancing market efficiency, especially when they encourage the use of new technologies. However, they may try to collaborate with competing businesses in ways that enable them to charge higher prices. This will reduce consumers' spending power and lead to lower standards of living. Similarly, large numbers of employees may belong to a trade union that encourages industrial action; it may act like a monopolist and become, effectively, a single seller of the appropriate labour. This can raise production costs and prices. Another kind of market power may occur when there are limited job choices available to those seeking work. They may receive very low pay because there is a monopsonist employer with considerable market power and few alternative jobs to apply for.

This section should enhance understanding of the fact that the model of perfect competition is in marked contrast to the markets in which anti-competitive practices distort the allocation of resources and standards of living are negatively affected.

- b Students should consider the many ways in which organisations can develop market power and the effect that this will have on the efficient functioning of the market concerned. They should explore the way in which vested interests may take decisions that will increase profitability and the extent to which such decisions may run counter to the public interest. They must be aware that economies of scale and new technologies often lead to lower prices and new products, while simultaneously enhancing the market power of the producer. Studying a natural monopoly too may highlight a situation where market power is inevitable but can be in the consumers' interest if appropriately regulated. Governments can be affected by the market power of suppliers – for example when they are awarding defence contracts – or by bilateral monopolies where both buyer and seller have market power – for example when the British Medical Association is negotiating pay with the NHS. The winner will be the side with the most powerful negotiating skills.

### 4.2.2 Business regulation

Throughout this section, case study material is needed to demonstrate the range of common issues.

- a Each source of market power has a possible solution that will enhance competition and help the market to work more efficiently. This work used to be covered by the Office of Fair Trading but in early 2014 it was replaced by the Competition and Markets Authority (CMA). This is an official body that prevents anti-competitive practices, carries out market studies, and reviews takeovers and mergers to ensure that they are in the public interest.
- b In a natural monopoly, having more than one supplier involves duplication of resources. Water is the best example because competition would require at least two sets of pipelines. Many natural monopolies were nationalised in the 1940s and after. Most were privatised in the 1980s and after, with a view to increasing efficiency and encouraging competition but without duplication of resources. However, they still have potential to charge the consumer more than is needed to ensure the supply. As such, regulators draw up strict rules for businesses in these markets to ensure that they provide a good service at a reasonable price. The outcome is often controversial; students should explore the arguments of both sides with appropriate case studies.
- c Students need to understand why consumers need protection and the kind of problems that are likely to occur, but do not need to learn the specific details of the legislation (although they may want to learn about the penalties awaiting guilty parties). The CMA deals with issues relating to unfair contract terms and the use of misleading pricing strategies. There are plenty of relevant examples, such as the way furniture retailers regularly advertise special sales with discount prices, interspersed with brief periods when the 'normal' higher price operates. This makes it hard for customers to work out whether the price they are offered really is competitive.
- d The CMA replaced both the OFT and the Competition Commission in March 2014; the objective was to reduce duplication of effort and streamline the regulation process. In terms of the implementation of competition law, future cases will probably be broadly similar to those of the past, so case studies do not have to be very recent but should include a merger investigation and a prosecution or investigation of an anti-competitive practice.

- e Globalisation means that, increasingly, cartels, collusion and price-fixing activities involve businesses in more than one country. The CMA collaborates with both the US anti-trust authorities and the EU Directorate General for Competition, which is part of the EU Commission. The case of Microsoft is perhaps the best known example of collaboration. In the US, anti-trust action will usually be triggered by a market share of around 60%. In the EU, a market share of 38% is taken as evidence of market power. In the UK, a monopoly is defined as 25% of the market but usually a more nuanced approach is taken, with attention being given to whether the market is actually contestable.
- f Employee protection is important because it requires firms to provide a safe environment for employees and to comply with the law on the process of employee dismissal. Where there are few choices about where and with whom jobs are available, employers may have the market power to exploit their employees with low pay and by dodging safety requirements. Although the UK has a very flexible labour market by EU standards, regulation is still important to prevent the worst abuses.

### 4.2.3 Arguments for and against regulation

- a Regulation has done much to improve the quality of life for consumers and employees. Products are generally safe. Competition provides goods and services at lower prices, increasing standards of living and wellbeing.

Students should be aware that the EU single market was designed to create a level playing field for all business, leading to strong competition with rules that are fair to all. Harmonising regulation makes this a reality.

The trade-off between employee protection and the level of employment and job creation is very real. Flexible labour markets in the UK and the Netherlands have been credited with facilitating lower rates of unemployment and livelier job creation. Germany got good results from similar structural reforms in the labour market of the early 2000s. The French government is aware of the need for similar policies as it grapples with high unemployment. Students should be aware that the UK already has less employment protection than many similar economies.

- b Regulation can be costly for businesses. Safe working environments, minimum wage rates and product standards can all increase their costs of production. Not being able to collude with one another may force them to compete on price. Almost all regulation has some potential to reduce profitability, so businesses typically complain about regulation and lobby politicians to try to reduce it.

It is important to displace populist attitudes with some case-by-case consideration of exactly what types of regulation are damaging to business and, of these, which might be eliminated without very detrimental effects on people.



### 4.3 Market failure across the economy

Market failure was introduced in section 1.5. Students should revise section 1.5 carefully before going on to explore market failure in greater depth.

Within society, freely functioning markets can fail to deliver an efficient allocation of resources. Some goods and services may not be produced at all; others may be produced but not in the quantity that would provide the optimum outcome for society. (Section 4.2 explored the way in which lack of competition may lead to smaller quantities supplied at higher prices.)

Free markets may also provide products that have detrimental effects on the economy and society. Markets may fail to clear; this means that there may be excess supply or excess demand that persists for long periods. There may be asymmetric information: either the buyer or the seller may know more about the product and its market than the other. The deal will be much more favourable for the one who knows more than it is for the other.

This section looks at the ways in which a variety of markets may fail and how the allocation of resources may change to a mix that provides optimum benefits to society. Students should have a good understanding of positive and negative externalities and the impact that these may have on individuals and society as a whole. They should be aware of the possibility of comparing costs and benefits where there are alternative possibilities, but they do not need to study cost benefit analysis in detail. They should understand private, external, and social costs and benefits, but they are not expected to use the diagrams for marginal social costs and benefits.

In examining the impact of market failure in the economy and society, the environment, public and merit goods, labour market issues and welfare issues should be explored. However, there may be other areas in which markets are seen to be failing, and students' understanding of market failure and externalities should be sufficient for them to be able to apply it in unfamiliar contexts.

#### 4.3.1 Market failure in society

a–f Using a range of real-world scenarios, students will develop an understanding of the ways in which markets can fail. They should appreciate the distinction between public and merit goods. They should understand why healthcare and education, as well as public goods and other merit goods, may be under-produced and under-consumed in the absence of government intervention. Exploring a range of examples of both positive and negative externalities will provide insights into the reasons for over- and under-consumption. Study of negative externalities will relate to the detrimental effects of environmental congestion and pollution. Negative externalities also explain the existence of demerit goods which may be over-consumed, looked at from the point of view of society.

The existence of imperfect and asymmetric information explains why the market price does not always reflect the true cost of the product. Students may find the debate about the misselling of financial products to be useful in this respect. Factor immobility refers either to situations in which people seeking work may be some distance from the locations where there are job vacancies, or to situations in which they are available to work but do not have the necessary skills to fill existing vacancies. Real-world examples are key to understanding all aspects of this section.



### 4.3.2 Externalities

- a Externalities include all the costs and benefits that affect people and communities that are neither buyers nor sellers of the product in question. They are economic side-effects, sometimes known as spillover effects. Negative externalities impose costs on society that are not paid for either by the producer or by the consumer. They include pollution, congestion and noise. Private costs are included in the price of the product; external costs are usually not. Social costs include both private and external costs and reflect the true cost of production. Private benefits are paid for by the buyer but positive externalities benefit people who have not had to pay for them – these are social benefits. Some external costs may be described as economic costs, if they are quantifiable. For example, the economic cost of congestion can be estimated, whereas the cost to society of excessive noise cannot.
- b The price that can be charged, through the profit-signalling mechanism, determines many business decisions about how much should be produced. If there are external costs, the amounts produced and consumed will be greater than they would be if all costs could be built into the calculation of price. There will be over-consumption because of negative externalities such as pollution, which mean that the polluter does not have to pay for the full costs to society.
- c Externalities are particularly visible in the effects on the environment of modern production and consumption. Energy consumption in particular is likely to involve prices that do not fully reflect the negative externalities and the social costs of energy use.

### 4.3.3 Policies to deal with market failure

- a Public goods should be defined as those that no one can be excluded from using if they are provided (non-excludability) and are available regardless of how many people benefit (non-rivalrous). Street lights are the standard example. However, these goods must be provided collectively because no individual has an incentive to provide them at all. Both public and merit goods address the problems of under-consumption of products that offer benefits to society as a whole: street lights reduce accidents, while an educated workforce leads to higher productivity and growing incomes across society. These are positive externalities.
- b Indirect taxation may raise prices so they are closer to the full social cost of the products concerned. This may reduce the consumption of demerit goods, for example tobacco products. Tradable permits can create an incentive for businesses to move towards less (and more efficient) fossil fuel use. If they can cut their emissions, they may be able to sell their permits to others that have a greater need for energy. Information, legislation and regulation all play a part in alerting decision takers to the need for responsible decision making. Students should consider the effectiveness of these measures; tradable permits in the EU have not always appeared to work well.

#### 4.4 Macroeconomic policies and impact on firms and individuals

Previous work on this topic includes sections 2.5 and 2.6 on the economic cycle and macroeconomic policy. This section requires increased depth of knowledge, together with an ability to analyse and evaluate the likely effects of specific policies. Revision is required, along with the more holistic view that is facilitated by wide-ranging subject knowledge.

This section requires students to learn the underpinning theories that will enable them to produce a more systematic analysis of events. In particular, the AD/AS model will allow students to achieve a stronger understanding of how the variables change over time and in relation to the economic cycle. They will learn how some situations require a combination of policies that can address potential policy conflicts.

It is quite possible that students will be studying the UK economy at a time when inflation is so low that it never becomes a problem. However, we cannot be sure about this so inflation must be included in the content of this section, even if only because low inflation would indicate some success in this policy area.

##### 4.4.1 The AD/AS model

- a Aggregate demand (AD) has a range of component parts. One way to introduce this would be to look first at the circular flow of money in the economy, which shows how healthy investment, government spending and exports can increase aggregate demand and savings, and taxation and imports can reduce it.
- b Changes in aggregate supply (AS) arise for two separate reasons. Lack of demand in the economy may cause business to cut production. However, this is a movement along the AS curve, not a change in the capacity of the economy to produce. So is an increase in supply that is simply a response to rising AD. These are usually termed short-run changes in AS. Longer term, aggregate supply may increase because investment and innovation can increase the productive capacity of the economy. This produces a long-term shift of the AS curve to the right.
- c Full capacity output is the amount of goods and services that can be produced when all usable resources are fully employed. This situation would be associated with low levels of unemployment, healthy economic growth and rising aggregate demand.
- d If AD is growing fast and the economy is already at its full capacity output, output cannot increase in the short run. Imports might rise to plug the gap but this is an excellent time for businesses to raise their prices. They can charge more and still sell their products. Profitability will increase but so will the rate of inflation. This will continue until economic policy changes. Given time, the economy may grow because many businesses are investing and using new technologies. But in the meantime, contractionary policies will be required to stop inflation from accelerating. Similarly, if AD is growing more slowly than AS, businesses will be left with unsold goods and will cut production and, after a while, employment too. If this process continues, expansionary policies will be required.
- e The multiplier is most easily seen in the context of the circular flow of money. Any injection into the circular flow (which could be increased investment or government spending) will raise AD and lead to some businesses and perhaps also the government (for example via the NHS) expanding and taking on more labour. That will increase incomes for some people, who will then be able to spend more than they could previously. This extra spending translates into increased demand for a wide range of products and it will also make businesses feel more confident about investing. The economy will expand. In this way a relatively small amount of extra spending on investment or public services will gather momentum that leads to continuing economic growth.

- f The AD/AS model gives insight into how changes in one part of the economy will affect other parts of the economy. If demand is falling, output will fall and so will incomes and employment. If there is technological change along with some growth in aggregate demand, it will be possible for the economy to expand without accelerating inflation. But AD/AS is not an all-purpose macroeconomic model because it ignores certain variables that may influence outcomes considerably. These include the effects of expectations and uncertainty, of monetary policies, and of changes in income distribution. In addition, the model will give different predictions depending on whether the supply curve is treated as short or long run. Sophisticated macroeconomic models have many more variables. In practice, it is important for students to understand that there are many influences on the economy and these may be crucial to the outcome. Detailed analysis of the limitations of the AD/AS model is not required.

#### 4.4.2 Demand-side policies

- a Fiscal policy is determined by the government and may involve changes in spending on public services or changes in tax rates (income tax, VAT and excise taxes on specific products). If unemployment is high, policy may be expansionary, but if inflation is accelerating then it will be contractionary. The Bank of England is responsible for deciding monetary policy; although it keeps in close touch with the government, it has a large measure of independence. The objective of this is to ensure that governments cannot pursue expansionary policies just in order to win a forthcoming election.
- b Expansionary policies leading to rising AD will give businesses an incentive to produce more; sales will be brisk. The economy may expand steadily but, if the process goes on for too long, the result may be accelerating inflation. Similarly, contractionary policies will depress AD leading to lower output and then redundancies and unemployment.
- c Students are required to draw AD/AS diagrams that capture specific situations arising from changes in AD. These will underpin their analysis of dynamic change in the economy.
- d Both fiscal and monetary policies can be used to encourage investment, job creation and economic growth, but supply-side policies are important too. Usually there is a need for a policy package that can deal with a range of problems and help to create optimistic expectations that will make investment look worthwhile. This may involve the private sector or the public sector. For example, there may be more spending on infrastructure projects. Education and training to improve skills can be very helpful in the long run.
- e Controlling inflation and unemployment can involve both demand-side and supply-side changes. However, supply-side changes are usually long term in nature, and the emphasis will normally be on fiscal and monetary policies to address the immediate problem.
- f Time lags need to be considered because the full effect of policy changes takes up to two years to appear. Unemployment usually persists for 12–18 months after the economy has begun to grow after a recession. (The UK in 2014 was exceptional in this respect.)

- g Demand-side policies work faster than supply-side policies. A major objective of fiscal policy is to adjust it so that it has a stabilising effect on the economy. However, fiscal policies can easily overshoot; any policy that raises aggregate demand may in time lead to accelerating inflation that may be hard to reverse. Expansionary policies may require deficit funding, in which case government expenditure will rise and, if interest rates are high, borrowing may be costly. Timing may be crucial. Similarly, tax cuts may be possible but may also raise borrowing costs. There may be a trade-off between inflation and unemployment. Expansion may be good for incomes and employment but lead to overheating, skill shortages, rising imports and accelerating inflation. Government borrowing may increase interest rates which may in turn make the currency more attractive and push up the exchange rate, reducing competitiveness. This list could continue with examples drawn from contractionary policy consequences.
- h Potential policy conflicts occur when an appropriate policy has knock-on effects that make it harder to achieve other desirable objectives. The trade-off between inflation and unemployment is the most significant but there are many other trade-offs; counter-inflation policies may slow economic growth and policies to redistribute income may entail increased benefits that reduce the incentive to work.

### 4.4.3 Supply-side policies

- a Market-based supply-side policies aim to make markets work more efficiently, whereas interventionist policies actually exert a measure of control over the market. The dividing line between the two is not precise but has political significance: left-leaning politicians may favour more intervention whereas right-leaning politicians may favour policies that free markets from legal and financial constraints and create incentives. (Notice that fiscal policies appear in both categories, as well as being demand-side policies.)
- b Market-based policies can include reducing both taxation and government expenditure while also cutting any public sector deficit. This might improve incentives to work and create jobs, although this is controversial. Other market-based policies include relaxation of employment protection law, which makes the labour market more flexible and encourages job creation; privatisation; reducing trade barriers; and facilitating immigration to address skills shortages. Competition policy makes markets more efficient by using legal measures in a very interventionist way to prevent anti-competitive business decisions. Other interventionist policies include investing in public services, infrastructure, education and skills training; regional policies; and business regulation, including controls on the financial sector. Changes in taxation, welfare payments and the minimum wage can create an incentive to work; they are classed as interventionist because they involve direct government action but they have the potential to make labour markets work better, reducing unemployment.
- c The AD/AS diagram should be used to analyse the impact of supply-side policies. The AS curve will shift to the right, indicating an increase in productive capacity and potential for non-inflationary economic growth and job creation. However, supply-side policies are almost always long term in nature; they may be powerful but it usually takes several years for their beneficial effects to emerge.

- d A weakness of supply-side policies is that they have little impact in the short run. The effects may not show up during the lifetime of the government so potentially useful policies may never be adopted. Some supply-side policies are unpopular with large numbers of people, for example regulation, which voters may oppose. The strength of supply-side policies is that they can be made to address the root cause of a problem that is preventing growth in output. They can be used to tackle vested interests that can benefit from restricting output and pushing up prices, for example through competition law. Supply-side policies can increase productivity and improve competitiveness.
- e Some supply-side policies make markets work better but have a downside. For example, when labour markets are made more flexible, employees are more likely to be made redundant. This has to be set against the benefits that come from employers being able to hire people without worrying that they may have to employ them forever, even if circumstances change. It is generally believed that the UK's flexible labour market keeps unemployment below that of France and some other developed economies. Policy conflict may appear if austerity policies (with tax increases and expenditure cuts) are required at a time when increased spending on education and training is clearly needed to reduce skills shortages and facilitate innovation. Other trade-offs may appear as circumstances change.

#### 4.4.4 The impact of macroeconomic policies

- a Macroeconomic policies affect the economy in different ways and the outcome depends greatly on the state of the economy at the time of implementation. Students should aim to provide carefully qualified explanations of likely outcomes, placed in the context of the underlying economic situation and the data that is available to them.
- b Most macroeconomic problems require a policy package that includes a range of different measures. Students should be able to compare alternative approaches within the context of the underlying economic situation and with reference to recent developments.
- c Students should be able to identify the economic and political objectives that trigger policy change and to evaluate the likely effectiveness of specific policies in relation to the relevant objective.

### 4.5 Risk and the financial sector

This section provides students with an overview of the events surrounding the Global Financial Crisis. Students are not required to develop a detailed understanding of financial markets and the banking system. The focus should be on the key aspects which can be applied to appropriate contexts.

Students should revise the role of the banking system introduced in section 1.3.3.

#### 4.5.1 Risks and uncertainty

- a Risks can be quantified. The probability of an event occurring can be calculated by looking at the circumstances in which it has occurred in the past. Therefore businesses can work out how risky a possible course of action is and make allowances for this in their planning. Uncertainty is different: it covers situations that may or may not happen but there is no way of knowing how likely they are. We simply do not know how likely it is that some particular events will occur. The difficulty is that government policies take time to work and decision takers have to adopt the policies they think they will need in the future on the basis of what has been happening lately. If they do not make allowances for time lags, their policies may turn out later to have been mistaken.

- b Shocks are unexpected changes that have a significant impact on the economy. They may be caused by natural disasters or by human error. The most recent was the Global Financial Crisis that developed in the period between 2007 and 2009, which was caused by excessive risk-taking in the financial sector.
- c Some risks can be insured against: people insure their lives, their homes and their cars. Businesses that need to buy and sell in foreign currencies can insure against exchange rate changes using forward markets. These allow them to buy a certain quantity of a currency at a price that is agreed now, and they will receive the money on a particular date in the future. This is very useful for businesses that know they must pay for something in foreign currency on a future date and do not want to find that it is costing much more because the exchange rate of that currency has risen in the meantime.
- d In general, insurance reduces risks. By paying a premium now, we avoid an unpleasant surprise in the future. Businesses can include the premium in their accounts, treating it as a cost of production and using it to help set the prices they are charging. The risk of making a loss is reduced.

### 4.5.2 The role of the financial sector

- a Revising section 1.3.3 will be helpful here. Individuals borrow to fund property purchases; businesses borrow to fund investment and for working capital. People and businesses save in order to have funds for emergencies and to spend in the future. Savings usually need to be safe and secure; too much risk would defeat the purpose of saving. Banks take in savings deposits and pay a fairly reliable, if often low, rate of interest. They provide safety and channel the funds towards businesses that want to invest, charging a higher rate of interest than they give to savers. The difference between the two rewards the banks for carrying risks and covers the costs of banking processes.
- b Businesses need working capital to cover the gap between paying for the costs of production and receiving payment from the customer. (Some businesses pay their customers 60 days after delivery.) Banks are a major source of loans and overdrafts for working capital.
- c Consumers need to borrow in order to buy expensive items; they need mortgages in order to buy their homes. Banks provide loans and overdrafts to reliable individual customers.
- d Any kind of trade requires payment mechanisms. Banks provide these for both domestic and international trade.
- e Banks would not be able to carry risks unless they could evaluate the probability of a loan not being repaid. Investigating the level of risk can be costly but makes it possible for banks to act as intermediaries between savers and borrowers. However, mistakes can be made in the estimation of risks, which was one cause of the financial crisis.
- f Banks can help businesses that need to arrange purchases ahead of the time they are needed, i.e. in the forward market. For example, they draw up contracts for future deliveries of raw materials or for buying foreign exchange on a specific date. For the business, this reduces the risks associated with price or exchange rate changes.
- g Until 1987, only specialist stockbrokers could buy and sell equities (shares) to the general public. Most banks now provide this facility; many stockbrokers have been taken over by banks.



### 4.5.3 The role of the central bank

- a The Bank of England was made independent of the government in 1997. This meant that the government was no longer taking monetary policy decisions, even though the Treasury keeps in close touch with the bank. The Monetary Policy Committee (MPC) was set up to consider and decide on the level of the base rate on a monthly basis. Its deliberations are minuted and then published approximately two weeks later so that the process is open to scrutiny. The MPC comprises nine members, including Bank of England officials and independent experts. Their target, set by the government, is a 2% rate of inflation. This is symmetrical and a deviation beyond 1% in either direction requires a letter of explanation from the Governor of the Bank of England to the Chancellor of the Exchequer. (Inflation below 2% can mean that prices are inflexible and this can make it harder for the economy to grow in a normal, healthy way.)
- b The base rate is set so as to meet the 2% inflation target and create long-term stability in the macroeconomy. If aggregate demand is growing faster than aggregate supply, the demand will bid up prices and inflation will accelerate. Demand can be damped down by raising rates of interest, making borrowing more expensive. This will discourage investment and consumer borrowing. The early signals that demand is growing too fast can usually be seen in the form of skills shortages across a range of industries. If inflation is too low, there will probably be rising unemployment and underutilised capacity in many businesses; there is scope for faster economic growth. In addition to controlling interest rates, central banks can buy assets from other banks and this pumps money into the economy. This is known in the UK as quantitative easing. These assets are mostly bonds sold to cover the public sector deficit but also bonds that are effectively loans to businesses. It is a useful way of stimulating the economy if low interest rates are having little effect.
- c Banks occupy a key position in the economy. It is important that they survive; if they are making big losses, their lending has to be curtailed, which can be disastrous for borrowers. The Financial Policy Committee (FPC) comprises senior officials at the Bank of England, other officials with major responsibilities for bank regulation, and economic policy specialists. They meet quarterly to take a more long-term view of the state of the economy and the position of the banking system within it. The FPC's objectives are to ensure financial stability, to reduce risks, to ensure that the financial system remains resilient and to support government policy. It focuses on determining the underlying principles of effective banking regulation.
- d Central banks have always been expected to act as lenders of last resort. This means lending to banks when they are temporarily unable to meet customer demands to withdraw money. There are two sides to this: smoothing out the day-to-day fluctuations in the money markets and lending to banks that are in serious difficulty.



#### 4.5.4 The Global Financial Crisis

This section requires the consideration of complex issues but students do not need to analyse the Global Financial Crisis in detail. This section indicates the required level of detail, and further resources will be provided on the Edexcel website to support the teaching and learning of this new content area.

- a For some years before 2008, banks had increasingly offered mortgages to people who could only afford to pay for them if house prices continued to rise and they managed to keep their jobs. (This actually increased the demand for property and led to a housing bubble.) This started in the US but was also common in many European countries, particularly the UK. In 2007, many booming economies began to slow down: their growth had become unsustainable. As unemployment rose, increasing numbers of people defaulted on payments and their homes were sold by the banks. This reduced property prices. Lenders made losses; they had speculated and taken unjustified risks. The banks had been unwise but they could not be allowed to fail because that would lead to widespread business failures and the resulting effect on the economy would be grave.

Moral hazard means that the protection offered to banks enables them to take greater risks without the fear of bankruptcy – they can always turn to the lender of last resort. In 2008–2009, at the height of the financial crisis, the banks stopped lending to each other and also made drastic cuts in their lending to businesses. They switched from risking too much to refusing to take any risks at all. Investment and business activity slowed and the economy went into recession. The excessive risk-taking prior to 2007 was, to a significant degree, a product of the organisational culture of the banking system. Bankers developed complex models that seemed to show that it was safe to take a range of risks, such as offering sub-prime mortgages. Their bonuses created an incentive to sell as many profitable financial products as they could, regardless of the risks involved. These incentives focused on short-term gains, so many financial bodies took decisions that a far-sighted culture would have discouraged. When the assumptions that underpinned the models proved wrong (for example, house prices did not continue to rise), the whole system began to crumble.

- b Banks have been regulated for a long time but regulation had become less strict, no longer able to prevent banks and other financial bodies from taking excessive risks. Since 2009, financial regulation has been strengthened, despite arguments against it from many banks; they must keep larger reserves than previously. The process of defining the rules and monitoring the banks is ongoing; some possible controls have been discussed but not implemented. However, most commentators believe that risks have been reduced. The Financial Conduct Authority supervises the entire financial services sector. It is independent of the Bank of England, regulating consumer credit, promoting competition and ensuring that customers get a fair deal. The Prudential Regulation Authority is part of the Bank of England and supervises banks, building societies, credit unions, insurers and major investment firms. It promotes the safety and soundness of these bodies in order to ensure that the financial system is stable and contributes effectively to the health of the economy.

- c The financial sector is a key element in the functioning of a modern economy. An efficient money market is essential to healthy investment and efficient production. It helps people to buy homes, helps investors to increase productivity and leads to improvements in living standards. However, there are several ways in which financial markets can fail. Lack of confidence can cause the supply of funds for investment to dry up, making life very difficult for businesses. This in turn can lead to businesses closing down and making employees redundant, so that incomes fall substantially. Furthermore, financial intermediaries can develop products and procedures that are potentially profitable for them but actually unfair to the consumer. Misselling of various financial products has been allowed to continue when it should have been tackled vigorously by regulators. Many such situations have led to compensation for customers and fines for sellers, but not before they did much damage. Financial products – such as investment schemes, pensions and insurance policies – are often very complex, sometimes intentionally so. This means that there is asymmetric information: the seller understands the true nature of the product but the customer does not. It is very easy to sell an inappropriate product to the customer in these circumstances. New financial regulation procedures are addressing these issues. This is in marked contrast to the pre-2008 period, when 'light touch' regulation was considered to be good for the economy because it encouraged business activity and economic growth.

## 5. Assessment guidance

---

### 5.1 Implications of linear assessment

For the AS level qualification, both exams (Paper 1 and Paper 2) must be sat at the end of the course – normally one year. First AS level assessment for the new specifications is 2016.

For the A level qualification, the three exams (Paper 1, Paper 2 and Paper 3) must be sat at the end of the course (normally two years). First A level assessment for the new specifications is 2017.

There will be no January assessment window and it will not be possible to take exams for the same qualification in different exam series: all assessments must be completed together at the end of the course.

It will not be possible for students to re-sit individual components. Students may re-take the whole AS or A level qualification.

### 5.2 AS level assessment

The focus at AS level is on building knowledge and understanding of core economic concepts, with a greater emphasis on breadth rather than depth.

There are two externally assessed papers at AS level. Each paper comprises 80 marks and is 1.5 hours in duration.

Each paper assesses distinct areas of the specification content, with Paper 1 assessing Theme 1 content and Paper 2 assessing Theme 2 content. In each paper, Section A and Section B are based on stimulus material and assess breadth, with data-response questions (including short-answer questions) that have a greater focus on AO1 and AO2. These questions integrate the requirements in the assessment objectives, ensuring that knowledge is not demonstrated in isolation from business applications. The stimulus material will be drawn from various business contexts.

Section C is based on stimulus material and assesses depth, enabling students to demonstrate higher-order skills. The extended open-response question in Section C assesses extended writing skills and enables students to make connections between the economic concepts and business contexts.

The structure of the two papers is the same to ensure a consistent approach to assessing the different content areas.

All of the stimulus material is based on real economic and business issues, real business contexts and real data. This supports students in developing a contextualised understanding of how the core concepts and theories relate to the real world in which they live and work. This approach also supports students in genuine application of economic concepts and theory to a range of relevant business contexts.

At AS level, synoptic assessment is achieved through linking topics within themes – students are required to make connections between topics and understand the linkages across core content areas.

### 5.3 A level assessment

There are three externally assessed papers at A level. Each comprises 100 marks and is 2 hours in duration.

Paper 1 and Paper 2 assess distinct areas of the qualification content, with Paper 1 assessing Theme 1 and Theme 4 content, and Paper 2 assessing Theme 2 and Theme 3 content. In each paper, each section is based on stimulus material. Section A comprises data-response questions (including short-answer questions), which have a greater focus on breadth and AO1 and AO2. The short-answer questions integrate the requirements in the assessment objectives, ensuring that knowledge is not demonstrated in isolation from business applications. Sections B and C comprise an extended open-response question which assesses depth, enabling students to demonstrate higher order and extended writing skills. The stimulus material will be drawn from various economic and business contexts.

As with the AS level, all of the stimulus material in the A level is based on real businesses and real data to support students in developing a holistic understanding of how the core concepts and theories relate to the real world in which they live and work. This approach also supports students in genuine application of economic concepts and theories to a range of business contexts.

At A level, synoptic assessment is achieved through linking themes across the specification (Theme 1 and Theme 4 in Paper 1, Theme 2 and Theme 3 in Paper 2), linking topics within themes, and linking across all themes (in Paper 3). At A level, students are required to make connections and understand the linkages across the whole specification content.

A key differentiator between the AS and A level assessments is that the A level papers draw on content from across all four themes; unlike the AS, Theme 1 and Theme 2 content is not assessed discretely at A level. A further differentiation is provided in the style of questions at A level when assessing content that is covered in Theme 1 and Theme 2. For example, students may be asked to define a concept from Theme 1 in the AS level assessments but may be asked to explain the impact of this concept in the A level assessments. Students may be required to perform a calculation at AS level but may be asked to complete an additional step (such as interpret the result of this calculation) at A level.

### 5.4 Pre-released context (A level Paper 3 only)

To support the investigatory nature of the specification, A level Paper 3 has a broad pre-released context. This broad context will be released in November of the previous year, will be available on the Edexcel website and will relate to the examination series in the following summer.

The focus is on a broad context, such as an economy, industry, market or economic issue. The first section of the paper will focus on this broad context and the second section will focus on at least one strand within the context provided, such as a particular firm. For example, in the sample assessment materials, the pre-released context is the Indian economy and the strand is a business operating within India, in this case JCB.

The purpose of the pre-released context is to enable students to conduct independent learning and research. These are important skills to develop for progression to university. The pre-released context provides a basis for further research and investigation by the student. It is also an opportunity for them to become familiar with current issues and trends, and enables them to draw on this familiar context to respond to unfamiliar stimulus material.

Each section of Paper 3 will contain unseen stimulus materials. Students will need to apply to this evidence their knowledge and understanding from all four themes and their understanding of the broad context. Through this, students will make connections between the content and will demonstrate a holistic understanding of the subject content (which is similar to the Unit 4b paper in the 2008 specification). Both sections have the same structure but will require students to apply their knowledge and understanding to two different unseen contexts which have been chosen to reflect the breadth and depth of the subject.

The pre-released context supports the findings of research conducted with key stakeholders, including universities, and supports the application of economic theory to real-world business contexts.

### 5.5 Question types

A range of question types have been used across the AS and A level Economics B assessments. All of the questions are based on stimulus material, underpinning the importance of the application of knowledge and understanding to a range of business contexts.

Short open-response questions have been used to assess both discrete knowledge and understanding of economic concepts and issues (AO1), as well as the application of these concepts to a particular business stimulus or context (AO2). Questions assessing AO1 target lower-order skills. Short open-response questions also allow for the development of student responses, requiring students to make connections and show a logical chain of reasoning and therefore access higher-order cognitive skills and demand (AO3). Extended open response items have been used to assess across the breadth of assessment objectives.

### 5.6 Taxonomy (command words)

Taxonomy relates to the command words used in assessments. A taxonomy for Economics B has been defined and will be applied consistently to ensure students are rewarded for demonstrating the appropriate skills for the subject. Careful consideration has been given to the taxonomies associated with particular question types to ensure that assessment objectives are targeted consistently across questions. The variety of command words used has been reduced to provide clarity and consistency in the skills students are expected to display in the assessments.

The skills students are required to demonstrate in their responses are summarised below and detailed in the skills-based mark schemes (see section 5.7).

Command	Definition
<b>What is meant by/give</b>	AS only. Assesses factual information and requires a definition or examples.
<b>Calculate/using</b>	Assesses quantitative skills. 'Calculate' requires a calculation and 'using' requires students to use a prescribed diagram or formula.
<b>Explain</b>	Requires a multi-stage definition relating to context and includes analysis. In terms of graphs, includes interpretation. Requires students to convey understanding by making a point and linking the point with a justification.
<b>Analyse</b>	Requires a chain of reasoning, explanation and/or justification. Does not include evaluation. In terms of graphs, includes interpretation.

Command	Definition
<b>Discuss</b>	Requires a balanced answer. Requires students to develop arguments using logical, coherent chains of reasoning. Requires evaluation.
<b>Assess</b>	Requires a balanced answer supported by relevant and well-chosen evidence. Requires logical, coherent chains of reasoning, with developed and evaluated arguments. Requires awareness of the validity and significance of competing arguments.
<b>Evaluate</b>	Requires a balanced answer supported by relevant and well-chosen evidence. Requires logical, coherent chains of reasoning, with developed and evaluated arguments. Students will draw on evidence including strengths, weaknesses, alternative actions, relevant data or information. Requires awareness of the validity and significance of competing arguments. Requires balanced comparisons, judgements or conclusions.

These command words are used consistently between sections within papers and across papers to ensure comparability.

### 5.7 Mark schemes

Skills-based mark schemes have been developed for extended open-response questions (8, 10, 12 and 20 mark questions). These mark schemes provide a consistent understanding of the skills and the connections between these skills for each question type and relate directly to the taxonomies (command words) used in the assessments. The bands within each mark scheme clearly show the progression of these skills from the lower bands to the higher bands. Focusing on the skills students are required to demonstrate within each command word ensures that wording is clear, reduces reliance on subjective statements such as 'some analysis' and reflects how teachers and examiners describe the qualities of student work, meaning the expectations are clear for teachers and for markers. There is a skills-based mark scheme for each of the command words and these will be applied consistently.

For example, below is the mark scheme for a 12 mark 'assess' question. The skills outlined in the Assessment Objectives ([knowledge and understanding](#), [application](#), [analysis](#) and [evaluation](#)) are connected and evidenced throughout the levels.

Level	Mark	Descriptor
<b>Level 1</b>	1–2	Isolated elements of knowledge and understanding, using little or no relevant evidence. Arguments and chains of reasoning may be attempted. Limited attempt to address the question.
<b>Level 2</b>	3–5	Elements of knowledge and understanding, using limited relevant evidence. Arguments and chains of reasoning are presented, but with limited attempt to address the question. Comparisons and judgements may be attempted.

## 5. Assessment guidance

Level	Mark	Descriptor
<b>Level 3</b>	6–9	Accurate knowledge and understanding, supported by use of relevant evidence to support the argument, clear chains of reasoning and well-developed arguments. An awareness of the significance of competing arguments is present although may lack balance.
<b>Level 4</b>	10–12	Accurate knowledge and understanding, supported throughout by use of relevant evidence which is well chosen, logical, coherent chains of reasoning, showing full understanding of the question. Arguments are developed and evaluated. A full and balanced awareness of the validity and significance of competing arguments.

The mark schemes focus on the *quality* of student answers rather than the *quantity* of points made and, as such, do not state any number of points students should make in their responses. To guide teachers and markers, the breakdown of marks allocated to each Assessment Objective is given within the levels-based mark schemes to identify the emphasis of each Assessment Objective within each question type.

The application of the new mark schemes will be demonstrated in the exemplar materials (marked student answers to the sample assessment questions with examiner commentary) which will be available on the Edexcel website in spring 2015.



## 6. Quantitative skills

### 6.1 Application of quantitative skills

Students are required to develop and demonstrate competence in the quantitative skills outlined in this section throughout the course of study. It is important for these skills to be applied to relevant economic contexts to ensure students develop a holistic understanding of the application of quantitative skills to economics. Students will already be familiar with most of the skills through their study of GCSE Maths and it is important to demonstrate how these mathematical skills are relevant to the study of economics.

Quantitative skills will be assessed in each exam series, with a minimum of 20% of the total marks across the A level and 15% of total marks across the AS level accounting for the assessment of the quantitative skills outlined in the Annex in the Department for Education's *Subject Content for Economics* document. These skills will be assessed at Level 2 mathematical skills applied in an AS or A level Economics context.

Where appropriate, the quantitative skills have been included within the specified content in each theme of the specification. The tables below capture the direct references to the quantitative skills within the specification content and make suggestions of where these skills may be further developed through application to economic contexts. These are not exhaustive and there are opportunities for students to develop these skills throughout the specification content – students should be encouraged to practise and apply these skills throughout each theme.

The skills can also be developed through the use of stimulus material and case studies, providing opportunities for students to apply a range of quantitative skills to analyse real economic issues. This stimulus material should take the form of both qualitative and quantitative information.

Further support materials for quantitative skills, covering the possible methods, some suggested themes to use for applying the skills, suggested practice questions and areas of possible confusion for students, are available on the subject pages of the Edexcel website.

Examples of where quantitative skills can be included within the teaching and learning are given in the table on the next page.

Quantitative skill	Application
Calculate, use and understand ratios, averages and fractions	1.6.2 The relationship between revenue and costs 1.6.3 Profit and loss 2.2.1 Price elasticity of demand 2.2.4 Income elasticity of supply 2.3.1 Productivity 2.3.2 Capacity utilisation 2.4.4 Exchange rates 3.6.1 Poverty and inequality 4.1.3 Oligopoly
Calculate, use and understand percentages, percentage changes and percentage point changes	1.6.1 Revenue and costs 2.2.1 Price elasticity of demand 2.2.2 Competing on price 2.2.4 Income elasticity of supply 2.4.2 Developed, emerging and developing economies
Understand and use the terms mean, median and relevant quantiles	2.4.2 Developed, emerging and developing economies
Construct and interpret a range of standard graphical forms	1.3.1 Demand 1.3.2 Supply 1.3.3 Price determination 1.3.4 Price mechanism 1.3.6 The competition 1.6.2 The relationship between revenue and cost 2.2.1 Price elasticity of demand 2.2.4 Income elasticity of demand 3.6.1 Poverty and inequality 4.4.1 The AD/AS model 4.4.2 Demand-side policies 4.4.3 Supply-side policies The use of stimulus material throughout the teaching and learning will enable students to interpret a wide range of standard graphical forms.
Calculate and interpret index numbers	2.4.2 Developed, emerging and developing economies 2.5.3 Inflation 3.1.1 Growing economies Index numbers can be applied to a range of examples throughout the specification, such as GDP, production, productivity, terms of trade and unit labour costs.

Quantitative skill	Application
Calculate cost, revenue and profit (marginal, average, totals)	<p>1.6.1 Revenue and costs</p> <p>1.6.2 The relationship between revenue and costs</p> <p>1.6.3 Profit and loss</p> <p>4.1.4 Business objectives and pricing decisions</p>
Make calculations to convert from money to real terms	<p>2.5.3 Inflation</p> <p>3.1.1 Growing economies</p>
Make calculations of elasticity and interpret the result	<p>2.2.1 Price elasticity of demand</p> <p>2.2.4 Income elasticity of demand</p>
Interpret, apply and analyse information in written, graphical, tabular and numerical forms	<p>This skill can be developed throughout all of the sections listed in this table. The use of stimulus material throughout the teaching and learning will enable students to interpret a wide range of information in written, graphical, tabular and numerical forms. Interpreting, analysing and challenging this information will also create opportunities to develop other quantitative skills listed in this table, such as percentage changes and percentage point changes.</p>

## 7. Transferable skills

### 7.1 The need for 21st century skills

Higher education institutions, as well as employers, have consistently highlighted the need for students to develop a range of transferable skills to enable them to respond to the demands of undergraduate study and the world of work with confidence.

The Organisation for Economic Co-operation and Development (OECD) defines skills, or competencies, as 'the bundle of knowledge, attributes and capacities that can be learned and that enable individuals to successfully and consistently perform an activity or task and can be built upon and extended through learning.'<sup>1</sup>

The National Research Council's 21st century skills framework identifies three overarching skills domains: cognitive skills, interpersonal skills and intrapersonal skills. This section maps the new A levels in Economics to these skills, and outlines how transferable skills can be developed through the teaching and learning of economics and how these skills are assessed (where applicable) through the relevant Assessment Objectives.

### 7.2 Cognitive skills

Cognitive skills relate to:

- Non-routine problem solving: expert thinking, metacognition and creativity
- Systems thinking: decision making, reasoning skills and critical thinking
- ICT literacy: the ability to access, manage, integrate, evaluate, construct and communicate using IT
- Collaborative problem solving.

	Cognitive skills		
	Assess	Teach	Evidence
<b>Non-routine problem solving</b>			
Expert thinking	X	X	Examine information and data, recognise patterns and trends, and use and select the appropriate information and data. Understand the limitations of making recommendations and drawing conclusions. Diagnose/identify issues and make recommendations.

<sup>1</sup> OECD (2012), *Better Skills, Better Jobs, Better Lives*:  
<http://skills.oecd.org/documents/OECDSkillsStrategyFINALENG.pdf>

Metacognition	X	X	Draw on knowledge and understanding to reflect on whether a strategy is working (or the likelihood of a strategy being effective) and make further recommendations as appropriate. Develop questioning skills and understand that 'there is no right answer'.
Creativity	X	X	Draw on a holistic understanding of economics to integrate available information and data.
<b>Systems thinking</b>			
Systems thinking	X	X	Develop a holistic understanding of economics in a range of contexts and understand economic influences. Develop a chain of reasoning of causes/consequences/costs/results, considering alternative explanations.
Decision making	X	X	Evaluate the consequences of actions by individuals, firms or governments for the national and global economy. Analyse and evaluate the relative costs and benefits of potential actions and make recommendations as appropriate.
Reasoning skills	X	X	Develop skills in systems analysis and systems evaluation, and abstract reasoning regarding how the different elements of a process interact.
Critical thinking	X	X	Develop a critical understanding of concepts and behaviour through understanding the extent to which economic agents are affected by, and respond to, economic issues, and the variables impacting on causes/consequences/costs/results. To develop the ability to think like an economist by using qualitative and quantitative evidence to make informed judgements, drawing on a toolkit of economic concepts, models and theories.
<b>ICT literacy</b>			
Access		X	Collect and/or retrieve information and data to form an evidence base from which recommendations and judgements can be made.
Manage		X	Develop skills through organising data; the complexity of the data will support higher level thinking.

## 7. Transferable skills

Integrate		X	Interpret, summarise, compare and contrast information and weigh up qualitative and quantitative evidence. Draw on similar or different forms of representation and media.
Evaluate		X	Reflect on information and data to make judgements about the quality, relevance, usefulness and efficiency of information. Use ICT to access a broad range of information and develop an understanding of the constraints of sources.
Construct		X	Use ICT to generate new knowledge by adapting, applying, representing and authoring information, for example using spreadsheets for data manipulation or graphing tools to illustrate trends.
Communicate		X	Convey information and knowledge to various individuals and/or groups; develop skills in communicating through a range of techniques and media.
<b>Collaborative problem solving</b>			
Collaborative problem solving		X	Establish and maintain shared understanding and team organisation and take appropriate action, developed through in-class group work, competitions and economic debates. Understand that there are different economic perspectives.

### 7.3 Interpersonal skills

Interpersonal skills relate to:

- Communication: active listening, oral communication, written communication, assertive communication and non-verbal communication
- Relationship building: teamwork, trust, intercultural sensitivity, self-presentation, social influence, and conflict resolution and negotiation.

	<b>Interpersonal skills</b>		
	<b>Assess</b>	<b>Teach</b>	<b>Evidence</b>
<b>Communication</b>			
Active listening		X	Engage with the viewpoints of others and understand any ambiguities in order to debate issues, especially with regards to questioning ideas and statements.
Oral communication		X	Develop skills in articulating arguments and debates, questioning concepts and providing answers to justify recommendations through group discussions and peer learning.

Written communication	X	X	Write coherently and structure responses in assessments. Develop skills in how to write for different audiences.
Assertive communication	X	X	Develop skills in forming and sustaining an argument, how to present an argument (i.e. being assertive, not aggressive), presenting facts and opinions and drawing on an evidence base to support a position.
Non-verbal communication		X	Develop skills in reinforcing spoken communication through body language, gestures, tone and artefacts, for example in-class presentations and group discussions.
<b>Relationship building</b>			
Teamwork		X	Develop an understanding of how to work with others and support team members through group work, joint research projects and debates.
Trust		X	Develop a belief in the integrity and reliability of another person offering a different perspective or behaviour in economics through teamwork and group work.
Intercultural sensitivity	X	X	Develop an understanding of intercultural sensitivity, supported through economic content, for example understanding the impact of economic factors influencing growth and development in different countries.
Self-presentation		X	Influence the reactions and images people have of individuals and their ideas. Understand that managing these impressions encompass a wide range of behaviours designed to create a positive influence on work colleagues.
Social influence	X	X	Develop an understanding of current issues, for example how society is changing, understanding different influences and the importance of these for economic agents.
Conflict resolution and negotiation		X	Weigh up arguments and, through doing this, develop an understanding of how to resolve conflicts in groups (different opinions). Synthesise the best ideas from all viewpoints and perspectives, and use these to make recommendations.



## 7.4 Intrapersonal skills

Intrapersonal skills relate to:

- **Adaptability:** the ability and willingness to cope with uncertain, new and rapidly changing conditions, handling work stress and adapting to different personalities, communication styles and cultures
- **Self-management and self-development:** work remotely in virtual terms, work autonomously, be self-motivating and self-monitoring, and the willingness and ability to acquire new information and skills related to work.

	Intrapersonal skills		
	Assess	Teach	Evidence
<b>Adaptability</b>			
Ability and willingness to cope with uncertain, new and rapidly changing conditions		X	Develop the ability to adapt to changing situations, unexpected events and ambiguity, for example understanding market failure and responding to current issues.
Handling work stress		X	Develop the ability to analyse the known and unknown as part of a process of making recommendations and coming to judgements. Direct efforts towards constructive solutions/recommendations.
Adapting to different personalities, communication styles and cultures		X	Understand that economics can be studied from a range of perspectives: develop skills in being flexible and listening to the views of others. Understand the importance of tailoring behaviour to persuade, influence and work efficiently; leading groups; adjusting behaviour to show respect for value and customs; and understand the implications of their own behaviour.
<b>Self-management and self-development</b>			
Work remotely, in virtual terms		X	Undertake independent learning and research, read around the subject, keep up-to-date with current issues, using the available tools to achieve this (i.e. range of media channels) and seek sources of help as appropriate (e.g. social media for peer support).
Work autonomously		X	Develop own way of working and manage homework and revision tasks with little or no supervision.

## 7. Transferable skills

Be self-motivating and self-monitoring		X	Through the course content, A level students develop an understanding of setting goals/targets, devising plans, the importance of motivation and performance strategies.
Willingness and ability to acquire new information and skills related to work		X	<p>Undertake wider reading and independent research skills to keep up-to-date with economic issues and thinking.</p> <p>Be proactive in developing relevant skills by drawing on and applying subject knowledge to competitions and related courses, or the Extended Project Qualification.</p>

## 8. Economics B and the EPQ

---

The Extended Project Qualification (EPQ) is a standalone qualification that can be taken alongside an A level. The EPQ supports the development of independent learning skills such as research, critical thinking, extended writing and project management. Students identify and agree a topic of their choice which may or may not be related to an A level subject they are already studying.

Economics students may wish to choose a topic of interest from within the Economics B specification content to explore for their EPQ. For example, they may be interested in exploring a controversial economic issue such as high-speed rail (HS2), UK membership of the EU or taxing wealth, or to investigate an aspect of economics such as a study of the impact of unemployment on the local community.

There is an opportunity for students to use the broad pre-released context for A level Paper 3 as a basis for their EPQ through completing an in-depth exploration of one aspect of the pre-released context. For example, when researching the Indian economy, students might investigate a particular issue they come across for their EPQ. Using the pre-released context in this way supports students in deepening their understanding and widening their perspective of this particular context.

Students are not permitted to use work which has been or will be submitted for another qualification for their EPQ. Centres should refer to the EPQ specifications for further guidance and contact the relevant awarding organisation if there are any questions regarding choice of topic for the EPQ.