

# A Level Economics A



## EXEMPLAR BOOKLET

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A level exemplar material

Issue 1

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# A level Economics A exemplar material

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## Contents

|  |           |
|--|-----------|
| <b>1. Introduction</b>                               | <b>1</b>  |
| 1.1 About this booklet                               | 1         |
| 1.2 How to use this booklet                          | 1         |
| 1.3 Further support                                  | 1         |
| <b>2. Paper 1: Markets and business behaviour</b>    | <b>2</b>  |
| Section B  | 3         |
| Question 6a  | 3         |
| Question 6b  | 5         |
| Question 6c  | 7         |
| Question 6d  | 10        |
| Question 6e  | 12        |
| Section C  | 14        |
| Question 7   | 14        |
| Question 8   | 17        |
| <b>3. Paper 2: The national and global economy</b>   | <b>19</b> |
| Section B  | 20        |
| Question 6a  | 20        |
| Question 6b  | 21        |
| Question 6c  | 23        |
| Question 6d  | 25        |
| Question 6e  | 28        |
| Section C  | 30        |
| Question 7   | 30        |
| Question 8   | 33        |
| <b>4. Paper 3: Microeconomics and macroeconomics</b> | <b>35</b> |
| Section A  | 36        |
| Question 1a  | 36        |
| Question 1b  | 37        |
| Question 1c  | 38        |
| Question 1d  | 40        |
| Question 1d  | 41        |
| Question 1e  | 42        |

|             |    |
|-------------|----|
| Section B   | 44 |
| Question 2a | 44 |
| Question 2b | 45 |
| Question 2c | 48 |
| Question 2d | 50 |
| Question 2e | 51 |

# 1. Introduction

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## 1.1 About this booklet

This booklet has been produced to support teachers delivering the new A level Economics A specifications. The booklet looks at questions from the Sample Assessment Materials. It shows real student responses to these questions and how examiners have applied the mark schemes to demonstrate how student responses would be marked.

It should be noted that responses were generated by school leavers in summer 2014 so may not have been completed in exam conditions. The sample of students had recently completed A2 examinations in Economics from different awarding bodies. As such, some students may not have studied all of the topics in the new A level specification. Students were also permitted to type their responses.

The short answer questions in Section A of Paper 1 and Paper 2 have not been included. For examples of student responses to short answer questions, please refer to the AS Economics A exemplars booklet. Remember, however, that the short answer questions are marked out of 5 for the A Level exams.

The responses are part of a small sample only and have not gone through the standardisation process. Therefore, all comments and marks are provided for guidance only.

## 1.2 How to use this booklet

Following each question you will find:

- Student-style responses to the question (one or two responses for each question)
- Examiner commentary on how the mark scheme has been applied and marks given
- Extracts from the mark scheme for levels based questions
- Comments relating to common errors for this style of question.

## 1.3 Further support

A range of materials are available to download from the Economics page of the Pearson website to support you in planning and delivering the new specifications.

We will provide an extra set of sample papers for A level to support with formative assessment. In addition, we will be holding training to support you with marking mocks in your centre and further information will be provided on our website when available.

Our subject advisor team, led by Colin Leith, is also here to help. You can contact Colin with any questions in the following ways:

**E-mail:** [TeachingEconomics@pearson.com](mailto:TeachingEconomics@pearson.com)

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**Twitter:** [twitter.com/PearsonEconBus](https://twitter.com/PearsonEconBus)

**Subject page:** [Economics subject page](#)

## 2. Paper 1: Markets and business behaviour

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This section includes student responses, marks and commentary for A level Paper 1 9EC0/01, *Markets and business behaviour*. A summary of the questions and marks for each response is provided in the table below.

| Question         | Response 1 | Response 2 |
|------------------|------------|------------|
| <b>Section B</b> |            |            |
| 6a (5)           | 3          | 3          |
| 6b (8)           | 3          | 6          |
| 6c (12)          | 3          | 3          |
| 6d (10)          | 5          | 7          |
| 6e (15)          | 2          | 12         |
| <b>Section C</b> |            |            |
| *7 (25)          | 10         | 18         |
| *8 (25)          | 13         | 19         |

\* Students choose one essay question (25 marks) from a choice of two, meaning students respond to either question 7 or 8.

## Section B

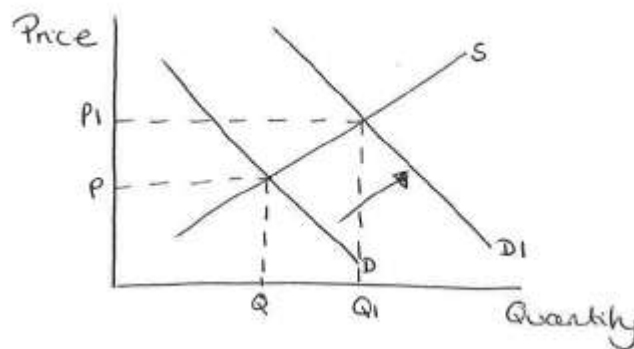
### Question 6a

#### Response 1

- 6 (a) Explain why the price of 'the average top-price ticket has risen by almost £10' (Extract A, line 2). Use a supply and demand diagram in your answer.

(5)

Due to rising demand for West End tickets alongside a non-increasing level of supply for West End shows (due to increasing costs and limited time slots), the price for a ticket has increased. The diagram below shows an increase in price from  $P$  to  $P_1$  and an increase in quantity from  $Q$  to  $Q_1$ .



#### Examiner's comments

The supply and demand diagram with original equilibrium is correct and demonstrates knowledge (1). There is a brief explanation to demonstrate application (1). Although the explanation of 'due to increasing costs and limited time slots' is correct it is not reflected in the diagram. The response includes analysis with the rightward shift of the demand curve (1).

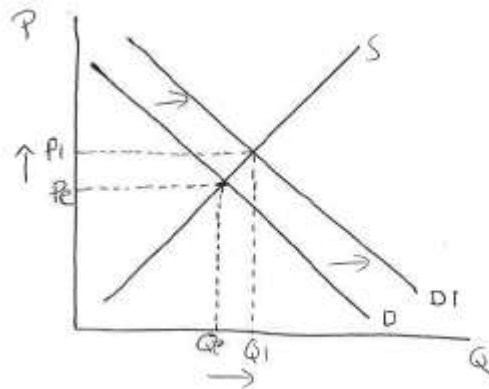
This response therefore gained 3 marks.

**Response 2**

- 6 (a) Explain why the price of 'the average top-price ticket has risen by almost £10' (Extract A, line 2). Use a supply and demand diagram in your answer.

(5)

The average top price ticket for West End shows has risen by almost £10 is due to an increase in demand for tickets. Record numbers of people have wanted to purchase tickets causing the demand curve to shift to the right forcing prices up from  $p_{-1}$  as illustrated on the demand and supply curve below.



Theatre running costs have also increased meaning that some costs of this will be passed onto the consumer in order to remain profitable hence causing the increase in price of top price tickets.

**Examiner's comments**

There is a good explanation of the increase in demand for tickets, which is accurately illustrated in the diagram. However, there is no reference to increased costs of production. 1 mark is awarded for the diagram showing initial equilibrium; 1 for application (explanation of the increase in demand); and 1 for analysis (use of diagram to show rightward shift in the demand curve).

This response therefore gained 3 marks.



## Question 6b

### Response 1

(b) Examine **two** reasons Cineworld plans to merge with CCI.

(8)

Cineworld plans to merge with CCI because of a lack of ability for growth opportunities in the UK and Ireland. As the CCI is an international company it allows access to foreign markets and growth via expansion into those markets. This also opens up international competitiveness between companies. Other Cineworld competitors already have presence overseas so, by merging with a company who is already overseas they have an advantage in that they are already have established cinemas and they do not have to do initial setups.

Another reason as to why Cineworld plans to merge with CCI is it will have more board members on the senior management meaning it will still possess a large amount of power even though it has merged. Cineworld can use this to their advantage in order to sway important decisions to the merged companies advantage. Also even though they have merged they still possess more power than CCI.

#### Examiner's comments:

The first paragraph identifies a relevant reason (1) together with a linked explanation (1) and clear reference to the information provided (1). However, the reason and analysis in the second paragraph is unconvincing so does not score any marks. There is no evaluation in this answer.

This response therefore gained 3 marks.

In an 8-mark question **examine** question, 2 marks will be available for evaluation so students must include evaluative comments in their response to access full marks.

**Response 2**

(b) Examine **two** reasons Cineworld plans to merge with CCI.

(8)

Cineworld has reached a plateau with the growth it can achieve domestically due to crackdowns from competition regulators preventing the company from expanding due to its high level of existing market share and size. By forming a merger with a company such as CCI, Cineworld is able to grow through them by branching out into the 7 European countries that CCI already owns a total of 100 cinemas in. This will allow them to grow as they will be able to have the opportunity to build or purchase more cinemas due to their low market share in these foreign countries, something they could not do domestically.

Merging with a partner company to gain access to international markets also allows Cineworld to spread their risk thinner, preventing the company from being vulnerable to any single market. The reduction in revenue for UK cinemas by 1% in 2013 may show that the market is on a downturn and could cause Cineworld to shut down if the trend continued. By branching out into foreign markets where this is not the case, Cineworld can still operate knowing that they didn't put all of their eggs in one basket and that they are receiving revenue from elsewhere.

**Examiner's comments**

Two reasons for the proposed merger are identified (2 knowledge marks), explained (2 analysis marks) and there is clear reference to the information provided (2 application marks). However, there is no evaluation in this answer.

This response therefore gained 6 marks.

In an 8-mark question **examine** question, 2 marks will be available for evaluation so students must include evaluative comments in their response to access full marks. For example, evaluation could include that it depends on the likelihood that the Competition and Markets Authority will investigate the merger, or depends on the other risks the firms might face, such as increasing rents or falling demand in a global downturn.

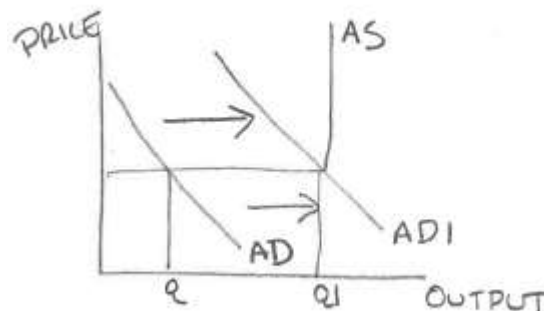
## Question 6c

### Response 1

- (c) With reference to Figure 1, discuss the likely impact of price discrimination on Cineworld's profit. Include an appropriate diagram in your answer.

(12)

The use of price discrimination as shown in figure 1 is likely to increase Cineworld's profits by creating an increase in demand for their tickets. Due to the perfect inelasticity of the supply curve past a certain point, it is important that the cinema tries to fill every time slot for each film showing that it holds in order to create maximum revenue and profit. By lowering the price for students after 5pm, it is likely that large groups of friends will be attracted to all go to the cinema after they have finished school which may have not been the case had the ticket prices been higher. By keeping the cost for an Adult ticket high but creating a deal for a family, it is likely that parents will bring their kids to the cinema to take advantage of the deal, this will lead to a higher amount of profit than just the parents going alone. Every demographic is covered by the price discrimination in a way that attracts the largest groups and the widest ranges of people possible. As shown by the graph below, an increase in demand brings the equilibrium point closer to the point where supply is inelastic (the cinema is full), this leads to a higher demand and a larger amount of profit if the demand can be kept high.



By increasing the demand for tickets, the cinema also has a chance of increasing the demand for its other services such as food and beverages which are the most profitable part of the cinema industry due to the large % profit made on items such as popcorn etc. This is the best way for the cinema to make profit and increasing the demand for the cinema tickets themselves does that.

**Examiner's comments**

There is some merit in this response. However, there is no definition of price discrimination or of the conditions required for it. The application of price elasticity of demand should have been included and a diagram showing third degree price discrimination would have enhanced the answer. The diagram used is not appropriate, the labelling is not accurate and no relevant reference is made to the diagram in the response.

The command word 'discuss' requires evaluation but none is included in this answer.

This response gained Level 2 and 3 marks (3/8) for knowledge, application and analysis and 0 marks for evaluation.

The total for this response is therefore 3 marks (3/12).

To demonstrate knowledge, students should define key terms in the question. This student could have defined price discrimination in the first sentence.

In a 12-mark question **discuss** question, 4 marks will be available for evaluation so students must include evaluative comments in their response to access full marks. Evaluative points could include the degree with which the conditions for price discrimination are met (how easy it is to resell in other sub-markets, for example), or use of game theory to show that it would depend on the reactions of other firms as to how profits will be affected.

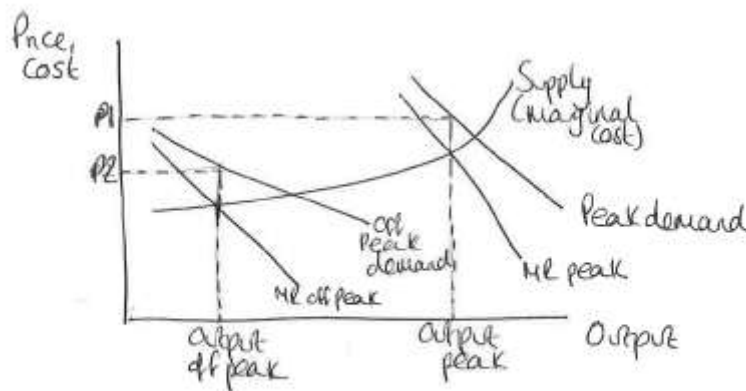
**Response 2**

- (c) With reference to Figure 1, discuss the likely impact of price discrimination on Cineworld's profit. Include an appropriate diagram in your answer.

(12)

Figure one shows that at a typically peak time at the cinema prices for children, students and seniors are the cheapest. However, the largest audience with ages from 19-59 years is the highest price at £9.60. Due to the price discrimination Cineworld's profit may be lowered as their largest audience group (adult) has the highest price tickets. Children, students and seniors have the cheapest prices meaning they will be the main cinema goers after 5pm. However, most working adults will finish work at around 5pm meaning a convenient time for them to go to the cinema would be after then so even though prices are higher for the working age group there will still be a demand which will cause Cineworld's profit levels to go up.

The diagram below shows off peak and on peak price discrimination. Prices at peak times  $p_1$  e.g. after 5pm will be higher than off peak demand prices  $p_2$  because demand is higher.



**Examiner's comments**

Like Response 1, there is no definition of price discrimination or identification of the conditions required. The statement that 'Due to the price discrimination Cineworld's profit may be lowered as their largest audience group (adult) has the highest price tickets' is inaccurate. However, the last sentence of the first paragraph and the diagram do have some merit.

The absence of evaluation means that no marks can be awarded.

This response gained Level 2 and 3 marks (3/8) for knowledge, application and analysis and 0 marks for evaluation.

The total for this response is therefore 3 marks (3/12).

**Question 6d****Response 1**

- (d) Apart from price discrimination, assess **one** pricing and **one** non-pricing strategy Cineworld could adopt to increase sales.

(10)

One non pricing strategy to increase sales for Cineworld could be advertising. By launching a successful advertising campaign Cineworld could see sales increase as more potential customers are attracted. This could be done by specifically targeting an audience such a teenagers. However, large scale advertising campaigns are very costly and if unsuccessful could see no change in sales levels.

A pricing strategy possibly used could be Geographical pricing. Geographical pricing is where by looking into markets in specific countries and regions you are able to work out which is the best price for maximising sales. By looking into the markets it allows you to set a competitive price against other providers that would cause an increase in demand.

**Examiner's comments**

Two relevant policies are identified and explained briefly. There is also a brief evaluative comment relating to advertising at the end of the first paragraph.

This response gained Level 3 and 4 marks (4/6) for knowledge, application and analysis and Level 1 and 1 mark (1/4) for evaluation.

The total for this response is therefore 5 marks (5/10).

**Response 2**

(d) Apart from price discrimination, assess **one** pricing and **one** non-pricing strategy Cineworld could adopt to increase sales.

(10)

Cineworld could adopt a pricing strategy such as predatory pricing in order to combat competition and increase sales. Predatory pricing is when a firm prices their goods at a price that intentionally makes a loss in the short run but attracts more demand and drives out rivals. For example Cineworld could price at a lower rate than Vue cinema and attract Vue's customers, driving them out of business. After Vue has been driven out of the market due to the low demand for their product, Cineworld can price higher than they previously could, due to the lessened competition. However in many countries (including the UK), predatory pricing is considered an anti-competitive practice and is illegal to use, if Cineworld were caught using this pricing strategy they would be imposed large fines and would lose a large amount of their revenue.

Cineworld could also adopt a non-pricing strategy such as advertising and marketing with the aim of attracting more customers to their cinema. By introducing loyalty cards for frequent customers the cinema will have an incentive for customers to continue to visit their cinema, increasing demand for the long run. A loyalty card would also prevent customers from visiting other cinemas as they have an incentive to continue visiting Cineworld due to the rewards they could reap from being a frequent visitor, this would be how the competition is lessened for Cineworld and how sales are increased. However, Cineworld will have to carefully decide its rewards as they need to be significant enough that customers are interested in getting them but not so significant that they cause Cineworld a large loss in revenue.

**Examiner's comments**

In this response a pricing and non-pricing policy are identified and applied to the context but could be analysed more fully. There are some evaluative comments. The final sentence of the first paragraph is a valid evaluative comment whereas the final sentence of the final paragraph is brief.

This response gained Level 3 and 4 marks (4/6) for knowledge, application and analysis and Level 2 and 3 marks (3/4) for evaluation.

The total for this response is therefore 7 marks (7/10).

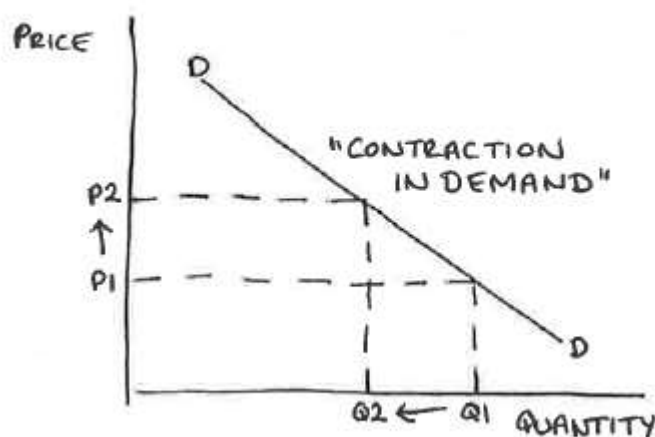
## Question 6e

### Response 1

- (e) Discuss the likely impact of 'a substantial lessening of competition in the cinema market in Aberdeen, Bury St Edmunds and Cambridge' (Extract C, line 6–7).

(15)

A substantial lessening of competition in the cinema market in Aberdeen, Bury St Edmunds and Cambridge may lead to an increase in prices. Without competition firms will see no reason to maintain a lower price meaning that they can charge what they want. In these cities there will effectively be a duopoly market as two firms dominate that market. Firms may see a drop in sales as people choose not to go to the cinema when prices are increased they may instead choose not to go at all or travel to a place where prices are more affordable. This is shown on the diagram below by a contraction in demand as when prices increase demand from the consumer decreases from  $Q_1$ - $Q_2$ .



Also with a lack of competition firms may become inefficient specifically allocatively inefficient as prices are set above the level of production. This means a loss of economic welfare for the consumer as they are paying more than they need to.

### Examiner's comments

This is a superficial response with very limited application of economic concepts and application to the specific context. There are no evaluative comments in the answer.

This response gained Level 1 and 2 marks (2/9) for knowledge, application and analysis and 0 marks for evaluation.

The total for this response is therefore 2 marks (2/15).

In a 15-mark question **discuss** question, 6 marks will be available for evaluation so students must include evaluative comments in their response to access full marks.



**Response 2**

- (e) Discuss the likely impact of 'a substantial lessening of competition in the cinema market in Aberdeen, Bury St Edmunds and Cambridge' (Extract C, line 6–7).

(15)

A lessening in competition in the cinema industry in Aberdeen would have large negative consequences for consumers and some positive benefits for remaining firms in the market. Less competition means that firms are free to price higher as consumers have less choice of where to purchase the product. Higher prices means there will be a loss of consumer surplus which can continue to get worse as competition continues to lessen. The reduced competition also means that there will be a lower incentive for firms that remain in the market to invest in innovating their cinemas and improving the quality of the product, this means that consumers will be getting worse value for their money as they will be paying more for less. However, the increased price and revenue for the firms may lead them to expand their business or use the extra money to invest if they wanted to continue to dominate the market.

The lack of competition in the market will also give consumers a lower choice or variety of firms that they can purchase a cinema ticket for. A lack of choice for consumers may lead to them choosing the 'lesser of the evils' remaining in the market rather than a cinema they actually enjoy using. On the other hand, the lack of a good firm in the industry may cause an abandonment in the remaining firms in the market leading to an increase in DVD sales or even piracy for the viewing of movies in the comfort of one's own home.

The lack of competition also leads to a lower incentive for firms to be allocatively or productively efficient. Allocative efficiency occurs when the price that consumers pay for a good or service is equal to the marginal cost of the product, at this point, consumer welfare is maximised. In a non-competitive market, a firm can keep price above marginal cost and boost profits. Productive efficiency occurs when a firm is using all of its resources efficiently and is exploiting its economies of scale as much as possible. A lack of competition leads to a lower incentive to maximise output and sales and therefore will reduce a firm's productive efficiency, leading to higher prices for the consumer and more profits for the firm.

**Examiner's comments**

This response covers the implications for price, choice, incentives for firms to invest and efficiency, with relevant application to the context. The statement 'Higher prices means there will be a loss of consumer surplus...' is an example of good application of an economic concept. There are also valid evaluative comments in the second and third paragraphs.

This response gained Level 3 and 8 marks (8/9) for knowledge, application and analysis and Level 2 and 4 marks (4/6) for evaluation.

The total for this response is therefore 12 marks (12/15).

## Section C

### Question 7

#### Response 1

7 'Tradable permits are less effective than taxation in reducing carbon emissions.'

To what extent do you agree with this statement?

(Total for Question 7 = 25 marks)

Firstly, tradable permits provide an incentive for a firm to reduce its carbon emissions in order to avoid purchasing a large permit, lower its overall costs and maximise its profits through trading its leftover emission allowance to another company that requires it. For a firm to reduce its carbon emissions it would implement the most cost effective solution possible in order to keep profits high. This could lead to a wave of innovation in technology and reforms in business practices led by the motivation of keeping profits high. However, some businesses may already be using the most efficient processes in carbon cutting and are unable to afford to invest in research in order to cut emissions further. For businesses such as these, the flat cost of an emissions permit may erode profits more than a flat or progressive rate of tax.

Due to the limited amount of permits released by government each year, there is an upper limit to how much carbon can be emitted each year and anything above this will lead to large fines being placed on firms who choose to over-emit. This limit can also be reduced as time goes on leading to a far more effective way of reducing carbon emissions in the future compared to a tax based system.

However, a tax rate on carbon emissions allows firms to produce more output in the instance of a boom in an economy where demand is high and they can afford to pay the extra amount of tax whilst also making significant additional profit. Though this is bad for carbon emissions as there isn't a large consequence for emitting a large amount during production processes.

#### Examiner's comments

This is a fairly brief response which includes some relevant analysis of tradable permits. However, there is only a limited consideration of taxation mostly in terms of evaluation. There is no application of the concept of external costs or a diagram to illustrate this concept.

There are some relevant evaluative comments at the end of the first paragraph and in the last paragraph.

This response gained Level 2 and 6 marks (6/16) for knowledge, application and analysis and Level 2 and 4 marks (4/9) for evaluation.

The total for this response is therefore 10 marks (10/25).

**Response 2**

7 'Tradable permits are less effective than taxation in reducing carbon emissions.'

To what extent do you agree with this statement?

(Total for Question 7 = 25 marks)

Reducing carbon emissions is one of the issues of the present day. Solutions to reduce these emissions have been made with some proving to be more effective than others.

To a large extent I agree with this statement as tradable permits are less effective than taxation. The permits work in that they are allocated to polluting companies and there is a cap on how much emissions can be released. A price is placed on the permit as a set amount of emissions is allocated to one permit. The firm must hold the number of permits it requires for the amount of emissions released. This then allows trade as it puts a price on emissions. If the firm does not use their allocated permits they can trade to over-polluting firms.

However, this does not stop the problem of reducing carbon emissions as while some firms will take measures to reduce their carbon output others will not and just buy the amount of permits they need from non polluters. As there is no real incentive to reduce carbon output some firms will carry on polluting even with a trading scheme. On the other hand as seen in the EU the carbon trading scheme was effective as it became a profit incentive for firms to invest in cleaner carbon reducing technologies and sell their credits. The scheme was successful as emissions across the EU were lowered by 2.5% but is this figure a mass reduction across all of the companies in the trading scheme or some individuals who have stopped polluting in order to gain profit from the trading scheme while others buy polluting permits with no real reduction plans.

Taxation would be more effective at reducing carbon emissions as it sets a higher price for fuels that pollute more and encourages the use of more green energy. By using a tax it means that each polluting individual and supplier has to pay for their own emissions. By taxing polluting energy sources non polluting energy sources become cheaper which encourages both consumers and suppliers to make the switch. This would overall see a more widespread reduction in emissions than carbon permits. As carbon emissions are negative externalities, in order to solve the market failure those creating the negative externalities, which have a wider overall effect on society, should pay for the cost via taxation and those not using "dirtier fuels" will not have to pay.

In conclusion taxation is a far more effective level of tackling carbon emissions as it targets both the supplier and consumer meaning incentives to reduce consumption become greater. Polluting firms will also not be able to pass costs onto consumers as they already have a cost so it will provide further incentives to them to swap to greener sources of energy therefore reducing overall carbon emissions.

**Examiner's comments**

There is good analysis of both tradable permits and taxation as means of reducing carbon emissions. However, the response could have been enhanced by the inclusion of diagrams to illustrate external costs and the impact of taxation. The last sentence is rather unclear.

The evaluation of tradable permits is effective but less convincing in relation to taxation, although there is an attempt at comparing the two methods.

This response gained Level 3 and 12 marks (12/16) for knowledge, application and analysis and Level 2 and 6 marks (6/9) for evaluation.

The total for this response is therefore 18 marks (18/25).

Students must consider two methods in their answer to ensure balance.

## Question 8

### Response 1

- 8 Evaluate the likely microeconomic impact of an increase in the UK national minimum wage.

(Total for Question 8 = 25 marks)

The national minimum wage is a pay floor that producers cannot legally undercut. It was put in place in place by the government to reduce pay differentials. An increase in the UK minimum wage price would have a number of microeconomic impacts.

By increasing the national minimum wage you increase costs for firms. As wages for firms are their biggest costs effects of an increase in the national minimum wage could be substantial. Firms may have to loose workers in order to remain profitable due to the wage rise. However, evidence from the installment of the UKs national minimum wage shows that it had little effect on unemployment which was what was feared.

Instead of getting rid of workers firms may choose to increase prices in order to remain profitable. This increase in costs will be offset as with a national wage increase people will have more disposable income to spend. Also workers can become more incentivised as wages increase which can lead to an increase in productivity and quality levels while output is increasing the competitiveness of the firm. Firms may also push for an improvement in productivity levels as they are paying out more wage money so in return expect to see an increase in the level of productivity amongst their workers.

The national minimum wage was also put in place to reduce poverty levels however, this may prove to be an ineffective way as if households are currently experiencing unemployment than an increase in the minimum wage will be ineffective in improving their financial condition. Therefore it could be seen as effective at reducing unemployment.

The government will see an increase in taxes incomes as more workers will be above the tax free threshold. This will improve government finances and allow them to pay off debt and improve the budget deficit which will help with the overall macroeconomic performance of a country. The national minimum wage also acts as an incentive to go out in active search of a job. This could benefit the economy as with a more active work force the productive potential of the economy would increase and the overall global competitiveness of firms would also increase.

In conclusion the benefits of an increase in the national minimum wage do outweigh the costs.

### Examiner's comments

Several possible effects of an increase in the national minimum wage are identified in this response but only some of them are analysed fully. For example, more explanation is needed to support the statement that 'The national minimum wage was also put in place to reduce poverty'.

The student could have included a diagram to analyse the point they make about increasing prices to remain profitable.

Evaluation is rather sparse but valid points are made in the second and fourth paragraphs.

This response gained Level 3 and 9 marks (9/16) for knowledge, application and analysis and Level 2 and 4 marks (4/9) for evaluation.

The total for this response is therefore 13 marks (13/25).

**Response 2**

- 8 Evaluate the likely microeconomic impact of an increase in the UK national minimum wage.

(Total for Question 8 = 25 marks)

Minimum wage is defined as the minimum hourly rate an employer is required to pay its employees. Businesses that employ workers to be paid at minimum wage are normally businesses that require unskilled labour to produce its good or service. By increasing minimum wage you automatically increase the cost for employing a person to do a task that is very simple and could possibly be completely by machinery or by less workers overall. This could lead to businesses choosing to lay off workers in order to keep costs down and get more profit, increasing local unemployment. Depending on the elasticity of the good, a business may otherwise choose to pass down extra costs as an increased price to consumers, leading to a reduction in consumer welfare overall and no overall benefit to the increase in the wage level, or even creating a wage price spiral.

By placing a minimum wage on workers, especially when there is inflation, allows workers to afford a decent standard of living for themselves and their family and will help reduce the number of people asking of unemployment benefits, reduction the need for government intervention in the market. However, if the higher wages leads to more people being unemployed due to businesses cutting costs, the overall expenditure by government will increase, which could lead to an overall deficit in the budget.

By raising the minimum wage, the competitiveness for jobs is increased and more people are willing to seek employment. This is especially important for young people who would otherwise be doing nothing and will be gaining zero skills that they can use to progress onto a better paying career path in the future. By raising the minimum wage, the government can create a better trained, more experienced and more efficient workforce without the need for education and training, which is more expensive.

An increased minimum wage may actually boost labour productivity due to existing workers working harder in order to prevent being replaced, this may lead to lower costs or higher profits for a firm as less work is required per unit output. This is a good reaction to a higher wage as it helps prevent the possible inflationary consequences of a wage rise and will help keep prices low and boost competition in an industry. However, without new employees being hired, the rise in the minimum wage does little to help those who need it most, the unemployed. Unless something is done to ensure new workers are being employed, poverty will stay as it is and there will still be people who are unable to provide enough earnings for a living wage.

**Examiner's comments**

In this response there is well-reasoned consideration of both the possible positive and negative effects of an increase in the national minimum wage. However, the response could have included diagrammatic analysis of the possible impact on unemployment.

There are some valid evaluative comments – there is relevant evaluation in the final sentence of the second paragraph and some good evaluation at the end of the response – although greater precision is needed in discussing price elasticity of demand.

This response gained Level 4 and 13 marks (13/16) for knowledge, application and analysis and Level 2 and 6 marks (6/9) for evaluation.

The total for this response is therefore 19 marks (19/25).

### 3. Paper 2: The national and global economy

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This section includes student responses, marks and commentary for A level Paper 2 9EC0/02, *The national and global economy*. A summary of the questions and marks for each response is provided in the table below.

| Question         | Response 1 | Response 2 |
|------------------|------------|------------|
| <b>Section B</b> |            |            |
| 6a (5)           | 3          | 5          |
| 6b (8)           | 4          | 6          |
| 6c (12)          | 3          | 8          |
| 6d (10)          | 2          | 7          |
| 6e (15)          | 6          | 9          |
| <b>Section C</b> |            |            |
| *7 (25)          | 10         | 11         |
| *8 (25)          | 6          | 8          |

\* Students choose one essay question (25 marks) from a choice of two, meaning students respond to either question 7 or 8.



## Section B

### Question 6a

#### Response 1

- 6 (a) With reference to Figure 1, calculate the ratio of Burundi's GDP per capita to Kenya's GDP per capita in 2012.

(5)

Burundi: 2.47 billion divided by 16.14 million = 153.036 (3.d.p);

Kenya: 37.23 billion divided by 62.78 million = 593.023 (3.d.p)

593.023 divided by 153.036 = ratio of 3.88 (3.d.p)

#### Examiner's comments

There is an implicit understanding of GDP per capita and the calculations of GDP per capita for Burundi and Kenya are correct. However, the ratio is not calculated accurately; the figure given is for Kenya to Burundi.

This response therefore gained 3 marks.

#### Response 2

- 6 (a) With reference to Figure 1, calculate the ratio of Burundi's GDP per capita to Kenya's GDP per capita in 2012.

(5)

GDP per capita = GDP/Population

Burundi's GDP is 2.47bn and population is 16.14mn.

$2,470,000,000 / 16,140,000 = 153.035935564$  (Burundi's GDP per capita)  
= 153.04

Kenya's GDP is 37.23bn and population is 62.78mn.

$37,230,000,000 / 62,780,000 = 593.023255814$   
= 593.02

Burundi:Kenya

153:593

1:3.9

Burundi's GDP per capita to Kenya's in 2012 is:

= 1:3.9 (1d.p.)

OR

=1:4

#### Examiner's comments

The calculations of GDP per capita for Burundi and Kenya are correct, and the ratio is also calculated accurately.

This response therefore gained 5 marks.



## Question 6b

### Response 1

- (b) With reference to Extract A and Extract B, examine **two** factors that constrain economic growth in Burundi.

(8)

Burundi's economic growth has been constrained by a variety of reasons. One of these reasons is geographical. As Source A states the country of Burundi is "landlocked". This means that it loses the opportunity to use the sea as a way of exporting goods and services to other countries around the world by the use of ships, which before the invention of aircraft would have largely hampered Burundi's economic growth and will be still having an effect to this day. In addition it means that Burundi is not able to use the sea as a way to attract tourists, who are looking for a beach holiday. This loss of potential tourist income affects and slows the economic growth of Burundi.

Secondly, as Source B states that Burundi, despite have joined the an trade agreement with other West African countries which is designed to help increase exports, which in turn can increase economic growth, exports have remained "static". One of the reasons that is given for this is the "civil war". The civil war will cause political instability within Burundi which will in turn mean that other countries looking for exports from Burundi will be hesitant to purchase from them due to this lack of stability and consequently the level of exports will not rise and neither will economic growth.

### Examiner's comments

Two factors are identified and there are supporting explanations. 4 marks are awarded for knowledge, application and analysis. However, there could be more direct reference to the information provided in the extracts to support the arguments. There is no effective evaluation in the response.

This response therefore gained 4 marks.

In an 8-mark question **examine** question, 2 marks will be available for evaluation so students must include evaluative comments in their response to access full marks. Examples could be given of landlocked countries such as Luxembourg or Switzerland which have not had this problem or comments that civil war might not be the main cause but rather an effect of other problems in the economy, such as poor resources.

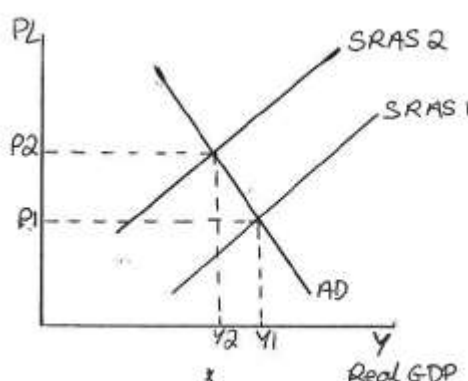
**Response 2**

(b) With reference to Extract A and Extract B, examine **two** factors that constrain economic growth in Burundi.

(8)

Extract A identifies that external supply side shocks constrain economic growth in Burundi. An example of an external shock is 'climate change' and with climate change harvests and productions could be impacted. Therefore, less goods and services are produced overall. This could impact Burundi particularly as 'coffee and tea make up almost 70% of Burundi's total export earnings'. As they are landlocked, transporting items is made harder and due to their poor infrastructure anyway, costs would be very high which limits opportunities for international trade.

Lack of supply



The diagram above shows the equilibrium of supply and demand at  $Y_1, P_1$ . There is a lack of demand so the  $SRAS_1$  line shifts inwards to  $SRAS_2$ . Due to this the real GDP moves from  $Y_1$  to  $Y_2$ , showing a decrease in the Real GDP. With price levels,  $P_1$  increases to  $P_2$ , which means that prices increase and goods are less likely to be sold domestically.

Another factor that constrains Burundi's growth is 'the lack of export diversity' (extract a), however have 'remained constant' (extract b). There is danger with a lack of export diversity because if the harvest is poor, it'll affect  $\frac{3}{4}$  of the population and the whole country would be hit. Also, if the prices of these goods fall, there would be limited revenue for the suppliers and tax for the government who are trying to make further improvements to the country. However, the government does get money through aid to deal with some of these matters.

Imports however have fallen due to inferior infrastructure. Infrastructure is key as it includes, physical mobility of labour, such as motorways, airports and train stations, which could potentially transport food, energy and water. This hinders growth as there are now higher supply costs and reduces the mobility of labour.

**Examiner's comments**

Two factors are identified in this response and there is supporting explanation of why these factors constrain growth in the context of Burundi. 6 marks are awarded for knowledge, application and analysis. However, there is no effective evaluation.

This response therefore gained 6 marks.

Two marks were available for evaluation in this question. The attempt to evaluate using 'aid' was not quite enough to gain the level required. The aid argument needs to be developed if it is to be an effective counter-argument.

### Question 6c

#### Response 1

- (c) With reference to Figure 1, discuss the use of GDP data as a means of comparing living standards among the five EAC member countries.

(12)

The use of GDP data can be useful to a certain extent to measure living standards because GDP data will show you how much money that country is physically producing and certainly, on the surface it would appear that because a country is producing more money than another country then it would mean that their living standards should be higher than the other country. However this is not necessarily the case. If there is a large disparity in the wealth that the country generates, i.e. a small proportion of the population have a large amount of the wealth on offer. This would therefore result in a small proportion of the population having very good living standards but the majority of the population having very low living standards, therefore demonstrating that using just GDP figures to measure living standards can be deceptive.

#### Examiner's comments

This is a superficial response but there is a valid evaluative comment relating to inequality.

This response gained Level 1 and 1 mark (1/8) for knowledge, application and analysis and Level 1 and 2 marks (2/4) for evaluation.

The total for this response is therefore 3 marks (3/10).

**Response 2**

(c) With reference to Figure 1, discuss the use of GDP data as a means of comparing living standards among the five EAC member countries.

(12)

Living standards are a measure of material welfare. GDP represents the dollar value of goods and services produced by an economy in a specific time period. Figure 1 says that Kenya has the highest GDP per capita PPP and Burundi have the lowest. This means that they have lower standards of living.

Many measures go into measuring living standards. For example, HDI which assesses the development of a country as well as how it impacts the growth of a country. HDI takes life expectancy, mean years of schooling and the GNI per capita into account when scoring a country.

It takes all of government expenditure into accounts, such as investment projects in infrastructure and social welfare from the tax has been collected by goods and services that have been consumed. Also most of the domestic consumption of final goods and services are taken into account.

It is quite a straight forward measure of living standards which makes it easier as it is internationally recognised so other countries can compare their data and know exactly what is going on. The GDP of a country can also be simply divided by the population to come up with the amount of GDP per capita which makes it more representative to different parts of the population.

However, GDP data can be flawed when measuring living standards as the shadow economy isn't taken into account, as some goods and services aren't sold at market value but are still forms of trade and the products are still consumed. It doesn't show how the income is distributed amongst the population and is most likely very unequal.

Also, some of the more developed counties such as Kenya and Tanzania could be experiencing externalities due to the higher levels of production, such as pollution, which could consequently have negative effects on economic welfare. We wouldn't know the quality of the goods and services produced, they could be mass produced in poor quality.

**Examiner's comments**

This response demonstrates understanding of GDP and HDI, and the fourth paragraph explains the value of GDP as a means of comparing living standards.

The last two paragraphs provide valid evaluative comments.

This response gained Level 2 and 4 marks (4/8) for knowledge, application and analysis and Level 2 and 4 marks (4/4) for evaluation.

The total for this response is therefore 8 marks (8/12).

## Question 6d

### Response 1

(d) Assess the benefits Kenya has gained from its membership of the EAC since 2000.

(10)

Kenya has benefitted greatly from being in the EAC since 2000. The EAC has restricted trade barriers which has meant that Kenya, along with the four other members of the EAC have been able to trade freely amongst themselves and this has enabled them to grow their economies at a faster rate than if the trade barriers were still put in place. However Kenya has benefitted far more than any other country within the EAC because of their economic status compared to the other countries within the EAC. Kenya is trading at unprecedented levels and this increased in trading means that Kenya is then able to have more of an impact within the global trade market rather than just trading within countries in Africa. This then enables them to grow their economy in a variety of ways. Firstly the amount of physical capital that they will earn from exports will increase as they are able to trade amongst a larger amount of nations. In addition they will be able to earn foreign currency from trading with a different variety of nations which will enable them to enter the Foreign exchange market which will open up another opportunity for Kenya to earn more money and therefore their economic growth will increase.

### Examiner's comments

This is a superficial and generalised answer which contains little detailed analysis. There are examples of *imprecise knowledge and understanding* – 'Firstly the amount of physical capital that they will earn from exports will increase as they are able to trade amongst a larger amount of nations' – and the final sentence is vague. There is no evaluation in the response.

This response gained Level 1 and 2 marks (2/6) for knowledge, application and analysis and 0 marks for evaluation.

The total for this response is therefore 2 marks (2/10).

In a 10-mark question **assess** question, 4 marks will be available for evaluation so students must include evaluative comments in their response to access full marks.

**Response 2**

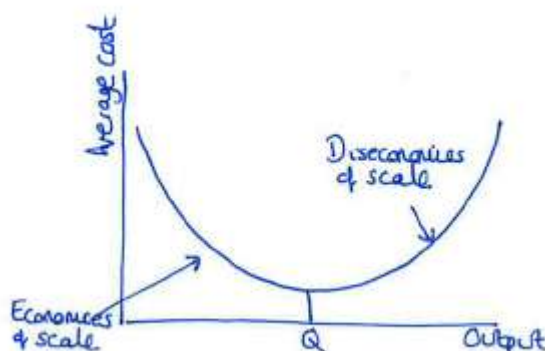
(d) Assess the benefits Kenya has gained from its membership of the EAC since 2000.

(10)

Kenya is the region's largest economy. Since joining the EAC, Kenya has increased its exports to the other EAC members (\$1.2 billion in 2010) [extract 2] which has led to faster economic growth for Kenya. This means that the benefits seem to be substantial.

Due to rapid economic growth, Kenya should attract investment from foreigners and domestically too. People from abroad may like to set up their factories and even company headquarters in Kenya in search for the best employees for their company with specialised skills and a dedicated workforce. This would mean that unemployment in Kenya would fall, and there would be more disposable income. Furthermore, this extra income can be spent on goods and services, which comes back to the government in forms of VAT and also income tax. This would help the government improve poorer areas of Kenya and keep it constantly growing.

Economies of scale diagram



Firms can also benefit from economies of scale. As shown above, output would increase with increased demand for Kenya's products which means the average cost would also fall. However, when it reaches the point of Q or minimum efficiency scale (MES), this is the point where the product is the lowest produced and after that point the average cost increases as you produce more, leading you to diseconomies of scale.

However, there could also be some costs of economic growth in Kenya. Kenya would lose import tariff revenue from the EAC countries, as they now have free trade and movement of goods. This would mean there should be higher levels of trade but they would lose out on taxes.

**Examiner's comments**

Three possible benefits are identified and explained with varying degrees of quality. One benefit, 'increased its exports', is briefly explained in the second sentence. There is a second benefit and linked analysis at the beginning of the second paragraph. Another benefit is identified at the beginning of the third paragraph but the explanation is rather generic.

The last paragraph shows evidence of some evaluation. There is one rather brief evaluative point: 'This would mean there should be higher levels of trade but they would lose out on taxes'.

This response gained Level 3 and 5 marks (5/6) for knowledge, application and analysis and Level 1 and 2 marks (2/4) for evaluation.

The total for this response is therefore 7 marks (7/10).



**Question 6e****Response 1**

- (e) Discuss the likely costs and benefits of monetary union to the five members of the EAC.

(15)

One of the major costs of setting up a monetary union between the countries of the EAC is the current status of Burundi. Burundi's economy has not been growing at the same rate as the other economies within the EAC and therefore by setting up a system whereby the economies of the EAC will now to a certain extent be reliant on the Burundi economy functioning well. The problem that this could potentially cause is similar to what has occurred within the Eurozone in the last few years. Countries that use the Euro as their currency such as Ireland, Italy, Spain and most prominently Greece, have all suffered poor economic growth and this had led to other countries within the currency union needing to bail them out. Fortunately the European Union is backed by powerful countries such as Germany so this means that the Euro as a currency was able to survive this. However the same could not be true for a currency union within the EAC. If Burundi's economy was to collapse then Kenya, being the strongest economy within the EAC, would have the majority of the responsibility to bail Burundi out but I doubt that Kenya has the wherewithal to be able to bail out a country of the EAC, even with help from the four others. This risk means that the currency union is not as strong as other currency unions around the world.

However a benefit of the EAC free trade area being developed into a currency union would mean that it would become simpler for transactions to occur between the members of the EAC. Currently for trade to occur between the members of the EAC, despite it on the surface seeming like an easy process due to the free-trade area being established there are still costs that have to be borne due to the fact that money has to be changed from one currency into another. If a currency union was set up, then this cost would not have to be borne any longer as the transaction would all occur in the same currency thereby meaning that trade would occur even more easily between the countries of the EAC than it had done previously.

**Examiner's comments**

In this response one cost of monetary union is explained followed by relevant evaluation. The last paragraph considers a benefit of monetary union. However, the response conflates monetary union with another degree of trade bloc, that is a free trade area. Overall, much more development is needed.

This response gained Level 2 and 4 marks (4/9) for knowledge, application and analysis and Level 1 and 2 marks (2/6) for evaluation.

The total for this response is therefore 6 marks (6/15).

One way to evaluate in this response would be to discuss the transition costs of moving to monetary union, and perhaps discussing the problems that Greece has faced.



## Response 2

- (e) Discuss the likely costs and benefits of monetary union to the five members of the EAC.

(15)

A monetary union is when a trading bloc has a common currency, controlled by one central bank. For example most of European Union has adopted the Euro. The Euro zone is more of an important trade partner holding together many more countries than the EAC countries.

A cost of a monetary union is how they would deal with asymmetric shocks. This means that an external shock can impact different member groups of the trading bloc differently and don't have an equal effect. This can be problematic when dealing with the likes of interest rates as they would impact all member states. For example, if one country was experiencing a negative shock, e.g. Burundi, they would need lower interest rates compared to the other countries. If economic openness is increased, there should be reduced chance of an asymmetric shock having much impact.

Another possible cost would be the loss of control over the country's monetary policy. The central bank would decide upon interest rates and make a decision best for the whole trading bloc as opposed to the interests best for a specific country alone. With a common currency different problems may branch out from the interest rate problems and cause further problems.

However, there could be benefits to a monetary union, as demonstrated by Kenya and Rwanda have already benefited from the EAC, they would probably benefit more than the other countries in particular Burundi with a monetary union. There wouldn't be an exchange rate risk. This could potentially mean that trade would increase, more in the trading bloc itself. Investors would also invest in these countries, as there would be free movement of goods and labour.

Another benefit of a monetary union would be that with a common exchange rate, things would be more controlled and there wouldn't be as much wage differentials. As there would be more trade, consumer surplus on the goods and services produced would increase. All members of the country would be somewhat equal and could bring the countries closer together. However, different prices may still be likely but they would reduce a big gap that currently exists.

### Examiner's comments

In this response two benefits and two costs have been considered in the context of the extracts provided. There is some attempted evaluation in the penultimate and last paragraphs.

This response gained Level 3 and 7 marks (7/9) for knowledge, application and analysis and Level 1 and 2 marks (2/6) for evaluation.

The total for this response is therefore 9 marks (9/15).

## Section C

### Question 7

#### Response 1

- 7 In 2012, it was estimated that Japan's national debt was equal to 214.3% of its GDP, and Greece's national debt was equal to 161.3% of its GDP.

Evaluate the likely impact of measures which a government could take to reduce the economy's national debt. Refer to a developed economy of your choice in your answer.

(Total for Question 7 = 25 marks)

To reduce a country's debt a government could step in by using a number of different measures. The government could try and generate economic growth. By this they could increase tax. This means that they would make more revenue through tax which can then be spent on the likes of investment projects which is part of fiscal policy. Investment projects would create further jobs for people, who will then pay tax on their incomes. They would also create more demand into the economy as they would want to spend their income on goods and services. Which would create further demand into the economy. Interest rates could also be lowered, so people would have less of an incentive to save and instead spend. The UK currently has an exchange rate of 1%, which means that people are likely to think there's no point putting money in the bank if you're getting nothing back from it. This is known as fiscal stimulus.

However, it can be argued that the government shouldn't invest money into the economy especially when in a huge debt. Higher government spending could instead increase the debt in the future, so it may not be the best idea. Instead they could reduce government spending. By this, they could make public sector jobs cuts as they have in UK. They can also cut down on social welfare, which is what a huge amount of money is spent on in the UK. Benefit caps could be something that can be introduced.

The government could start privatising their assets. For example, the UK chose to sell the Royal Mail. This would mean further demand would be created in a specific sector of work. This would lead to more firms and businesses being set up and more jobs being created. Consequently, these new firms would have to pay corporation tax which the government would benefit from.

Tax avoidance and the shadow economy is where much of the tax revenue is being lost. So there could be more measures put out there to try and stop people from avoiding tax and being some more serious punishments for offenders.

In conclusion, there are number of ways to deal with reducing public debt. However, all of the reasons have costs and benefits. None of the policies are perfect, but the best is to increase taxes and then after a reasonable amount of revenue has been collected, you can then use fiscal policy. Fiscal policy would allow you to inject demand into the economy.

**Examiner's comments**

Several methods of reducing an economy's national debt are identified in this response but their impact is not always explored fully. The answer is not related to a specific developed country, as required by the question.

In the sentence 'By this they could increase tax' the student should have included the word 'revenues' after 'tax' or refer to a type of tax, such as corporation tax. The final sentence of the first paragraph is also confused.

There is some analysis in the response but this is unconvincing. For example, 'This would mean further demand would be created in a specific sector of work. This would lead to more firms and businesses being set up and more jobs being created. Consequently, these new firms would have to pay corporation tax which the government would benefit from.'

Evaluation is very limited. For example, this sentence includes an evaluative point but it is very thin: 'Higher government spending could instead increase the debt in the future, so it may not be the best idea.'

This response gained Level 2 and 8 marks (8/16) for knowledge, application and analysis and Level 1 and 2 marks (2/9) for evaluation.

The total for this response is therefore 10 marks (10/25).

**Response 2**

- 7 In 2012, it was estimated that Japan's national debt was equal to 214.3% of its GDP, and Greece's national debt was equal to 161.3% of its GDP.

Evaluate the likely impact of measures which a government could take to reduce the economy's national debt. Refer to a developed economy of your choice in your answer.

(Total for Question 7 = 25 marks)

A government could firstly impose austerity measures in an attempt to reduce the amount the country is spending in order to try and bridge the gap between the amount the country is spending and the amount that the country is generating. The impact of this would be felt on various areas of the economy. Firstly the population would be affected as the government has to make cuts to various services as the national debt means that the government cannot afford to run them in their current state. The result of this is that many people would be likely to lose their jobs, which would in turn result in these people then being productively inefficient for a short period of time as they try and find new jobs. However the negative trade off of these people losing jobs is less than the positive trade off of money being saved by not paying their wages.

Another thing the government could do to reduce the national debt would be to increase taxation. This would help to reduce the national debt as it would increase the amount of money that the collect would collect which would therefore result in the difference between the amount of the money the government generates and the amount it spends decreasing. Additionally, regarding income tax if the government were to tax the highest income earners a large amount then it would more successful for them as the amount of money that they would generate would increase. However the caveat to that can be seen in what happened with the French government when they imposed a top level taxation rate of 70% on the highest income earners. After the French government placed this tax burden the majority of the highest income earners, decided to leave the country as they were not prepared to give 70% of their tax to the French government and, due to their being very rich were easily able to move to a different country where the tax level was not so high. Thereby taxation has its benefits in the short term for reducing the national debt however its potency can be negated in the short run.

**Examiner's comments**

This response explores two methods of reducing the national debt of a country and includes some evaluation of each. However, greater depth and breadth is required in both analysis and evaluation to secure higher marks.

This response gained Level 2 and 7 marks (7/16) for knowledge, application and analysis and Level 2 and 4 marks (4/9) for evaluation.

The total for this response is therefore 11 marks (11/25).

## Question 8

### Response 1

- 8 Over the past 25 years, income inequality has been increasing in many developed countries. For example, from 2007 to 2011 Spain's Gini coefficient rose by 6.0 percentage points, and Ireland's by 6.6 percentage points.

Evaluate the factors which may have caused this **increase** in income inequality. Refer to a developed economy of your choice in your answer.

(Total for Question 8 = 25 marks)

An increase in income equality could have been caused by the poverty trap. This is when the poor remain poor and dependent on benefits - known as the dependency culture, so know they are entitled to welfare benefits and have the mentality that they can get money and a house by doing nothing like in UK, so don't think they have to bother seeking work. Also, it is known that the rich get richer and the poor get poorer. They would expand by investing in more assets which would increase their wealth. There are increased incomes at the top of the income distribution, so the owners of huge companies compared to their employees.

There has been increased pressure on educational boundaries, which means people are working harder in order to find their place at the top. Therefore, people are more dedicated and will try work their way further to progress in life. There are more graduates, and they are taking other people who aren't as well qualified jobs.

Also, there is no manufacturing sector in the UK anymore, so some people are suffering from structural unemployment. This means that they don't have the specific skill set required for some jobs, so they pretty much have to take anything they can get and is available to them. This makes it harder for them to progress, especially if they have been in the specific sector for a large amount of their working career. There are robots that do the work instead of people. So factories would be cutting back on employees as they aren't needed anymore. Technology has advanced and they can work 24 hours a day and not get sick, rather than a human being. It depends on what the economy specialises in, and their job losses.

In conclusion, income inequality has been on the rise for many factors. For example with England, many people argue that the people at the top are multiplying their fortunes whilst the employees at the bottom of the hierarchy aren't seeing or experiencing much change. This is because they are investing their money elsewhere and expanding, this is what can be seen as the main reason as to why income inequality is always on the rise. Also due to a dependency culture that is experienced in Britain, it can be argued that some people simply can't be bothered to work.

### Examiner's comments

Much of the analysis in this response is inaccurate and/or explained imprecisely although there is some merit in some of the latter part of the answer. There is some evaluation in the answer although this is limited.

This response gained Level 1 and 2 marks (2/16) for knowledge, application and analysis and Level 2 and 4 marks (4/9) for evaluation.

The total for this response is therefore 6 marks (6/25).



**Response 2**

- 8 Over the past 25 years, income inequality has been increasing in many developed countries. For example, from 2007 to 2011 Spain's Gini coefficient rose by 6.0 percentage points, and Ireland's by 6.6 percentage points.

Evaluate the factors which may have caused this **increase** in income inequality. Refer to a developed economy of your choice in your answer.

(Total for Question 8 = 25 marks)

There are a number of factors that could have caused the amount of income inequality to have increased between the years of 2007 and 2011. The first of these is obviously the financial crisis which occurred in 2008. The reason for this having an impact on income inequality is that the financial crisis will have affected people in many different due to not all industries being affected and with some industries being affected at different levels. However the overarching theme is that people who may have been originally had modest incomes with modest savings maybe have been affected by the financial crisis due to the main income earner losing their job for example as was common in countries such as Spain who, even in 2014 still have very large problems surrounding the high level of unemployment. This then results in more people become poorer due to loss of income and therefore the disparity in income or the income inequality increases as there are a smaller amount of the population who are considered to be rich and a larger amount that are considered to be poor, due to the financial crisis.

Another reason as to why income disparity has increased between the years of 2007 and 2011 is due to difference between the rise in prices, or inflation, and the rise of wages. Despite the fact that during the years of 2007 and 2011 inflation was fairly low, the amount by which wages rose was even less with the majority of workers having wage freezes throughout this period, mostly brought on by the economic problems caused by the financial crisis. This therefore causes more disparity in the income earned by the population as it is clear to see that not everyone will be affected by this. The "mega-rich" will always keep on getting rich no matter what the state of the economy, which therefore leaves a small minority who are unaffected by these economic problems. However the majority of the population are not immune to changes in the economic welfare of the country therefore when the economy of the entire country does not do well then their incomes will suffer as a result. Therefore meaning that the gap between the incomes of the richest and the poorest will increase and the amount of people who fit into each category with less people being in the "rich" category" and more people being in the "poor" category due to their rise in wages not keeping up with the rise in prices meaning that they are becoming steadily worse off, year after year.

**Examiner's comments**

This answer explores two reasons for the increase in inequality but there is no effective evaluation. The addition of a Lorenz curve would have supported the analysis.

This response gained Level 2 and 8 marks (8/16) for knowledge, application and analysis and 0 marks for evaluation.

The total for this response is therefore 8 marks (8/25).

The evaluation could include a discussion of the Global Financial Crisis and recession as reasons why we would have expected inequality to reduce, and suggest reasons why this did not in fact do so. This is a rich area for using recent knowledge of important economic events.

## 4. Paper 3: Microeconomics and macroeconomics

This section includes student responses, marks and commentary for A level Paper 3 9EC0/03, *Microeconomics and macroeconomics*. A summary of the questions and marks for each response is provided in the table below.

| Question         | Response 1 | Response 2 |
|------------------|------------|------------|
| <b>Section A</b> |            |            |
| 1a (5)           | 1          | 2          |
| 1b (8)           | 5          | 6          |
| 1c (12)          | 5          | 7          |
| *1d (25)         | 10         | 17         |
| *1e (25)         | 14         | 17         |
| <b>Section B</b> |            |            |
| 2a (5)           | 2          | 5          |
| 2b (12)          | 8          | 12         |
| 2c (8)           | 6          | 6          |
| *2d (25)         | 10         | -          |
| *2e (25)         | 20         | 22         |

\* Students choose one essay question (25 marks) from a choice of two, meaning students respond to either question 1d or 1e in Section A and either 2d or 2e in Section B.

## Section A

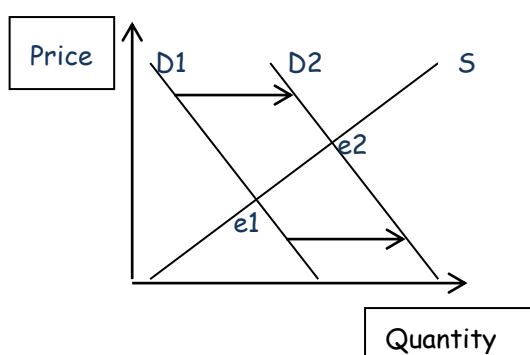
### Question 1a

#### Response 1

- 1 (a) With reference to Figure 1, explain **one** possible cause of the forecast change in total energy use.

(5)

Figure 1 forecasts an increase in global energy use for all of the energy sources. This change is likely to be due to positive economic growth globally. This will lead to an increase in the demand for energy and cause the demand curve for energy to shift to the right. If supply is elastic, then the equilibrium point will also shift to the right, so the equilibrium quantity will increase.



#### Examiner's comments

This response identifies one possible cause of the forecast change in energy use (positive economic growth) (1). However, there is no reference to the data or linked analysis.

This response therefore gained 1 mark.

#### Response 2

- 1 (a) With reference to Figure 1, explain **one** possible cause of the forecast change in total energy use.

(5)

One possible cause of the forecast change in total energy use is demand for the resources. Figure 1 shows that by 2035 all five core energy sources are going to see increased demand, with the largest being gas, going from demand of 1,400 million tonnes, to 2,600 million tonnes. This is likely to be down to the greater number of cars in existence, especially in developed countries, as well as greater demands in these places for electricity. This is despite the improvements in energy saving, such as more fuel efficient cars and energy saving lightbulbs. Increased demand will increase prices (assuming supply does not change), as more people want the same scarce resources.

#### Examiner's comments

This answer identifies one possible cause of the forecast change in energy use (1) and makes an appropriate reference to the data (1).

This response therefore gained 2 marks.



### Question 1b

#### Response 1

- (b) With reference to Figure 4, examine the likely impact on the USA's circular flow of income of the trends in exports and imports of natural gas between 2000 and 2020.

(8)

In the circular flow of income, imports are a leakage and exports are an injection into the circular flow of income. Figure 4 shows that over time there has been a reduction in imports of natural gas, whilst exports has risen. The expected trend means that by 2020 there will be no net impact on the circular flow of income, whereas currently there is a large deficit of 1.5 trillion cubic feet, although this itself has been improved by over 2 trillion since 2000.

#### Examiner's comments

This response explains exports and imports in terms of injections and leakages and there is some reference to the data. The response is awarded 2 marks for knowledge, 2 marks for application and 1 mark for analysis. However, there is no evaluation.

This response therefore gained 5 marks.

In an 8-mark question **examine** question, 2 marks will be available for evaluation so students must include evaluative comments in their response to access full marks.

#### Response 2

- (b) With reference to Figure 4, examine the likely impact on the USA's circular flow of income of the trends in exports and imports of natural gas between 2000 and 2020.

(8)

The USA's circular flow of income is the movement of income between firms and households. Income from factors of production is paid from firms to households, while firms receive income in return for the goods and services they produce. In addition to this, leakages from the circular flow of income exist as savings, taxation, and money spent on imports, and injections to the flow exist as government spending, investment, and exports. Historically, the USA has imported more natural gas than it has exported, so there is a net leakage in the circular flow of income. This will contribute to a potential balance of payments deficit. Figure 4 shows that exports and imports of natural gas are forecast to be the same by 2020, mostly due to a large increase in exports from 0.3 trillion cubic feet in 2000 to 3.1 trillion cubic feet in 2020. In the same period, imports are forecast to remain relatedly constant.

This will increase the size of the injections into the USA's circular flow of income, helping the circular flow of income to be in equilibrium, which occurs when leakages and injections are equivalent.

#### Examiner's comments

Injections and leakages are explained clearly in the context of this question and there are relevant references to the data. However, there is no evaluation.

This response therefore gained 6 marks.

**Question 1c****Response 1**

- (c) With reference to the information provided, discuss the likely impact of a change in the price of gas on the markets for solar energy and nuclear energy.

(12)

Solar, nuclear and gas are all similar goods; they all produce electricity, just from different sources. As a result a change in price for one of them will affect the other two. If gas becomes more expensive, more people will want to source their energy from other sources, such as via nuclear power and solar energy, which may be cheaper.

However it will depend on why the prices are increasing. If gas supply is reducing as the available gas resources are running dry, making prices higher, people will look elsewhere to find a long term solution. However, if it due to consumer demand, such as the predicted increase 54% increase in gas demand by 2035, this too will increase prices. This would have the opposite effect, as new firms will come to the gas industry as there is such great demand.

There will also be differences between nuclear and solar markets. Gas, such as shale gas, is an environmentally sound source of energy, meaning that it is perhaps closer to the solar industry, with that too being green. In contrast nuclear power has come under much scrutiny for its potentially damaging effect on the environment. However, the solar industry is one which is relatively small, currently being used to provide heating for homes, whereas the nuclear sources operate on a much larger scale, much more like the natural gas market.

**Examiner's comments**

In this response the analysis is rather shallow and lacks application of economic concepts. For example, 'Gas, such as shale gas, is an environmentally sound source of energy' is a dubious statement and the concept of cross elasticity of demand could have been applied in the first paragraph to strengthen the answer.

There is some application in the second paragraph and some evaluation in the second and third paragraphs.

This response gained Level 2 and 3 marks (3/8) for knowledge, application and analysis and Level 1 and 2 marks (2/4) for evaluation.

The total for this response is therefore 5 marks (5/12).

**Response 2**

- (c) With reference to the information provided, discuss the likely impact of a change in the price of gas on the markets for solar energy and nuclear energy.

(12)

Energy derived from natural gas is a substitute good for nuclear and solar energy. This means that there is a positive cross elasticity of demand between these products, so as the price of gas rises or falls, the quantity of nuclear and solar energy demanded will rise and fall respectively.

Figure 2 shows a large increase in natural gas production in the USA, from 19 units in 2005 to 25 units in 2014. This would suggest that the price of gas should fall in response to a shift in the supply curve, causing the equilibrium price and quantity to fall in the markets for nuclear and solar energy.

However, in Figure 3, there does not appear to be any significant fall in the price of gas from 2005 to 2014, which suggests that the price falls due to the shift in the demand curve will be offset by a shift in the demand curve caused by increasing demand for energy. If this is the case and there is only a small change in the price of gas, then a change in demand for nuclear energy and solar energy would not be expected. Nevertheless, the shift in demand for energy will still increase the quantity demanded for these forms of energy. This is reflected in the data for figure 1, where global energy usage for gas, nuclear, and solar power is predicted to rise.

**Examiner's comments**

This response has a good first paragraph which references cross elasticity of demand. However, there is a weak use of data in the second paragraph and the student has made a slip in the third paragraph (second line), stating 'demand' rather than 'supply'.

There is relevant analysis in the answer, which includes the application of economic concepts. There is also some evaluation at the end of the response.

This response gained Level 2 and 5 marks (5/8) for knowledge, application and analysis and Level 1 and 2 marks (2/4) for evaluation.

The total for this response is therefore 7 marks (7/12).

**Question 1d****Response 1**

(d) With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects on the UK economy of a decision by the government to encourage fracking.

(25)

One potential benefit of fracking is the impact on employment. Fracking is expected to create 3.6 million jobs in the US, and that scale of employment would help to reduce the current levels of unemployment in the UK.

Another potential benefit of fracking is the impact on the environment. Fracking is a clean way of producing energy on a large scale, much cleaner than burning coal.

However, fracking also has potential negative environmental impacts. There are studies which have linked fracking to earthquakes from the drilling process, which could outweigh any positives.

There are other benefits in the wider national economy. Currently the UK spends a huge amount of money on importing energy, which is then passed onto firms and households. This will reduce household bills, bringing more people out of relative poverty, as well as giving a boost to UK industry as their costs will decrease, making them more competitive internationally.

However, fracking will impact on the areas where it is taking place. Although jobs will be provided, the fracking process and the consequent arrival of heavy industry will have impacts on locals such as reducing house prices and reducing quality of life, which will need to be compensated for by the government.

There are also perhaps better alternatives. Wind, solar and hydroelectric power are all means of generating power without the same potential risks of fracking. Although they are limited to smaller scale, they give individuals the opportunity to do their part to tackle climate change, which could be considered more powerful.

**Examiner's comments**

This response identifies some benefits of fracking but the analysis is rather superficial as the benefits identified are not analysed in depth. There is little evidence of the application of economic concepts such as negative externalities.

There is some evaluation in the third and fifth paragraphs but in this area also there is little evidence of the application of economic concepts.

This response gained Level 2 and 6 marks (6/16) for knowledge, application and analysis and Level 2 and 4 marks (4/9) for evaluation.

The total for this response is therefore 10 marks (10/25).

To improve the response the student must focus on some of the broad elements of the question and to improve the response further there must be a distinction between micro and macro effects.

## Question 1d

### Response 2

- (d) With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects on the UK economy of a decision by the government to encourage fracking.

(25)

If the UK government encourages fracking, the first impact would be an increase in the supply of natural gas, causing a shift of the supply curve to the right. This would result in a fall in the equilibrium price for natural gas, and an increase in the equilibrium quantity. As natural gas is a substitute for other energy sources, it would be expected that these would see a fall in their price as well as a decrease in the amount demanded.

Lower energy costs in the UK would be largely beneficial to the economy, and Extract A states that in the US, shale gas is predicted to create 3.6 million jobs by 2020. Increased employment may lead to rising inflation in the UK economy, in particular if increases in aggregate demand outstrip increases in aggregate supply. Increased taxation may be needed to prevent this.

By decreasing energy imports into the UK, domestic production of gas will also limit the amount of leakages from the UK's circular flow of income, and may increase injections if the gas is exported to other countries instead of being consumed in the UK. This will reduce the UK's balance payments deficit, as well as providing lower costs to UK businesses and allowing them to be more competitive internationally.

However, there are negative externalities in the consumption of natural gas, as it is a demerit good. Burning natural gas produces harmful emissions which are damaging to the environment, so the cost of consumption to the consumer is not the same as the cost of consumption to society. Traditionally, a government would seek to tax or regulate demerit goods, but this would act to discourage fracking, which would counteract the UK government's goal of increasing fracking. This is a market failure if it is not addressed. Natural gas is less harmful to the environment than coal or oil, so increased use of natural gas may be justified if it reduced the use of these fuel sources.

In conclusion, while there are significant economic benefits to encouraging the use of natural gas derived from fracking, there is also a possibility of a market failure if the negative externalities to the environment outweigh the negative externalities avoided by reducing the consumption of more harmful energy sources.

### Examiner's comments

In this response there is analysis of both microeconomic and macroeconomic effects of fracking, with economic concepts employed to good effect.

The last two paragraphs contain some effective evaluation, although the focus is rather narrow.

This response gained Level 3 and 11 marks (11/16) for knowledge, application and analysis and Level 2 and 6 marks (6/9) for evaluation.

The total for this response is therefore 17 marks (17/25).

**Question 1e****Response 1**

- (e) With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects on the global economy of lower energy prices.

(25)

One benefit from lower energy prices is the impact on firms. If energy prices are lower, then the costs of production for firms is reduced, meaning that they can produce more for the same costs. This could also incentivise firms to expand, providing more jobs. This all can improve the UK's international competitiveness, currently suffering with the US's comparative low energy costs.

Another benefit is on households. They will see reduced energy bills, as well as cheaper fuel for transport see household goods and food costs go down as well. This can generate a greater quality of life, and bring people out of relative poverty in the UK.

There are also benefits for developing countries. Electricity becoming cheaper means that more people have access to it, enabling businesses to grow, government revenues to increase and more people being brought out of absolute poverty.

However, not all developing countries will benefit. Those whose economies are dependent on exporting energy, such as Saudi Arabia, Iraq and Nigeria, who are heavily dependent on exporting oil, could see their economies damaged by lower prices and potentially cheaper alternatives.

There is also the issue over whether the low costs are sustainable. If a large oil field has been discovered, this will see in the short term a greater supply of energy, but in the long run will not be sustained, meaning any benefits will not be seen in the long run.

It also depends on the source of the lower costs. If it is due to more fuel efficient cars reducing the demand for petrol, this is a good thing, but if it is due to the relaxation of laws over burning fossil fuels leading to greater supply, this will have harmful environmental impacts.

**Examiner's comments**

Microeconomic and macroeconomic effects are identified in this response. However, linked analysis and explanation is only evident in the first paragraph.

The evaluation is rather more impressive, with three issues considered in the last three paragraphs.

This response gained Level 2 and 7 marks (7/16) for knowledge, application and analysis and Level 3 and 7 marks (7/9) for evaluation.

The total for this response is therefore 14 marks (14/25).



**Question 1e**

**Response 2**

- (e) With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects on the global economy of lower energy prices.

(25)

Lower energy prices globally will result increased consumption of energy, which will likely translate into an increase in global economic activity, as most economic activity requires energy of some form to occur. If the decrease in prices is the same for all countries, then it is unlikely that there will be any major competitive advantages for firms over one another.

Increased economic growth would require a shift of both the aggregate demand curve and the aggregate supply curve to the right. While this is likely to occur, it is possible that these shifts could create either inflationary or deflationary pressure on the economy. If lower energy costs cause the price of other goods to fall, it is likely that this would be a deflationary pressure. Deflation can be very damaging to the economy if consumers choose to withhold spending in anticipation of further price reductions, and could cause the global economy to contract if measures are not taken by governments to prevent this, such as by increasing their spending or cutting taxation to boost aggregate demand.

Additionally, it is possible that the negative externalities involved in the consumption or production of some energy sources may not be accounted for by the free market, forcing governments to impose regulation or taxation to limit the use of these energy sources. If the price of energy sources with fewer negative externalities or with positive externalities has also fallen, then this may cause the global economy to make more use of these less harmful alternatives. This may be reflected in the predicted global energy demand in figure 1, where gas, renewables and nuclear power see much larger percentage increases than coal or oil, which are more harmful to the environment.

Many sources of energy are finite. If lower prices increase consumption in the short-term, then these supplies may be exhausted, causing supply to fall in the long term, as easily accessible deposits are exhausted. A global economy which has become heavily dependent on non-renewable energy would struggle in these conditions, as the price of energy could rapidly increase.

In conclusion, while lower energy prices would likely cause the global economy to grow in the short term, it is possible that this could be at the expense of long term growth, if steps are not taken to reduce dependence on finite resources which would be exhausted very quickly if they were the basis for economic growth.

**Examiner's comments**

There is some good analysis and explanation of two macroeconomic effects and one microeconomic impact. Consideration of a broader range of issues would have achieved higher marks. There are also two evaluative comments in the final two paragraphs.

This response gained Level 3 and 11 marks (11/16) for knowledge, application and analysis and Level 2 and 6 marks (6/9) for evaluation.

The total for this response is therefore 17 marks (17/25).

## Section B

### Question 2a

#### Response 1

- 2 (a) With reference to Figure 5 and Extract C, explain **one** likely reason for the fall in the exchange rate of the Turkish lira.

(5)

Due to the slow down in economic growth and the resulting panic, lots of people tried to sell the lira, which flooded the market with lira, giving the drop in value of 6% down to roughly 84 lira from the original mark of 90. This is because increased supply with similar demand makes prices increase.

#### Examiner's comments

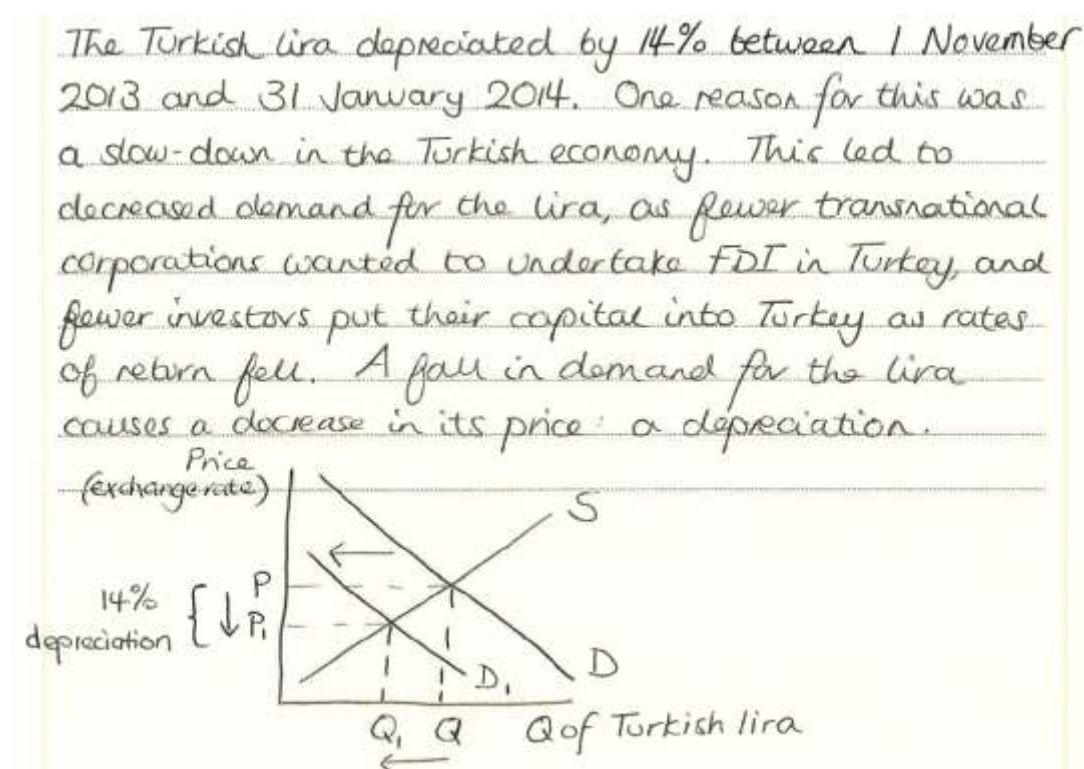
In this response a reason is identified (1) and there is a reference from Extract C (1). However, the explanation is rather superficial.

This response therefore gained 2 marks.

#### Response 2

- 2 (a) With reference to Figure 5 and Extract C, explain **one** likely reason for the fall in the exchange rate of the Turkish lira.

(5)



#### Examiner's comments

In this response a reason is identified (slow-down in the Turkish economy) and this is explained clearly. There is also a clear reference to the data.

This response therefore gained 5 marks.



## Question 2b

### Response 1

(b) Discuss the costs to the Argentine economy of an inflation rate "estimated by some economists to be over 25%". (Extract D, line 9)

(12)

One potential issue with rapid inflation is on those with fixed wages. If wages stay the same but the costs of living increase, people are not going to be happy, seen in the police strikes in Argentina in 2013. This can have major issues as without a police force crime would increase, and similar situations could arise with other fixed income workers.

Another potential issue is international competitiveness. If prices in Argentina rise faster than overseas, goods can become comparatively cheaper abroad, meaning that people import rather than buy domestically. This can be damaging firstly on domestic firms who lose customers, as well as on the current account which may risk suffering a deficit.

However, the potential long term impacts will depend on the governments ability to deal with this excessive inflation. Some economists see that a tighter monetary policy, whereby the central bank raises interest rates, should bring inflation back down to a more manageable level.

However, other economists disagree. Some see the sudden devaluation may risk worsening the inflation, which may mean that simply tightening monetary policy may not be enough.

Also, the potential issues over international competitiveness will depend on inflation in other countries. If other countries are also experiencing high inflation, this will reduce the negative impacts of Argentina's inflation.

### Examiner's comments

This response contains relevant points both in terms of the issues raised and evaluation of them. However, to score more highly in terms of knowledge, application and analysis, economic concepts need to be applied more fully.

For example, an issue is identified in the first sentence but there is limited explanation. Another issue is identified but not explored fully in the second paragraph.

An evaluative point is identified but not explained in the final paragraphs. However, the evaluative comments are just sufficient to secure full marks for that assessment objective.

This response gained Level 2 and 4 marks (4/8) for knowledge, application and analysis and Level 2 and 4 marks (4/4) for evaluation.

The total for this response is therefore 8 marks (8/12).

**Response 2**

(b) Discuss the costs to the Argentine economy of an inflation rate "estimated by some economists to be over 25%". (Extract D, line 9)

(12)

A high inflation rate reduces the international competitiveness of an economy's goods and services, as their price is rising more quickly than the price of goods and services elsewhere. This leads to a decrease in export sales and an increase in imports, worsening an economy's trade balance. From Fig 7 we see that Argentina's current account balance has indeed fallen. As net exports is a component of aggregate demand, this depresses demand and hence growth, particularly hitting employment in export industries. As Argentina also relies on exports for foreign exchange, its access to this will reduce, possibly causing problems of a foreign currency gap. However, the extent to which the trade balance worsens depends on the PED of exports in particular. If demand for them is price inelastic (as may be the case for soya), demand will fall less than proportionally, and export revenue may even rise.

Additionally, high inflation may cause problems of a wage-price spiral, as workers bargain for wage increases to try to maintain their purchasing power. Extract D refers to a "fresh round of wage bargaining". This raises firms' production costs, further increasing cost-push inflationary pressures and entrenching the high inflation. However, the figure of 25% inflation is only an estimate, meaning that it

may be lower than this in reality, limiting the possibility of a wage-price spiral. The government's use of price controls also means that consumers' real incomes may not be falling as quickly as they otherwise would, giving workers less reason to push for high wage increases.

**Examiner's comments**

This is a strong response. Two costs of high inflation in Argentina are identified and explained clearly in the context of Argentina. Both of the costs identified are evaluated effectively.

This response gained Level 3 and 8 marks (8/8) for knowledge, application and analysis and Level 2 and 4 marks (4/4) for evaluation.

The total for this response is therefore the full 12 marks.

**Question 2c****Response 1**

- (c) With reference to Extract E, examine the impact of restrictions on beef exports on how Argentine farmers decide to use their land.

(8)

Restrictions on beef exports will reduce the amount of beef that farmers can sell internationally in Argentina. This will have the effect of more farmers moving away from producing beef, to products such as soya, as the extract explains.

However, the impact may not be as great as feared. Argentines eat twice as much beef as people in other countries, and restrictions on exports will not affect the domestic market. As a result not as many beef farmers will switch as first feared.

Also, not all farmers may be able to switch to soya or other alternatives. Soil types may restrict what a farm can produce, and many farmers may be unwilling to invest the time or money to switch to a different product to farm.

**Examiner's comments**

One impact of beef restrictions is identified in this response with a brief explanation in the first paragraph. This followed by some evaluation in the subsequent two paragraphs (2). However, there is no direct reference to the data.

This response therefore gained 6 marks.

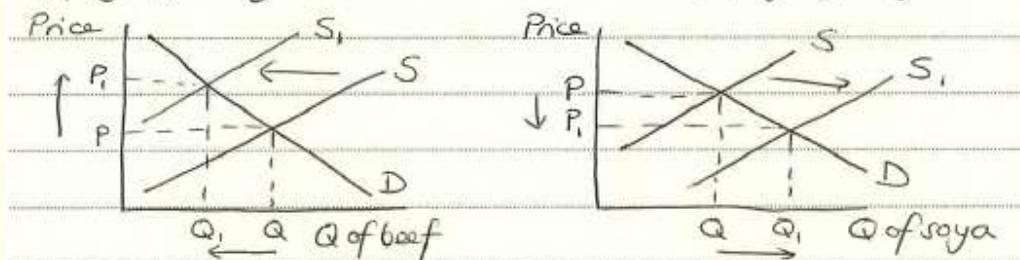


**Response 2**

- (c) With reference to Extract E, examine the impact of restrictions on beef exports on how Argentine farmers decide to use their land.

(8)

Restrictions on beef exports mean that producers can no longer make as much profit from selling beef. This will reduce their incentive to produce it, and instead they may look for producer substitutes: alternative goods they could produce with their land which will make them more profit. In this case, "many farmers have switched from raising cattle to growing soya". This decreases the supply of beef, and increases the supply of soya:



However, such a switch may only be possible for farmers in the long run - it will take them time to sell their beef cattle, make necessary changes to their land, and plant and grow the soya. Additionally, some farmers might not have the right land/conditions/knowledge to produce soya, so may not change. Finally, it depends on how long farmers think the export restrictions on beef will stay in place for, and whether or not they expect similar government intervention in the soya market.

**Examiner's comments**

This response begins well by indicating that less profit would be made from producing beef. However, it would be better if this were illustrated with a diagram showing a fall in demand for beef.

There is very good evaluation which is easily worth the 2 marks available.

This response therefore gained 6 marks.

**Question 2d**

(d) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic effects of the imposition of 'price controls' (Extract E, line 8) in Argentina.

(25)

Price controls are a government imposed policy which creates a maximum price that a good can be sold for. This can be used to combat monopolies such as the ones seen with the There are several different types of price controls, such as simply imposing a maximum price, as well as types that adjust based on inflation.

One maximum price scheme is a RPI-X regulation scheme. This is when the government caps prices at a certain level which is reduced on an annual basis. This is to allow for potential efficiency savings, incentivising firms to cut costs.

This method is somewhat limited as it is very difficult to decide the level of the efficiency saving, and may lead to a reduction in quality. It also does not allow enough for investment. This is why a RPI+K. K allows for firms to invest and become more competitive internationally.

Another problem with the price capping is the sector which is being capped. Supermarkets have great monopsony power, meaning that they have buying power over the goods they buy. This means they can pass off any potential costs onto the suppliers, in this case the farmers. This would worsen the issues of farmers switching to goods that can be sold more internationally, such as soya. This has been seen with price controls forcing "many cattle farmers out of business".

Another alternative is a rate of return regulation. This is when a government decides what levels of profit are needed for investment, and then they tax any extra profit at 100%, meaning that excessive profits are not achieved.

This also has some issues, as firms can suffer from not having a sufficient profit motive. They can let costs rise, knowing that abusing monopoly power will continue to provide them with their maximum potential profits.

**Examiner's comments**

This response is a rather generic response and not well-focused on the context of price controls in Argentina. Further, most of the effects discussed are microeconomic; there is little reference to the possible macroeconomic implications.

There is some limited attempt to evaluate the types of price controls identified.

This response gained Level 2 and 6 marks (6/16) for knowledge, application and analysis and Level 2 and 4 marks (4/9) for evaluation.

The total for this response is therefore 10 marks (10/25).

## Question 2e

### Response 1

- (e) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic effects of the 23% devaluation of the Argentine peso.

(25)

One downside of the weaker peso is the impact on businesses and customers. By having a weaker currency, firms that need to import as part of their business will see costs increase as having a weaker peso will increase import costs. This will impact on the consumer as some of these increased costs will pass onto them, making them relatively poorer compared to people in other countries.

Another potentially negative impact is the impacts on trying to solve the currency devaluation. To do this, the central bank may raise interest rates to attract more people to save their money overseas in Argentine banks, leading to the exchange rate to improve. However, this will lead to a greater savings ratio, as people are more inclined to save their money given that they can make more off interest rates, a leakage from the circular flow of income. Similarly, firms may be put off investing as the costs of loans will increase.

However, natural methods may correct the exchange rate deficit without the need for corrective methods. If the currency is weak, exports are relatively cheaper and imports more expensive. This may lead to a trade surplus, increasing the demand internationally for the peso, and hence increasing the exchange rate.

A benefit could be the increase in FDI. If the exchange rate drops a country becomes more competitive internationally. This will attract investment from overseas who want to take advantage of this. FDI is valuable as it helps to plug the savings gap, inject into the circular flow of income, as well as helping to improve infrastructure as the foreign firms need good transport links, as well as other things such as electricity that the firms needs, which will benefit the country as a whole.

Another potential benefit is from the tourism industry. If the currency is weaker, it becomes cheaper from people from overseas to visit the country, as their currency is comparatively stronger. This can help a countries tourism industry, which can be an important part of the country's economic growth especially as people's incomes increase and more people spend money on travel globally.

However, both these benefits could be harmed by the potential impact on confidence. The 23% drop in currency has been down to a drop in confidence, which may well continue. This will put firms, both internal and external, from investing within Argentina, which would severely damage the country's economic status.

### Examiner's comments

This response includes a range of likely microeconomic and macroeconomic effects of a devaluation in the peso, with the macroeconomic effects being explained well. There are some relevant evaluative comments relating to the issues raised.

This response gained Level 4 and 14 marks (14/16) for knowledge, application and analysis and Level 2 and 6 marks (6/9) for evaluation.

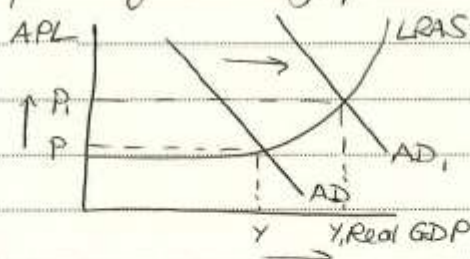
The total for this response is therefore 20 marks (20/25).

**Response 2**

- (e) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic effects of the 23% devaluation of the Argentine peso.

(25)

A 23% devaluation of the peso will make imports into Argentina more expensive, and exports from Argentina cheaper. This will decrease demand for imports and increase demand for exports. This is likely to improve Argentina's trade balance and hence their balance of payments on current account position. An increase in net exports would also increase Argentina's aggregate demand, with a subsequent multiplier effect, leading to an increase in the economy's real GDP and employment (as the negative output gap closes), but also strengthening demand-pull inflationary pressures.

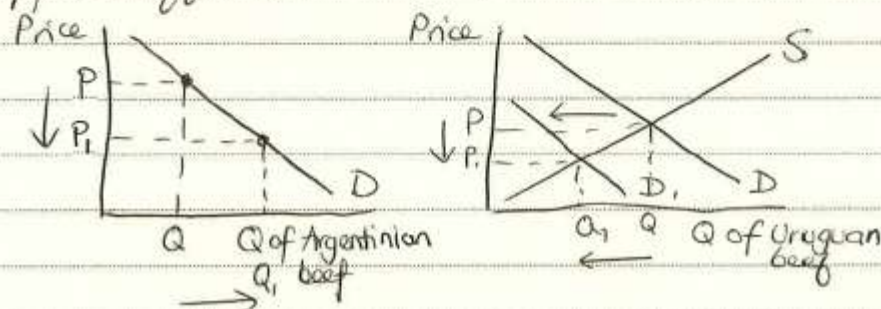


In evaluation of this, the trade balance will not improve if the Marshall-Lerner condition ( $PED_x + PED_m > 1$ ) is not satisfied. Given that Argentina seems to export a large amount of commodities ("total agricultural



production... accounted for almost half of Argentina's \$83 bn of exports in 2013"), and demand for these tends to be price inelastic, it is possible that the Marshall-Lerner condition is not met, and hence the devaluation will lead to a worsening of the trade balance. Additionally, even if this condition is satisfied in the LR, it is highly unlikely to be in the SR, and hence Argentina would experience a 'J-curve' effect, where the trade balance worsens in the SR before improving in the LR. Finally, given the high inflation rates in Argentina, even a 23% devaluation may not be sufficient to make Argentinian beef more price competitive than Uruguian or Paraguayan beef.

In microeconomic terms, a devaluation should increase <sup>quantity</sup> demand for Argentinian beef, causing an increase in quantity traded and ~~an increase in price~~. At the same time, demand for substitute goods, such as Uruguian or Paraguian beef may fall, leading to the opposite effects:



At the same time, this may halt the movement of

Argentine farmers out of beef and into soya as beef becomes more profitable for them. However, a cabinet minister has threatened to "step up intervention in the beef market" implying that perhaps more strict price controls and export restrictions may be implemented. This would reduce profitability for beef producers and so discourage them from moving back into beef production. Additionally, much of the soya produced is also exported, so the devaluation would similarly increase quantity demanded of this, leading to a commensurate increase in profitability, reducing the incentive to return to beef production.

(Total for Question 2 = 50 marks)

TOTAL FOR SECTION B = 50 MARKS

TOTAL FOR PAPER = 100 MARKS

**Examiner's comments**

There is good analysis of some of the macroeconomic and microeconomic impacts of devaluation in this response. Further development of the microeconomic impacts would have ensured a higher mark. The response also contains effective evaluation of the issues raised.

This response gained Level 4 and 13 marks (13/16) for knowledge, application and analysis and Level 3 and 9 marks (9/9) for evaluation.

The total for this response is therefore 22 marks (22/25).