

Examiners' Report  
June 2019

GCE Economics 9EC0 03

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June 2019

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# Introduction

9EC0\_03 was seen by many to be an interesting and informative exam paper, which tested a wide range of concepts, including some areas which had not been examined before and some 'old favourites' in a new context.

The paper was considered to be more challenging than that in June 2018, and the mean returned to 0.43 above the 2017 value, 2.4 below 2018.

The instructions 'apart from ....' were reported by some centres as causing problems although there was little evidence of this in the scripts themselves nor the comparative means when looking at similar questions in 2017 and 2018. In the examiner's report in June 2018 it was stated that 'it should be stressed that own knowledge of the issues or countries is not required for this paper, and the data provided means that the data marks can be fully awarded to the candidates who take the time to read the paper carefully'. This advice seems to have been broadened out and candidates were disturbed by the need to write about reasons for inequality 'apart from' the main factors given in the data. Candidates clearly could draw upon large sections of the specification (as reflected in a very large list in the mark scheme) but some did feel that the answers had to be drawn from the data entirely. It has been suggested by some that the question might say 'using your own knowledge', but this would have some problems of its own and is not recommended for future examinations. Some observers felt there was overlap with other papers (collusion on 9EC0\_01 and a requirement to use game theory in 9EC0\_03 1(c)). The main concern was the need to discuss the micro effects of inflation 2(e). The mean on the question at 14.04 was lower than all the other three essays by a factor of at least 2 raw marks, and lower than the equivalent question in 2018 except 1(d) in 2018 - which had a similar problem in asking for the macro effects of an increase in the micro demand for coffee shops.

Compared to 2018 there was a far more even split on the choice questions 1(d) and (e) and 2(d) and (e). In 2018 the split was 1:2 and in 2019 it was approximately 9:10.

There were some areas of the specification that were tested for the first time on this paper, for example the benefits of microfinance, and performance was in general well-argued and answers were thoughtful and mature but many candidates did not focus on the demands of the question to look at the benefits for borrowers and discussed the benefits more generally. There were far fewer blank or one-paragraph answers for the final question (2(d)/2(e)) than seen in 2018. 2(b) and 2(c) were also blank in several instances, but this is explained by lack of specific knowledge that was required for these questions – SMEs and microfinance.

Many answers were extremely difficult to read, and bad handwriting was the main reason that items were sent to review. It makes it hard for the examiner to follow a chain of reasoning if some words cannot be deciphered without an element of guesswork, and candidates are advised to write well-formed letters; short but logical answers can often score the highest marks.

There was very little evidence of candidates running out of paper to write on, having seen an equivalent number of lines and spare paper this year in the number of lines provided when compared to 2018. The corollary of this, however, was a tendency of candidates to write far too much for the 5-mark and 8-mark questions, running out of time at the end. Candidates should be reminded that full marks can be earned in a fraction of the space available, and there is an especially large amount of space given when diagrams or calculations are required, to allow for crossings out.

## Question 1 (a)

This was mainly well-answered, with good responses able to both explain the characteristics of a highly concentrated market (knowledge and analysis) and calculate an appropriate n-firm concentration ratio. The mean was 3.8 out of 5.

Many candidates scored well on this question, showing a clear understanding of highly concentrated markets which was often developed through an understanding of the market structure being an oligopoly or monopoly power.

- (a) With reference to Figure 1 and Extract A, explain what is meant by a 'highly concentrated' market for potato crisps (Extract A, lines 2–3).

(5)

A highly concentrated market refers to a market structure whereby few firms have a large proportion of market share – tends to be an oligopoly. With reference to Figure 1, Waukes, KP and Tayto hold 82.2% across a 3 firm ratio of potato chips. This essentially means the ~~the~~ industry is highly saturated with waukes especially having monopoly power and so the industry isn't seen as highly contestable, for new entrants.



The best answers calculated an accurate concentration ratio in order to gain both marks, although many just listed market shares to score one application mark.

Weaker responses tended to make errors through confusing 'highly concentrated' and 'highly competitive', or simply listing the firms' market shares rather than using them to show the concentrated nature of the market. The data could be numerical or verbal, and it is advised to use both sources (though not required for full marks).

A highly concentrated market is one that has many firms operating within it ~~and the~~ and each of them have a considerable market share. For example, ~~we~~ in Figure 1, it is evident that Walkers have the majority of the market share at 55%, followed by KP with 22.7% and then Tayto with 4.2%. In a highly concentrated market, since Walkers has the highest market share, other firms would follow in their footsteps with any cuts in prices in order to maintain their market share and remain competitive. Walkers, through price leadership can alter price levels in the potato chip industry.



We were strict in not awarding a mark for the observation that Walker's had or was a (pure) monopoly; rather we were looking for candidates to appreciate that it was a legal or working monopoly, or in another way showing market dominance rather than overall control. Please note the similarity with the marking on the coffee shop question in 2018 1(a).



Don't list data. Use it. Try to make two separate points if you can't use the data in a calculation.

## **Question 1 (b)**

Some candidates seemed not to appreciate the need to evaluate their responses in an 8 mark 'examine' question, although this was more the case for Q2(b) than for Q1(b).

This question allowed candidates to draw from their knowledge of the UK economy from the last ten years mentioned in the Theme 2 specification or relevant country examples they had studied during Theme 4. It was also rich in pickings from the Theme 3 Labour Markets section.

The stronger candidates on this question were able to analyse effectively by providing two clear causes of inequality, giving good examples (often from the UK but sometimes other developed countries) to support their answer. The strongest candidates gave specific numerical examples and were heavily rewarded in terms of application, although figures are not required to gain full marks.

Weaker candidates gave generic answers or failed to give relevant examples that would lead to inequality in a developed country, such as a rise in the national minimum wage, or used indirect and subsidies that were not permitted in this question.

Evaluation marks were often scored for counter points for the causes analysed or how they could be reduced by government intervention over time. The best candidates also developed their evaluation in context, such as the government introducing T-levels to improve educational opportunities in the UK. This was an effective method for candidates to score both evaluation marks for one point.

We were strict in only awarding application marks for data/contextual references which actually supported the point being made, for example, no application mark was awarded if a candidate wrote about direct taxes being regressive or less progressive, but then gave an example of the UK's progressive tax bands/personal allowances etc. We also did not award reasons for wealth inequality unless a candidate made it explicit why this would lead to income inequality. Candidates do need to pay close attention to the question where certain lines of argument are excluded, such as indirect taxation in this question. While some candidates wrote about particular indirect taxes as they had clearly misunderstood the meaning of the term, others lost marks simply by not reading the question carefully.



(b) Apart from changes in indirect taxes and subsidies, examine **two** causes of income inequality within a developed economy such as the UK.

(8)

Income inequality is a term used to describe the income difference between the poor and the rich, and is a regular point of controversy when new policies get passed in the UK.

~~One~~ One cause of income inequality in the UK could be ~~the~~ changes in income tax, this is an example of an indirect tax on income. Each year the personal allowance changes, ~~from~~ in 2018 it was £11,850 and as of April 2019 it is £12,500, this is income that is not tax liable, the first taxable band also ~~is~~ rises slightly each year which is 20% of earnings over ~~200~~ £12,500 which could cause income inequality if the higher tax bands remain the same.

However, this is unlikely to have a massive impact on income equality as they are only slight changes and perhaps if a new tax band was implemented then income equality could be greatly ~~affected~~ affected.

A ~~of~~ second cause of income equality could be ~~employment~~ the employment rate. For some developed countries such as the UK, this is not an issue as they have an unemployment rate of around 3.8% which is close to full employment, however countries such as the US ~~are~~ have a relatively high unemployment rate, if we assume that the unemployment is mostly in unskilled, low paid jobs, then it is likely that income inequality is getting wider as the poorer ~~and~~ percentage of the population are earning less ~~while~~ ~~the~~ as they are unemployed and the richer ~~percentage~~ ~~as~~ ~~the~~ poorer are earning more as they are still employed thus causing the gap to increase.

However, this assumes that the ~~lack~~ of employment is felt only in unskilled jobs which may not be true, as the USA have a diverse economy, it is ~~likely~~ likely that people in all kinds of jobs ~~are~~ ~~are~~ are unemployed regardless of the skills required.





Factors such as unemployment or wealth need a clear link to incomes.



If you are asked for causes, reasons, effects or similar, then there is no good reason to define the key terms. On short questions such as this the knowledge marks are for identifying the causes and there are no definition marks.

Stronger responses were able to produce a good structure to this question, bringing in their own knowledge of a developed economy to pick up application marks. But many, as here, chose points that were not clearly income related.

Income inequality occurs when people's income is unevenly distributed. One ~~cause~~ <sup>cause</sup> may be inheritance. Those from affluent families may have naturally have more wealth than those from the poor families since they can inherit wealth from their parents. Greater wealth ~~and~~ <sup>as</sup> means higher income to some degree. However, inheritance tax can be too high, so ~~it is very to~~ <sup>this may mitigate</sup> mitigate the effect ~~of~~ <sup>on</sup> inequality. Another cause is the uneven distribution of resource. Those from the poor families are less likely to receive ~~better~~ <sup>(private education)</sup> high quality education so therefore, have lower skill and marginal revenue product. They then earn lower ~~the~~ wages than others. However, the government could improve the situation by launching education programme and invest more to improve ~~the quality~~ <sup>state school</sup> schools.



Education could be awarded as an application mark. Wealth is a valid cause but the link to income must be clear. It was also valid to talk about MRP (although not required) but the link was not clearly made.



For application you do not need to use the passage. Any practical application, such as rising house prices affecting rents or higher education affecting incomes is good application.

## **Question 1 (c)**

Stronger answers were able to produce some excellent responses to this question showing a well-developed and applied understanding of game theory. The best responses tended to include a pay-off matrix illustrating the prisoner's dilemma, which was applied to two HFSS food producing firms (although this was not required for full marks) and a written explanation of the firms' strategies and the expected outcome in this scenario. Although it is not included in the specification and hence was not expected in candidates' answers, it is clear that many centres are teaching the kinked demand curve model, and candidates who knew this were able to make good use of it to explain firms' actions.

Common reasons for not attaining full marks on this question were: producing a purely theoretical response which was not applied to the context or did not refer to the data (such responses could not achieve a Level 3 mark for KAA); errors in the production of a pay-off matrix so that it either did not show workable pay-offs, or did not represent the prisoner's dilemma game; and not referring to game theory at all. Weaker responses also tended to be confused by assuming that the dominant firms would collude to lower prices. While there is perhaps an acceptable line of argument here through predatory/limit pricing, it tended not to be successfully made and this was rather a case of candidates misapplying the theory they had been taught to the question.

- (c) In Extract A, lines 15–16, it was suggested that some firms may respond to the advertising ban by cutting the prices of their products.

Using game theory and the information provided in Figure 1 and Extract A, discuss the effects **on firms** of cutting prices in an oligopolistic market.

(12)

Walkers	£.30 / £.50	£.50 / £.50
KP	£.50 / £.50	£0.30 / £0.50

If Walkers cuts its price from £.50 to £.30 while KP still has its price at £.50, Walkers will have the opportunity to steal KP's best customers. This would increase demand for Walker chips as they are a cheaper substitute. Walkers' profits, revenue, and profit margins increase. There will also be an increase in consumer surplus and Walker's producer surplus.

An Oligopoly is a market with a few large firms with the majority of market share.

Since KP still has the higher price, KP will lose customers and experience a fall in revenue and profit. This leads to KP cutting its own price to £0.50, which leads KP to a Nash equilibrium, forcing them to compete and make normal profit. This leads to an increase in non-price competition (to make

the market more competitive...?). This will increase the efficiency and productivity for both firms.

However, Walker's profits <sup>and total revenue</sup> ~~is~~ <sup>is</sup> what the cut prices depend on their PED for their chips. If PED is inelastic a price cut will lead to a less than proportional increase in demand. This may make the increase in total revenue and profits ~~inelastic~~ insignificant.

Also, Walker is a monopoly in the crisps/chips market meaning it could use limit pricing ~~to~~ meaning its costs could be lower or average compared to KP ~~meaning~~ (for example) meaning firms will struggle more to compete with Walker due to their higher costs.



This answer needs high price/low price on the 'axes', and a firm on each 'axis'.

There is a jump in the logic on several occasions, and the logic is muddled.



Check that the figures in the pay-off matrix work.

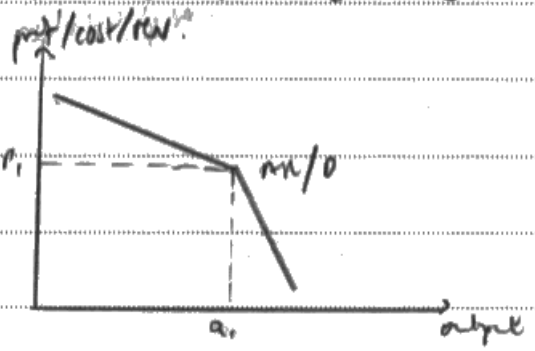
An oligopolistic market is a market in which there are a few firms that are dominant and interdependent. A common occurrence in an oligopolistic market is collusive behaviour, where firms either tacitly or overtly or overtly engage in price-fixing behaviour to increase and maximise industry profits, these by maintaining high industry-wide prices (e.g. OPEC). However, cutting prices leads to a breakdown in the collusive agreement:

PROFITS		Walkers	
		High Price	Low Price
KP	High Price	Walkers £100m KP £100m	Walkers £150m KP £20m
	Low Price	Walkers £20m KP £150m	Walkers £60m KP £60m

This payoff matrix demonstrates that there is an incentive for each firm to cut prices from the maximax price: ~~however, this will lead to~~ whichever firm cuts prices first will have increased profits, however, due to the sticky nature of prices in oligopolistic markets, and linked demand, if one firm cuts prices, the



One firm will do so, leading to an overall loss of profits. The limited demand curve shows that demand is inelastic and lowering prices so overall revenue will decrease if prices are cut (because other firms follow the price cuts)



However, price cuts may not necessarily lead to a fall in revenue for each firm. If they still compete on non-price factors, for example, Walkers' advertisements with Gary Lineker, this boosts revenue (AR and demand) for the product - KP may also innovate by bringing out new products like healthier alternative KP low-fat crisps. This means that AR shifts out, leading to this company the proposed fall in revenue as a result of cutting prices in a oligopolistic market.





Common reasons for not attaining full marks on this question were: producing a purely theoretical response which was not applied to the context and/or did not refer to the data (such responses could not achieve a Level 3 mark for KAA); errors in the production of a pay-off matrix so that it either did not show pay-offs, or did not represent the prisoner's dilemma game; and not referring to game theory at all. This answer does both well, and very efficiently. The application is clear in the table, and also in the discussion of Gary Lineker (although prior knowledge of the market was not required and there were many other ways to earn application marks).



Make sure the payoff matrix works.

## **Question 1 (d)**

The best answers used the economic toolkit of theories and diagrams incorporated into rigorous analysis to score the higher levels.

For microeconomic effects, effective answers often looked at the impact on the profits of firms providing healthy and unhealthy products, with the best responses backing this up with costs and revenues diagrams. There was also well-developed analysis of solving the market failure of externalities through the provision of information but confusion between the production and consumption negative externalities diagrams was a common error. Whilst some candidates effectively illustrated negative consumption externalities for a demerit good, this is beyond the specification and often included errors. It is important to note that candidates can bring in from outside the course and will be rewarded but this is not required to achieve the top level. For example, a positive consumption externality diagram could have been an effective way of analysing the impact of the information provided by the government.

On the macroeconomics side the best answers ensured they focused on government spending on promoting healthy eating. This often meant going beyond the impact of the spending on aggregate demand but also on aggregate supply through a healthier workforce.

Evaluation tended to focus on how effective the government scheme would be in the context of habitual behaviour by consumers and the implications for other objectives such as inflation and the fiscal deficit. Strong informed judgements were also provided that questioned whether the issue was really an information gap or the unaffordability of healthy food, with subsidies suggested.

Most candidates provided an answer that was in context to healthy eating but far too many seemed to ignore the context of education. This is a rare good exemplar. Many candidates talked generically about subsidies and assumed it was really a question about increasing government spending.

**EITHER**

- (d) Evaluate the microeconomic and macroeconomic effects of increased government spending on education to promote healthy eating in the UK. (25)

**OR**

- (e) Evaluate the likely microeconomic and macroeconomic effects of imposing a tax on HFSS foods. (25)

Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number:      **Question 1(d)**       **Question 1(e)**

Write your answer here:

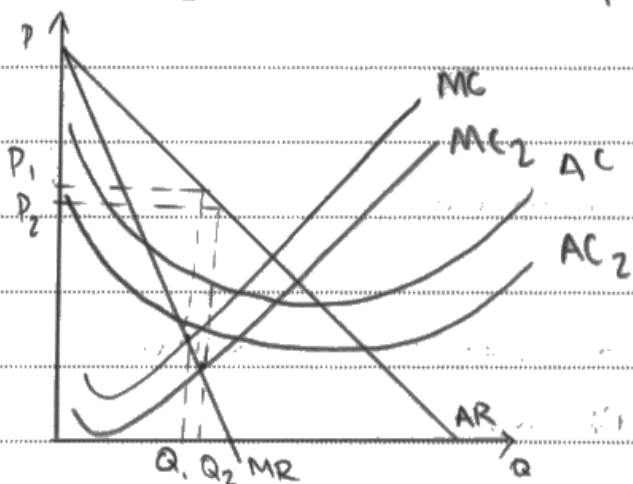
→ Improved productivity - AC ↓, firms gain higher profit

→ Higher human capital → attract FDI

Government spending on education is a supply side policy which is aimed at improving productivity by improving the quality of human capital. This could involve investment in schools, training, or apprenticeship schemes.

By increasing spending on education, workers are likely to be more productive. Since ~~work~~ there is no longer an information asymmetry about the dangers of unhealthy eating, more people will be incentivised to eat healthy food instead. This could, in turn, lead to a healthier workforce. Obesity rates could drop and worker absenteeism due to illness may also

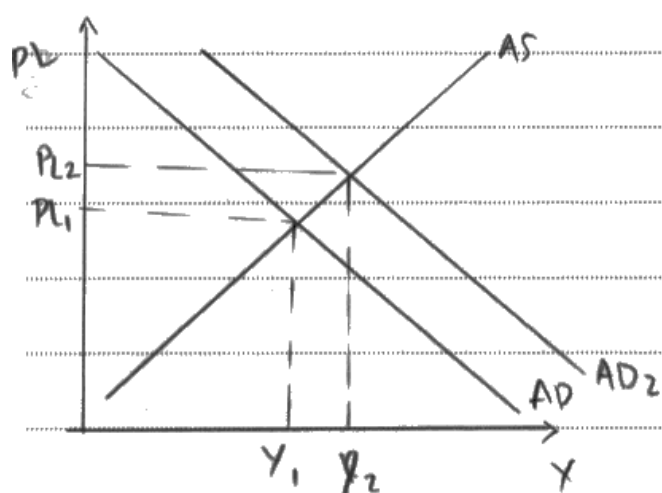
be combatted. A more productive workforce would be of benefit to firms as it could result in lower unit labour costs. Lower costs would result in higher profit margins, therefore making firms more profitable. ~~As a result,~~



In additions, firms could choose to pass on these lower costs in the form of lower prices. This would increase consumer surplus and be of

benefit to consumers. Alternatively, firms could reinvest their profits into research and development which could lead to improvements in dynamic efficiency. However, there is a time lag associated with education. It may take a long time for people to change the pattern of their behaviour. In addition, unhealthy food is often the cheapest food. ~~Fam~~ Households on low incomes are therefore likely to continue buying unhealthy food because they lack the finance to switch to more expensive healthier food. Perhaps a more successful strategy, therefore, would be to subsidise healthy food.

A healthier population would ~~put~~ <sup>put</sup> less strain on public services like the NHS. ~~The~~ Since obesity is a major issue in the UK, a reduction in the number of cases due to improved eating habits would lead to less pressure on the NHS. The government may, therefore, not need to spend as much on the NHS and could allocate the money elsewhere - for instance, towards benefit payments. Since government spending is a component of AD and an injection into the circular flow, AD would shift out. A healthier



population would also attract FDI, since the workforce is more productive. This, too, would shift AD out.

However, diets are

only one element of the causes of obesity. Fitness levels due to inactive lifestyles could also be a cause. The two would have to be addressed simultaneously for the issue to be significantly impacted. In addition, government spending on education may be expensive or ineffective. There is an opportunity cost of <sup>this</sup> government spending, ~~which~~ and it is not guaranteed



to work.

In conclusion, increased government spending could ~~lead~~ have several positive effects which would have far reaching implications on the economy as a whole; It could lead to a happier, healthier, more productive population. However, spending on education may not be a successful way of achieving this outcome, for the reasons I have outlined in this essay.



This has sustained development of arguments in context, and makes informed judgements.

There is a common inaccuracy shown here, however, that is the assumption that AD is rising if education spending is rising. Clearly this is an assumption and should be considered carefully.



The tendency is to make a summary at the end. What is needed, however, is an informed judgement. **The difference is critical.**



A top level response had to engage with the full question, i.e. not just to focus on the likely effects of an increase in government spending, or an increase in government spending on education, but of an increase in government spending on education as to healthy eating. Many candidates were unable to do this and produced far more generic responses, for example, the impact of an increase in government spending on aggregate demand within the UK.

Equally, some candidates wrote simply about the likely impacts of healthier eating on the economy; while this was no doubt closely related to the question, a sole focus on this made it very unlikely that candidates would be awarded a Level 4 score for KAA. Perhaps given that the data was more about unhealthy foods, many candidates who chose to write about the potential for correcting market failure focused on education reducing the external costs from the consumption of unhealthy foods, rather than increasing the external benefits from the consumption of healthy foods. While this was just as acceptable a line of argument, it was far easier for candidates to support their written analysis with an externality diagram if they focused on the external benefits in consumption of healthy food.

As a diagram to show the external costs in consumption of a good or service in not on the specification, many candidates drew a diagram instead showing external costs in production, which did not match their written analysis and did not therefore add to their response. In terms of macroeconomic analysis, the weakest candidates often confused the government budget/fiscal balance with the trade or current account on the balance of payments balance.

Finally, it would have been good to see some appreciation of the likely significance of the impacts. For example, the extent to which this would really increase the UK's labour productivity, make exports more internationally competitive etc. Many candidates presented this policy as a panacea for all of the UK's economic issues without really showing an understanding of issues of magnitude and significance.

Microeconomics

Micro

Macro

Stakeholders  
Market  
Failure

Markets  
Business  
Gov intervention

Productivity  
Efficiency  
Cost Revenue

BOP Inflation Unemployment  
Growth Poverty Govt  
IR FDI Currency  
Growth/development

EITHER

(d) Evaluate the microeconomic and macroeconomic effects of increased government spending on education to promote healthy eating in the UK.

(25)

OR

Policies  
of Cost

(e) Evaluate the likely microeconomic and macroeconomic effects of imposing a tax on HFSS foods.

(25)

Indicate which question you are answering by marking a cross in the box . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number:

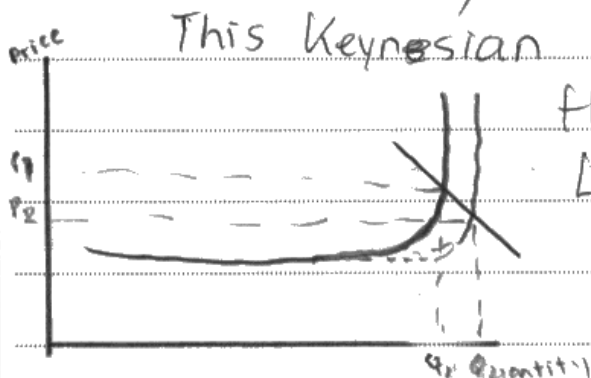
Question 1(d)

Question 1(e)

Write your answer here:

Increasing government spending on education is a supply side policy. This means it takes long to implement but the ~~area~~ it doesn't shift LRAS to the right resulting in growth. Government spending can be in the form of a subsidy. ~~This will~~

~~improve the quality of human capital in a country~~ This will improve the quality of ~~labour~~ human capital in an economy, resulting in growth.



This Keynesian AS/AD diagram shows the ~~#~~ increase in LRAS resulting in lower prices and a higher output.

This can be seen as an interventionist

strategy that promotes growth.

It has been seen with countries such as Sweden <sup>and</sup> Denmark, they have high levels of government expenditure which results in residents being more subjectively happier.

~~On the other hand, government spending may be financed by~~

Government spending may result in the economy running a fiscal deficit.

This has an adverse effect on the countries current account, ~~as~~

~~this supply side~~ ~~of~~ balance of payments resulting in a deterioration in the current account. Spending on education also means

that there is an increase in human capital which leads to less dependency ratios and a more flexible workforce.

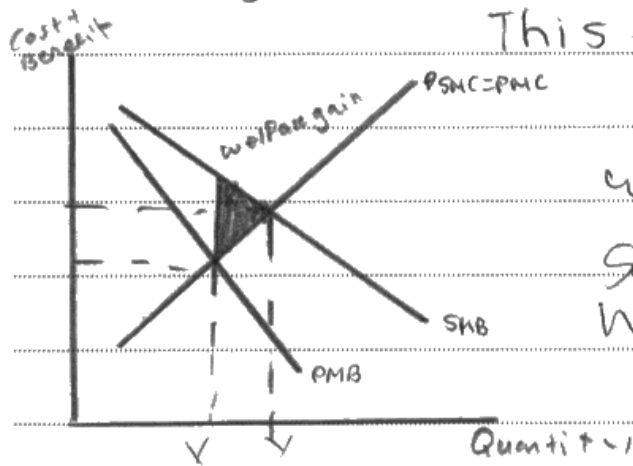
It is dependant on the extent of tax revenues which may offset this.

If tax revenues are very high, people are paying more tax. This destroys incentives for people to work. Also,

education spending is a supply side policy so it will take time to implement.

Improvements may only be seen in the long run.

The micro economic effects of an increase in gov ~~spend~~ government spending on education would be that ~~for~~ there will be less information gaps. As the public are more educated, Government spending ~~as~~ would be in the form of a subsidy.



This ~~exhibit~~ externality diagram shows the welfare gain. The social benefits are higher than the private benefits resulting

in an underconsumption/welfare gain.

Subsidies can be seen to be beneficial as 'all income groups are encouraged to buy more fruit. ~~that~~ The quantity

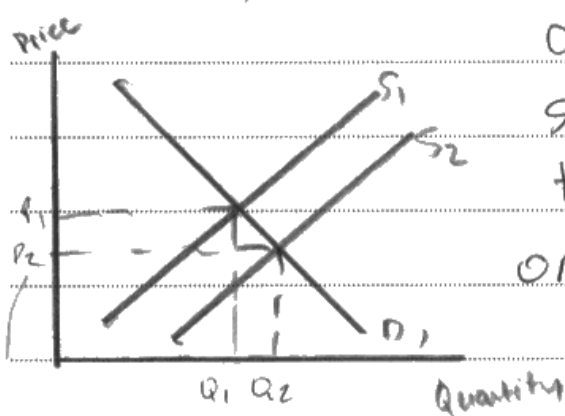


diagram shows how supply will shift to the right. Only those on higher incomes proved more responsive due to their larger disposable <sup>income</sup>



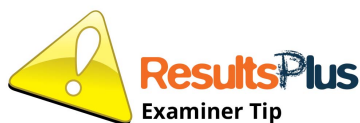
It is however difficult to quantify a correct value of the subsidy. Also interfering in the market can lead to market failure - government failure due to a worse misallocation of resources.

There can be ~~be~~ clashing objectives however. Government expenditure results in a fiscal deficit in the short run but a fiscal surplus in the long run as there would be an increase in human capital - greater tax revenues/less spending.

There is also an opportunity cost with government spending, political priorities may even influence decisions which can be biased.



This scored 9/16 KAA and 5/9 Eval. The KAA is low L3 on micro and macro, and is a very generic answer. It focuses on subsidies rather than spending on education.



Label diagrams and make sure you relate to them in your answer, fully.

Don't write about G generically if the question is on education.

## Question 1 (e)

This was the slightly more popular essay on question 1. As with 1(d), candidates provided diagrams to help improve their analysis and there were a wide variety of diagrams that could be effective on this question to strengthen answers when integrated into valid and carefully explained chains of reasoning.

Common microeconomic arguments included the impact on tax revenue and price/quantity for both healthy and unhealthy foods. There was again some confusion with the externality diagrams. Although many candidates correctly reproduced externalities diagram, this was very commonly shown on a negative **production** externalities diagram, which is not relevant to the context of the question. Healthy eating clearly implies it must be based on consumption, and it was difficult to see how a production diagram would add value to the answer, unless, perhaps, linked via the workforce.

For macroeconomics, many candidates effectively used the extracts to develop arguments around inequality or focused on the use of tax revenue to improve UK macroeconomic performance. The best answers used an inward shift in SRAS in order to analyse implications such as inflation and reduced growth, although other logical arguments were accepted for other shifts.

There was a lot of evidence of effective use of diagrams in this question including incidence of tax, cost and revenue and AS/AD. However, there was some common inaccuracy in the analysis of how the tax would be applied and the question was intended to be an application of **an indirect tax**, not a direct tax or tariff. Specific taxes (as in Extract C in Denmark) or ad valorem taxes (as with the UK's so called 'sugar tax') were both valid.

This answer does have a good amount of context, but it is too focused on a particular type of tax and the AD arguments are tenuous. We ignored the rubbed out D+tax on the first diagram which still shows (the problem of using pencil is that it shows up well).



**EITHER**

(d) Evaluate the microeconomic and macroeconomic effects of increased government spending on education to promote healthy eating in the UK.

(25)

**OR**

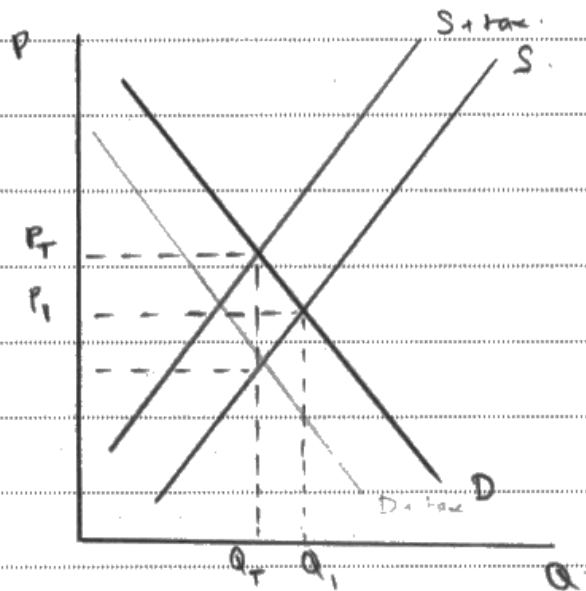
(e) Evaluate the likely microeconomic and macroeconomic effects of imposing a tax on HFSS foods.

(25)

Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box  and then indicate your new question with a cross .

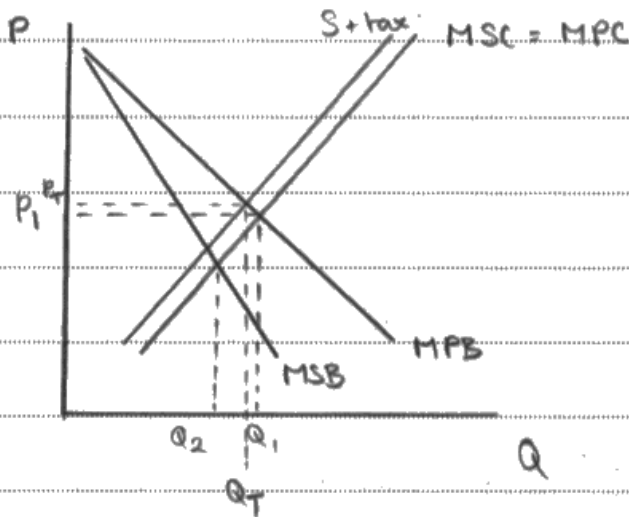
Chosen question number:      **Question 1(d)**       **Question 1(e)**

Write your answer here:



Imposing a tax on a HFSS food such as soft drinks would shift the supply curve ~~out~~<sup>in</sup> as, on an industry level, the tax would increase costs of production for soft drink providers and this would be passed on to consumers

in the form of higher prices, as shown in the diagram, thus reducing the quantity demanded and leading to a loss of revenue and therefore profit for the supplier. Obviously the intention of the tax is to ~~not~~ internalise the negative consumption externality shown on the next page by decreasing quantity consumed from  $Q_1$  to  $Q_2$  in that way.



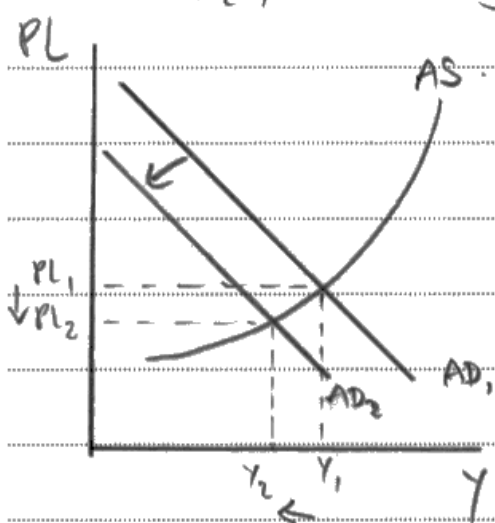
However, the tax is unlikely to reflect the actual value of the externality as this is difficult to measure, and so may not lead to reduced consumption as it is set too low (pushed to the left, where the social

optimum quantity of  $Q_2$  is much lower than the quantity consumed with the tax in place,  $Q_T$ ).

Furthermore, the elasticity of HESS goods is fairly price inelastic to a price rise for low-income households, as Exhibit B shows in line 16.

Therefore, since the elasticity of ~~the~~ opt drinks is low, the consumer burden of the tax would be greater than the producer burden and the effect of raising prices on quantity consumed would be very small. ~~as~~ low-income consumers, ~~who~~ make up most of ~~the~~ <sup>the</sup> consumer demographic of HESS products.

Since HFSS products are largely consumed by low-income households, this also means that the price rise of HFSS goods caused by the tax would exacerbate ~~income~~ and increase income inequalities as HFSS products and general food make up a larger proportion of low-income households' disposable income, and so they will have ~~less~~ less leftover income to spend on other goods and services while for higher-income households it is likely that their savings ~~is~~ would decrease while their consumption levels remained more or less the same. Since approximately 20% of UK residents are dependent on Govt benefits, this decrease in consumption would also cause AD to shift in from  $AD_1$  to  $AD_2$ , causing disinflation and a decrease



in rate of economic growth.

Since CPI is currently 1.9% and core inflation is at 1.8%, this would bring inflation further from the 2% target and also reduce economic growth - 2 of the macro objectives would suffer

in addition to inequality increasing. Furthermore, the price rise could see more low-middle income households turning to the welfare system, increasing the amount of Govt spending on welfare and thus increasing the fiscal deficit.

However, the increase in tax revenue gained by the Govt through HFSS taxes could help offset this; ~~especially is the Spt. Duties liability~~ ~~long, for instance~~ if the Govt spend the tax revenue gained on other policies to combat inequality ~~and~~ then these effects could be ~~reduced~~. For example, Theresa May wants to introduce Free School Breakfasts (in place of instant lunches) for low-income households, enabling low-income household children to obtain a full, balanced meal before school that will allow them to learn better (hopefully contributing to future productivity gains) and increasing education about food and diet, which Tabarack advocates for.

Overall, although in theory taxes do result in reduction in consumption of a good, in the case of HFSS, where demand is price inelastic for the consumers who are the most affected by

the tax, other policies make more sense and are more effective e.g. the move to make traffic light packaging on HFSS foods compulsory to increase food education.

Indirect taxes are ineffective, shown by Denmark with ~~the~~ "80% of Danish consumers" not changing their habits at all as a result of the saturated fat tax, and especially as the ability to import from other countries means that, though Q consumed may not decrease, Q consumed domestically might, resulting in loss of Danish tax revenue as said in line 11 of Exhat C, and so ~~so~~ businesses would suffer profit losses and the externality of poor health would still not be internalised.



As stated on 1(d), the best approach is to use the diagrams that candidates know well. Good responses used the tax diagram or a cost/revenue diagram to develop effective, top-level KAA microeconomic effects. Whilst a small minority of candidates could draw a negative consumption externality diagram with a tax, this was an overcomplicated and risky approach to scoring top marks, as shown here, and the first diagram was enough to take the micro to Level 4. The externality diagram did not add any marks on the micro side, being negative in production; the macro diagram is also taking the argument to Level 4.





The best evaluation again used the context effectively. Candidates should practise reading the case studies under timed conditions to efficiently pick out key points and quotes that they can use in their answers, including for evaluation, as it really lifts their answers to the higher levels. Use of the Danish fat tax as an example of consumers switching to other unhealthy food could be used to make a case for government failure as an effective counter point. This data also allowed informed judgements about whether an indirect tax like this is really the best way forward.



This response has been chosen to reflect the ongoing debate about negative externalities in consumption, that clearly can be used in this answer, but is not required for full marks. Certainly a diagram showing negative consumption externalities is neither expected nor required, although it would be one way to score marks if given. This is not advised as an approach, however, and there are much simpler and more effective ways to bring out analysis marks.

Here are the concepts they need to know and the diagrams are the only time when they are narrowed down to consumption/production so we must presume that here we mean both types of externalities:

### 1.3.2 Externalities

a) Distinction between private costs, external costs and social costs.

b) Distinction between private benefits, external benefits and social benefits.

The reason the diagram wasn't credited is because the description in the text was about consumption and the diagram about production. If you use the negative in production then the two ideas are confused.

Write your answer here:

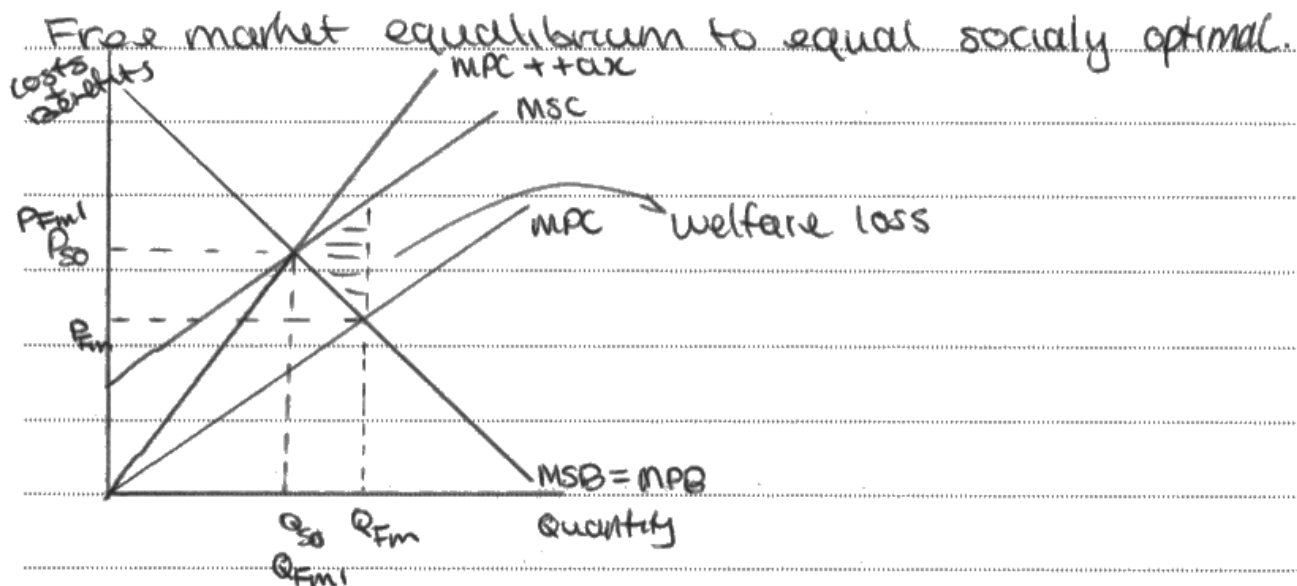
Tax

Macro benefits	cost	Decision
- Budget - Trade	- inequality - corruption	rationelle
Micro benefits	cost	Aims and objectives
- Externalities - Productivity	- inelastic - Profitability	

The government is considering imposing a tax on High Fat salt and sugar (HFSS) foods in order to improve the wellbeing of consumers and raise tax revenue to negate the effects.

One benefit of imposing a tax on HFSS foods is a reduction in negative externalities. Junk / HFSS food is a demerit good as the marginal social costs are greater than the marginal private costs due to the strain it puts on the NHS and the tax payer.

An imposition of indirect taxes means that ~~HFSS~~ the negative externalities are reduced. This is shown on the diagram as the indirect tax corrects the



However, the impact depends on the elasticity of demand for HFSS goods. According to extract C the imposition of tax lead to shoppers "crossing the border to Sweden and Germany to do their shopping" suggesting consumers are more likely to look for other unhealthy substitutes than healthy options.

Another benefit of imposing a tax on HFSS goods is increased productivity. Lower consumption of HFSS goods means the workers have less health problems. A reduction in health problems means that the workforce is able to ~~live~~ <sup>live</sup> to an older age, and needs less time off due to doctor visits or sickness. This reduces the amount of wasted time, and increases the amount that an employee can work. This therefore improves their productivity and a firm's ~~of~~ productive efficiency. However, An imposition of an indirect tax also reduces the profitability of many HFSS producers. In order to maintain profit margins producers may cut FOPs, including labour.

this ~~may~~ may negate productivity gains as the work force is under utilised.

Another benefit of imposing a tax on HFSS goods is an improvement in the budget deficit. The deficit is the difference between government spending and taxation revenue. By imposing a tax the deficit is reduced as more tax revenue is generated, on the production of firms producing HFSS goods. Budget also improves due to spending cuts as the NHS is likely to face less obesity related issues. This is important as obesity is the biggest cause of heart disease which is the biggest killer in the UK. Similarly it is important for the deficit as it is currently over £40 bn. However, <sup>large</sup> firms are good at tax avoidance. An example is Starbucks avoiding tax through it's dutch entity, meaning impact on the deficit is limited. The imposition of the tax may also have positive effects on economic development. The taxation revenue generated by the HFSS tax is likely to be high due to the inelastic demand for junk food. This increase in funds can be used to improve infrastructure such as schools, and can educate consumers on the drawbacks of junk food in order to improve health and development in the long run. However, large firms like Asda have high political sway. This can be seen in many countries such as the USA where

Boeing lobbied Congress to buy 80 F-15X's it didn't need. Similarly according to extract B the government is also thinking of 'subsidies on healthy food', meaning less tax money is available for development due to the high opportunity cost.

In conclusion although the ~~benefits~~<sup>effects</sup> of a HFSS tax are generally positive, they are likely to be limited. The government must therefore utilize the increased tax revenue to educate consumers on the drawbacks to decrease consumption in the long run as has happened with the anti smoking campaign.



It came across to the examiners as a confusion between the two concepts (negative in consumption and negative in production) which the specification clearly states has to be learned. Negative in consumption has to be learned *but not drawn* so clearly we are saying that the mark scheme will not expect a diagram at this point.



Often candidates learn or are taught more than the specification e.g. Nash equilibria, Rostow etc. The point we are making is that you do not have to know everything and there are diminishing returns in overteaching these four diagrams. A better option is a tax diagram or other diagrams such as positive in consumption of the healthy good, but in no way is anyone at an advantage if they have been taught things which are specifically not expected, and the point the senior examiners want to drive home is that you can teach what you will but the candidate cannot be marked down, ever, for not knowing something that someone in another centre has been taught as an extra.



## Question 2 (a)

This question was very accessible for most candidates. The concept of opportunity cost was understood well and knowledge of the definition well-rehearsed. The majority of candidates then developed this in terms of a choice between paying interest on debt and spending in other areas of the economy.

The extract was rich with examples candidates could use to achieve the two application marks, with effective candidates quoting two relevant figures to gain these marks. Candidates could not score full marks without the use of Extract D but could score one mark for an effective example of an opportunity cost a developing country could face, such as less available to develop infrastructure around Mozambique.

Few candidates showed a good understanding of what was meant by servicing a debt, in terms of paying interest as well as a proportion of the principal of a loan, but this is in fact explained in Line 2 of Extract D in full. It was one of several ways to earn the analysis mark.

This is a typical excellent response, although it should be noted that the last three lines were redundant as it had already gained all the marks.

- (a) With reference to Extract D line 21, explain why 'opportunity cost' is a problem for governments of developing countries when servicing debt.

(5)

Opportunity cost in economic terms is the benefit of the next best alternative that is forgone by carrying out certain actions. ~~At~~ Developing sub-Saharan countries are seen to make large debt payments in order to finance large interest rates on debt taken out between 2010-2015. As seen in the extract several of these countries use 20% of government revenues each year to service this debt. This is a problem as this money could have been used elsewhere to tackle other problems such as the high levels of poverty that exists and well as helping to build up infrastructure that could lead to future economic growth. Debt ~~is~~ can act as a barrier to development ~~to~~ due to the significant opportunity cost it poses to countries.



2 separate application points - high interest on debts 2010-15 and 20% of G.

Knowledge of opportunity cost (1).

Analysis that the money could be used elsewhere to tackle poverty - the point could have been given as Application but the full Ap marks had already been awarded.



Use the data 1+1 or 2 for a significant application point on all 5 mark questions.

Remember that you must do some analysis, but there is only 1 mark for this.

Most candidates were able to suggest what the government of a developing country were giving up - the opportunity to spend this money on education, infrastructure etc.

Opportunity cost is the next best alternative forgone. As there is already such little investment/money available, opportunity cost is important as the money could have been spent elsewhere. 'Debt burdens were heavier than they appeared' however. 'The real thing to look for is debt to revenue, or debt-service as a percentage of government spending'.



**ResultsPlus**  
Examiner Comments

2 Knowledge marks - opp cost, spend elsewhere.

2 Application marks - two uses of passage.

No analysis.



**ResultsPlus**  
Examiner Tip

Don't make the examiner do the work for you. Explain why **high interest rates** prevent the government spending elsewhere - the rise in one means a fall elsewhere.

## **Question 2 (b)**

This question prompted wide-ranging responses, as reasons could originate from more macroeconomic focused causes (e.g. high interest rate, low levels of human capital etc.) or more microeconomic focused causes (e.g. low MES/lack of available economies of scale - niche markets etc.). As with question 1(b), candidates do need to be sure to read questions carefully to ensure that they are not discussing factors which have been explicitly excluded - here access to finance - although we did take 'access to finance' to mean the ability to borrow money, meaning that arguments as to the high cost of finance/credit, or falling FDI were acceptable.

One of the main issues here was that candidates often failed to pick up both knowledge and application marks for a point, as they used a quotation from the data to identify a relevant reason for the small scale of 90% of Mozambique's manufacturing firms (knowledge), e.g. 'falling FDI' or 'high interest rates' and as their application. Centres should remember the distinction between knowledge and application when structuring responses. Candidates also seemed to find it fairly challenging to effectively evaluate their responses to this question, and either did not attempt any evaluation, or fell back on a benefits/costs type of approach which tended not to be relevant here, e.g. "A reason for this is the tight fiscal policy enacted by the Mozambique government... however, in evaluation it is good that the government is doing this to reduce its budget deficit as this will reduce debt servicing liabilities in the future" without relating the evaluation to the question asked. A better approach is to consider the larger firms, such as the energy firms in Extract E.

Examiner pointed out that the extracts again were packed full of potential reasons why there was a large number of small manufacturing firms in Mozambique. Some candidates approached this in a microeconomics manner, drawing on the constraints of growth covered in Theme 3, whilst others focused on more macroeconomic issues faced by Mozambique and their manufacturers. Both approaches were accepted, and Paper 3 does allow a wide variety of approaches on questions.

The best responses showed a very clear structure to their answer, with two points identified, explained and with context quoted from the extracts before providing one or two evaluation points. This structure really helps the examiners follow a candidate's answer, especially on a points-based question.

(b) Examine **two** reasons, apart from access to finance, why 90% of the manufacturing sector in Mozambique 'is made up of small enterprises' (Extract E, line 9).

(8)

One reason is due to depressed global demand, meaning many manufacturing sector industries are unable to generate enough profit to expand. Economic growth in the region is just 3.6% and with reliance on commodity exports, depressed demand has led to many ~~small~~ small scale industries failing to receive the profit and demand to be able to expand. As a result, over 90% of manufacturing is small enterprises, not only lacking finance and FDI, but lacking export revenue to create internal growth and drive expansion. ~~Mozambique has a low~~

~~The low is further~~ However, the depreciation in the metical to a low of 100 meticals to £1 should help to boost export earnings. The weaker currency makes exports more price competitive and as a result, in the future this should help to stimulate demand.

Another cause of why 90% of manufacturing is small industry is due to poor infrastructure, stemming from corruption. Despite a budget deficit of 10.7% of GDP, infrastructure in the region is poor due to corrupt spending via official washing. £2bn on bogus tuna fishing fleets and squandering investment. Consequently there are heavily underdeveloped public services, and services such as transport and internet access are poor in comparison to the rest of the world. This has meant businesses face higher costs and consequently



are unable to grow, limited by the poor infrastructure network in the country.

In evaluation, the longer term prospects do look more promising, not a commitment by the government to restore international confidence in their management of the economy. Having already received significant aid, a restoration of confidence and more prudent management should lead to increased loans and productive investment, helping to reduce business costs, boost productivity and foster business growth.



This is well-structured and clearly earns the K2 A2 Ap2 Ev2.



Make the examiner's work easy by setting out your answer with point, explain, example and evaluate x2, if two points are required specifically in the question. Also remember that sometimes only one point might be needed for an 8-mark question, and you can earn the Ap and Ev marks in clumps of 2.

When the question asks for two points, there is no point in making three (as here). The application and evaluation marks can be awarded as 2 marks each or 1+1, as on all the 9ECO papers.

Access to finance, is a firm or a country (in this case) 's ability to gather ~~financ~~ financial resources from intermediaries who lend money with a fixed amount of interest.

Most of the manufacturing sector in Mozambique, is made up of small enterprises, because of the country's late independence from Portugal, which has caused a lack of economic development within the country and meant that they couldn't have a takeoff period where resources are employed towards the industrial sector to spike an industrial revolution.

Furthermore, more than half of the population living below the poverty line, doesn't help as it will be that there is a severe lack of employment

within the economy and to compromise with the limited employment, "small enterprises" are formed.

Moreover, foreign investments/investors are not quite attracted towards Mozambique as it doesn't pose as a investment-friendly environment, causing ~~a~~ inflows of money to be reduced dramatically and meaning that the manufacturing sector wouldn't have the capital to scale up, remaining only as small enterprises.



In this case we mark all three (3, 2, 3) then award the best two up to a maximum of 6KAA marks. As with so many 8-mark questions, there was no hint of evaluation in the answers in many cases.



**Apply** on 8-mark questions. It is best to make two brief points, but one well-developed point would do.

**Evaluate** on 8-mark questions. It is best to make two brief points, but one well-developed point would do.

## Question 2 (c)

Responses to this question were of a very variable quality, with a fair number of candidates either not attempting this question or writing very little in response to it, while others were able to show an excellent understanding of the possible benefits and costs of microfinance, both as referenced in the data and from their own knowledge. The main reasons for candidates not achieving full marks on this question were as follows:

- The question explicitly asked about benefits to borrowers. Many candidates wrote more general responses about the benefits of microfinance to the whole economy, or to the government of Mozambique. While some credit was given for such answers, responses which did not explain the benefits to borrowers could not achieve Level 3 scores for KAA.
- Many candidates appeared to have been taught that microfinance loans were made at low rates of interest and continued with this argument despite evidence to the contrary in Figure 3. Arguments that a benefit to borrowers of microfinance was simply the very low rate of interest were therefore given no marks. Some answers were confused by the central bank rate of interest in Figure 2 (21.75%).
- The weakest answers confused borrowers and lenders, and wrote about the benefits to lenders of extending microfinance loans at high rates of interest, i.e. a very rate of return on the principal.
- Some candidates thought that it was the Mozambique government (relating to the £2bn default Extract D) which was borrowing money through microfinance schemes and so wrote about how this would be beneficial in terms of allowing increased state spending on education/infrastructure etc. or an ability to service existing loans more easily.
- More generally, many responses were made up of 50% KAA and 50% evaluation, rather than mirroring the available marks, which are 67% for KAA and 33% for evaluation. While we awarded the marks whichever way round gave candidates the best score (i.e. KAA marks could be given for either the benefits of microfinance, or the likely costs), this still meant that a good number of candidates 'maxed out' on evaluation marks but only achieved a Level 2 score for KAA.

The best responses were able to integrate relevant economic theory into their applied responses, for example explaining how microfinance plugged the savings gap (reference to Harrod-Domar or the high rate of absolute poverty in Mozambique), or allowed borrowers to diversify away from primary product dependency (reference to price volatility, Prebisch-Singer theory or the recent severe drought in Mozambique). Similarly in evaluation, such candidates were able to recognise that the manufacturing industry in Mozambique appeared to be close to monopolistic competition/microfinance reduced barriers to entry/made the industry more contestable, meaning that firms were unlikely to be making supernormal profits in the long-run, which allowed them to question the benefits of microfinance to borrowers.

As an aside, a fair number of candidates used the unlined space at the end of question 2(c) to plan their response to question 2(d) or 2(e). Centres and candidates should be aware that as papers are marked on a question-by-question basis, rather than as whole papers, in this case the examiner marking the essay would not see the plan and so it would not be marked. If a candidate wants the examiner to mark/see their plan, they must include it in the answer space for the relevant question.

Some answers such as this did not discuss microfinance, but finance more generally.

This question was similar in style to the aid question asked in Summer 2018, covering one aspect of development economics. It was not clear that all candidates precisely understood the concept of microfinance in enough depth to gain full marks.

Those that did know microfinance well were able to access top level analysis by explaining the benefits in context for the borrowers. This meant focusing on the benefit for their incomes, standard of living etc. due to being able to start their own small businesses, for example.

Weaker responses confused the benefit for borrowers with the benefit for lenders themselves. Others focused too much on the benefits in general or for Mozambique's economy in terms of growth and inflation.

(c) Discuss whether borrowers benefit from microfinance. Make reference to Mozambique in your answer.

(12)

Microfinancing is when other foreign countries, through their financial intermediaries, make money available for lending to a developing country, to develop its financial stability, and to generally, create growth and economic expansion.

For Mozambique, microfinancing has been quite beneficial for borrowers, as the amount of borrowers since when it was started in the 1980's, has increased very significantly. Evidently, the microfinance did result in many start-ups being funded, which would boost the overall economic climate.



It also suggests in the extract, that there is an 'unfulfilled demand' level for microfinancing, as many new businesses and enterprises can use the money

that is received through microfinancing, to develop and grow increasing employment and gradually in the LR, econ. growth.

Generally, borrowers will benefit from microfinancing, as it will be easier to clear debt and loans with increased financing per household. This can also be finance with little or no interest, so borrowers wouldn't have to worry about paying more than the original amount lent.

Microfinancing would also help the banking system operate more independently, as the market for loanable funds and the returns on investment, are all increased very significantly.



Candidates who used the case appropriately tended to do very well, because the passages, especially Extract F, provided the information required.

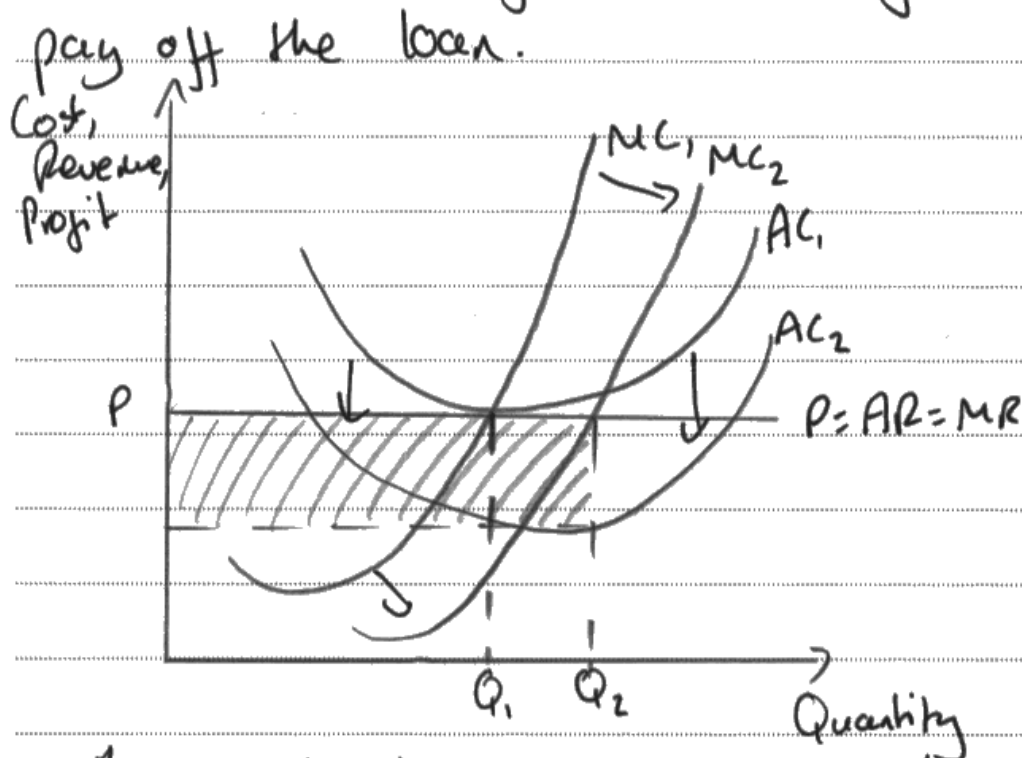
The other main issue with this question was candidates not focusing on borrowers but rather explaining broader macroeconomic benefits.



The passages contain a quarter of the marks. Application is key.

It is valid to use Theme 3 theory on development economics, especially here when the perfect competition model is used for the microfinance market.

Microfinance in Mozambique has benefited 100,000 borrowers in providing enough capital to set up their own "business start-ups", which could not have been set up through other finance methods. This allows borrowers to have a business with higher income on a regular basis, so in the long run will allow greater income growth as they pay off the loan.



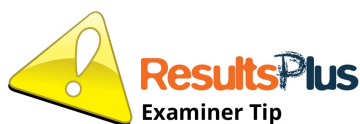
The availability of microfinance loans allows for investment which reduces costs, like in machinery or infrastructure, and so allows small businesses to be set up with lower costs, as shown from  $MC_1 - MC_2$  and  $AC_1 - AC_2$ . Since there are many small firms with no price-setting power, there is perfect competition, so the reduction in costs creates

Supernormal profits of the shaded area, so borrowers earn more, have income growth and so are able to benefit significantly from the microfinance.

However, as shown in Figure 3, many microfinance loans of small values of neticals have higher than average interest rates, which significantly reduces the benefit to the borrower as the cost of repaying the debt may outweigh the increase in income, with some rates as high as 200%. Also, if too many individuals benefit from microfinance it may cause over-saturation of the market and borrowers may in fact lose money as there will be excess supply, and they will be unable to pay back debts, so in fact becoming worse off.



This is a well-structured response.



Make sure the MC goes through the lowest part of the AC. Although this didn't cost the answer any marks (we only give marks, never take them away), it did mean the diagram's profit area was slightly incorrect.

## Question 2 (d)

43% chose 2(d) rather than 2(e). Although constraints on growth and development is in the macroeconomic side of the specification, there are clearly microeconomic issues in the country, such as labour market issues from emigration.

As with all the synoptic essays in Paper 3 there is flexibility on what a candidate uses as a microeconomic or macroeconomic factor, but candidates should try to make this clear in the structure of their answer. For example, one candidate may deem primary product dependence a microeconomic factor linking it to volatility of prices (using demand and supply), whilst another places emphasis on it as a macroeconomic factor in terms of the structural development of the economy as a whole.

Again, some candidates referred to access to finance in their answer and were therefore not rewarded for this. However, many candidates were able to explain one microeconomic and one macroeconomic factor, often drawing this directly from the stimulus material, such as brain drain / loss of FDI / higher interest rates etc.

Evaluation was often focused on how these issues could be overcome in future, such as through government intervention in the long-run or improvements in the economy (such as the development of oil and gas fields). The best answers used this as a basis for an informed judgement on the future growth prospects of Mozambique.

There were some very good responses to this question, particularly in terms of the likely macroeconomic factors which influenced Mozambique's growth and development. The best candidates tended to develop ideas of primary product dependency, savings gaps, or a lack of human capital/emigration here, although there were many other ways to answer this question. Candidates tended to find it more difficult to identify relevant microeconomic factors, although this was marked leniently, in that labour market issues, primary product price volatility etc. could be used as either micro or macroeconomic factors: they were marked as presented by the candidate. The two main issues with candidate responses here were: candidates wrote about policies which could be used to promote growth and development, rather than the factors which influenced these variables; and that candidates did not explicitly develop links to both growth and development in their responses. For a Level 4 score for KAA, candidates did need to link their chosen factors to both of these at least once.

As for all responses to the 25-mark questions, candidates are too often just summarising/repeating their points in their conclusions, rather than making a reasoned judgement. Without this, candidates are able to achieve a Level 3 score for evaluation, but not to be awarded full marks.



This answer is all about policies rather than factors, but it was still allowed and reaches Level 4.

**EITHER**

- (d) Evaluate the microeconomic and macroeconomic factors, apart from access to credit and banking, influencing growth and development in Mozambique. (25)

**OR**

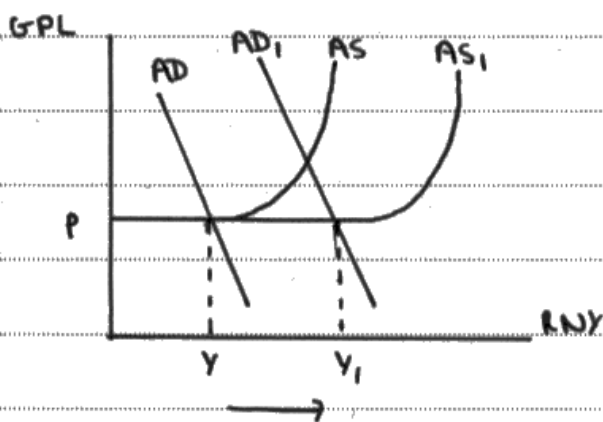
- (e) Evaluate the likely microeconomic and macroeconomic effects of relatively high inflation rates in many African countries. (25)

Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number: Question 2(d)  Question 2(e)

Write your answer here:

One macroeconomic factor influencing growth and development in Mozambique is government spending on education and healthcare. An increase in government



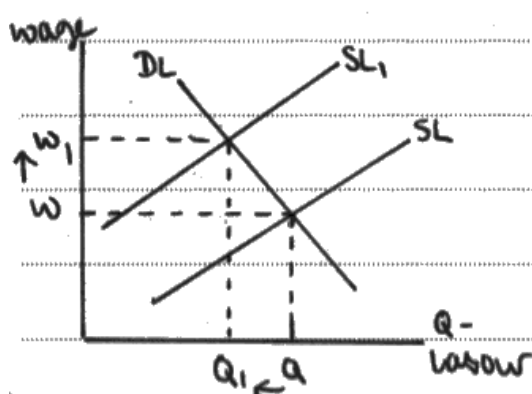
spending in these areas would cause an increase in both AD and AS since government spending is a component of AD but also a supply side policy.

Spending on education would increase labour productivity and the size of the skilled labour force. This would allow Mozambique to become more internationally competitive since it is currently ranked 136<sup>th</sup> out of 137<sup>th</sup>. In the short run this would increase growth since the diagram shows growth from Y to Y<sub>1</sub> since government spending would create a positive multiplier effect. Furthermore, there is no trade off with inflation since price would remain the same.

if both AD and AS shift out. This should prevent inflation rising above 18% and could help lower inflation in the long run. Education spending will also improve development in Mozambique since more people are likely to complete at least primary education. This would improve their human development index. Therefore, the level of government spending on education is an important factor influencing growth and development in Mozambique and the government should continue to invest where possible.

However, in the short run government spending will remain higher than tax revenue. This could cause the budget deficit to increase beyond the current level of 10.7% of GDP in 2017. This could be bad for future generations since fiscal austerity measures will need to be implemented to reduce the national debt. However, it is hoped that investment on education will improve future GDP which should make debt repayments less of a burden.

One microeconomic factor affecting growth and development in Mozambique is large scale emigration. This would create a fall in supply of the labour market.



This reduces the quantity of labour available and the productive potential of Mozambique since the size of the skilled labour force has fallen.

This would reduce the competitiveness of small businesses in Mozambique since wage costs would ~~rise~~ rise so firms would have to increase prices in order to continue making a profit. This may prevent firms in Mozambique from being able to gain a comparative advantage. Furthermore, fewer skilled workers in Mozambique means that knowledge cannot be shared between workers. This reduces the human capital of the workforce. This is a barrier to development since workers will be less educated so have low future earning potential; which will keep higher numbers of people in Mozambique in poverty - currently there are 26 million.

However, skilled workers who emigrate away from Mozambique may be able to send remittances to family who still live here. These workers may add more to Mozambique's GDP than they would staying in Mozambique since they can work in a high-wage country showing they have higher earning potential. This would improve living standards for them and their family; who may boost the local economy by spending their remittances in Mozambique. Overall, this means that high levels of emigration may not have a large effect on the economic growth of Mozambique.



This answer is in the context of Mozambique, and there is judgement about the importance of education. Diagrams are used as part of the argument.



You can get Level 4 by using just one micro and one macro factor, if both are valid. Fewer points done well and in context, with diagrams, makes a good strategy for 25-mark questions.

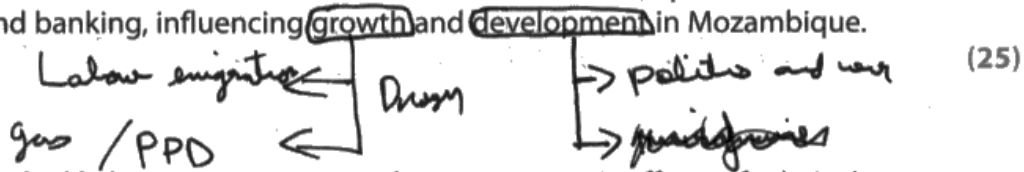


High interest rates are allowed as an answer, as they do not relate to **access** to finance. We took a very generous approach to the points allowed, in general.

**EITHER**

(d) Evaluate the microeconomic and macroeconomic factors, apart from access to credit and banking, influencing growth and development in Mozambique. (25)

OR



(e) Evaluate the likely microeconomic and macroeconomic effects of relatively high inflation rates in many African countries. (25)

Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number: Question 2(d)  Question 2(e)

Write your answer here:

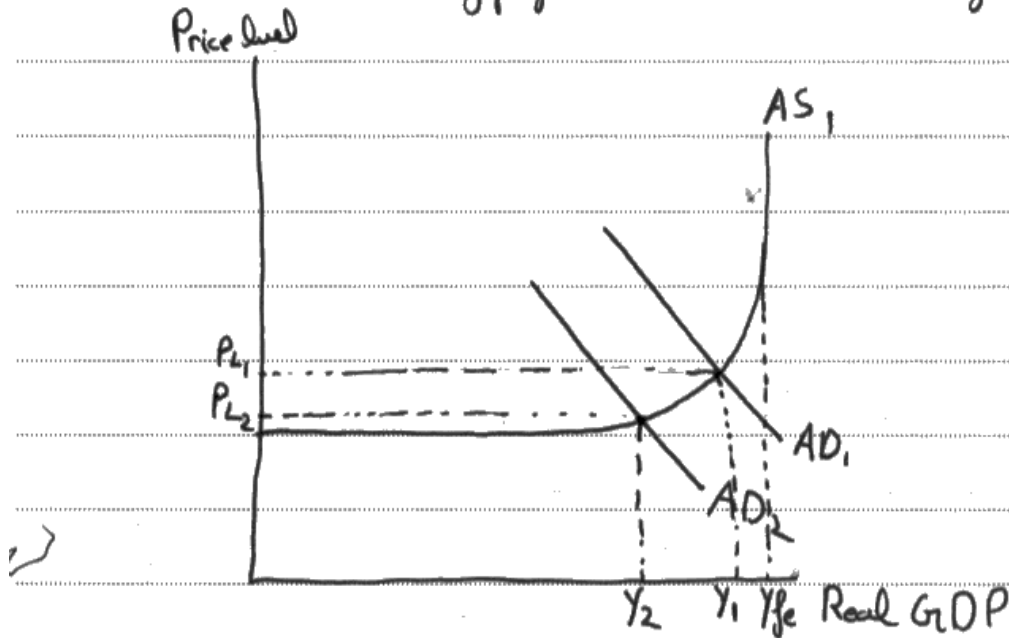
One likely macroeconomic factor that seems to affect Mozambique's growth and development in Mozambique would be the fact that due to it being a colony until 1975 it lacks manufacturing industries as it was mostly exploited for raw material. Mozambique largely depends on its agriculture sector. This can be seen as a constraint to its growth as it is primary product dependency. In the long run the terms of trade are likely to deteriorate for Mozambique as demand for manufactured goods is much more income elastic in contrast to raw commodities. This is known as the Prebisch-Singer hypothesis. Such products are also associated with price volatility and could be largely affected by global shocks such as oil prices in 2016.

However, it can be argued that diversification in Mozambique is imminent due to reasons such as a stable government willing to promote confidence in the economy as well as recent development that includes the discovery of offshore gas reserves.



These factors allow the new firms to establish and increase economic growth.

Another factor macroeconomic factor that seems to impact growth and development in the ~~the~~ Maastricht would be high interest rate. High interest rates cause the aggregated demand in economy to go down.



This is due to the fact that high rates cause the consumer to save their incomes rather than spend as they would likely gain greater returns this. Lowered demand can be seen to impact domestic firms that would incur losses and overtime could lead to redundancies. To counter the former it can be argued that higher interest rates are likely to attract hot money from overseas as investment would reap greater returns. This could overtime lead to a surplus on financial account similar to UK. This surplus could then be used to correct deficit on current account to some extent and promote economic growth.

One microeconomic factor that seems to influence growth and development in Mozambique would be large scale emigration which can largely be attributed to the poor economy as well as geopolitical tension in the region. High levels of emigration meant ~~lower level~~ less availability of labour in ~~so~~ various sectors. This can be seen to ~~not~~ inhibit the growth of manufacturing industry. Lack of capital machinery along with that meant greater dependency on manual workers that weren't available.

Although it can be argued that ~~the~~ market conditions in the economy have been seen to be improving recently due to better government initiatives. Intervention in key areas can be seen to allow the economy to grow e.g. Disinflation, Manufacturing etc.

In conclusion it is evident that the economic growth as well as development in Mozambique are largely impacted by macroeconomic factors such as primary product dependency, higher interest along with low exchange rate. These factors largely affect how firms as well as consumer behave. Lower rates leads to less affordability of machinery and interest affects consumer behaviour.

Although there are microeconomic factors such as labour market the impact it seems to have on the nation's growth and development is rather small.



The answer never gets above Level 3 as explanations are under-developed, and there is a lack of context. The analysis is weak but L3 overall awarded 10/16, and evaluation L2 mid (5/9) although there is an argument for low Level 2.



Do not repeat points in the conclusion. Make a critical, supported judgement.

## **Question 2 (e)**

Answers must be focused on the effects of inflation and not the causes. The Phillips Curve can be problematic and frequently it added nothing to analysis and often detracted from or contradicted what had been written, for example where candidates argued that inflation causes a fall in AD, an odd approach in itself. Also candidates must ensure that they have strong understanding of the relationship between domestic inflation and export prices. Many candidates confused a fall of the the internal value of a currency (a loss of domestic purchasing power) with a fall in the external value of a currency (a depreciation).

In terms of likely microeconomic effects, most strong candidates discussed the likely impact on firms of either increased costs of production (from either higher wage demands from employees, or higher raw material prices) or lower demand from overseas. This was mostly done well, although candidates often wrote about an increase in the cost of raw materials but then illustrated an increase in fixed - rather than variable - costs.

The most successful line of reasoning as to a likely macroeconomic effect of high inflation tended to be through reduced international competitiveness and hence the impact on an economy's trade balance or its current account on the balance of payments. As ever, some weaker candidates confused the latter with the government fiscal/budget balance. The most important thing here was for candidates to present a valid chain of reasoning within their arguments; simple assertions that high inflation would cause the currency to depreciate, or unemployment to fall etc., without any explanation of these effects were awarded limited marks (particularly as candidates who asserted the former often then went on to argue that the main effect of this would be increased international competitiveness for the economy experiencing high inflation).

As the question was about a range of African economies, we were looking for application/reference to more than just one country in candidates' responses in order for them to receive the highest marks. This could either come from the data or from their own knowledge.

This answer is light on context, and there is a huge issue with the Marshall-Lerner argument in that there is no link to the exchange rate.

(e) Evaluate the likely microeconomic and macroeconomic effects of relatively high inflation rates in many African countries.

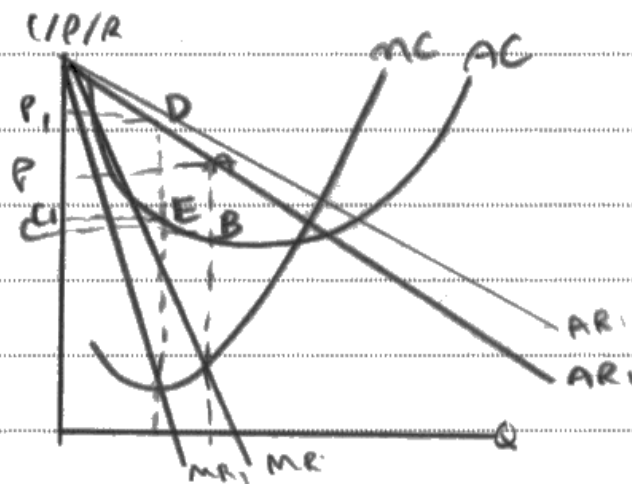
(25)

Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number: Question 2(d)  Question 2(e)

Write your answer here:

One microeconomic effect of high inflation rates in countries such as Malawi which has an inflation rate of 21.4% is a less profit for producers. This is because as a result of high inflation, Malawian firms will be less internationally competitive. This will mean that demand for their goods and services will decrease as consumers will demand other alternatives at lower prices. This can be shown by the AR and MR curves shifting to the left of  $AR_1$  and  $MR_1$ .





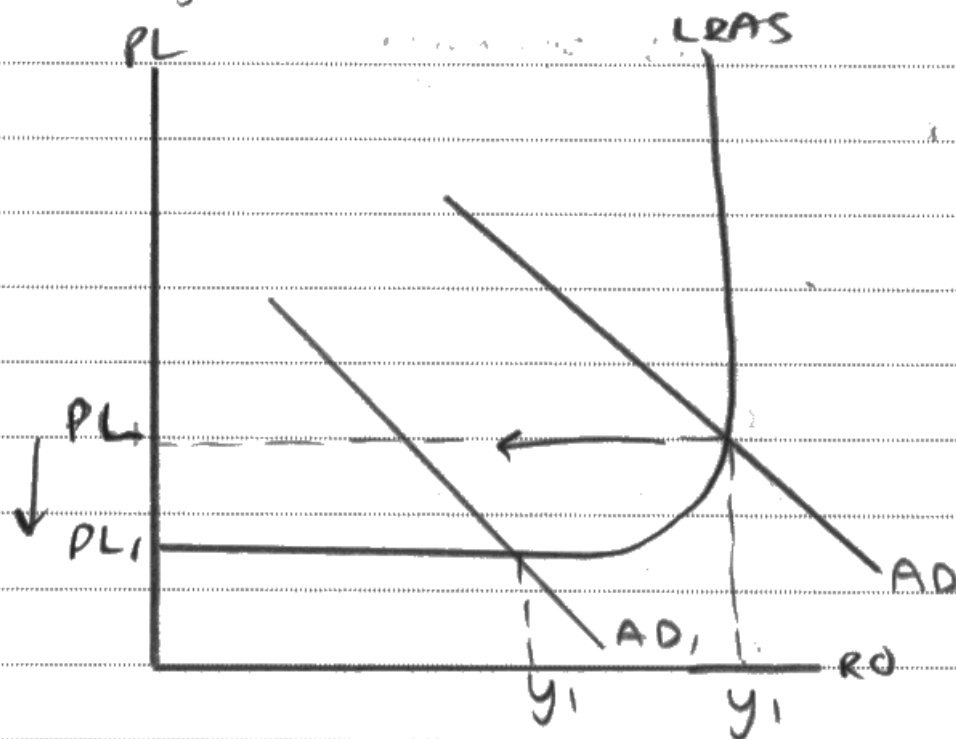
Profits will decrease from PABC to P1DEC<sub>1</sub>. As a result a firm will have less revenue and less money to invest in research and development with, meaning that they can't improve the quality of their products. They will also not be able to become dynamically efficient as a result of this. And due to a lack of demand they will not be able to cover their costs and benefit from economies of scale, potentially, further increasing their prices.

However, it could be argued that this 'effect on demand depends on other goods produced internationally. This is because, & there are not good substitutes for goods produced in countries like Malawi, consumers will still demand their goods despite high prices meaning that firm demand won't decrease and their profits consequently won't fall. As well as this it also depends on inflation rates in other countries, if they have relatively high

inflation rates or exchange rates, the price of their goods will also be expensive, reducing demand for them and improving Malawi's competitiveness and hence improving their firms' profits - this will mean they have more money to invest in becoming dynamically efficient and benefit from economies of scale.

One macroeconomic effect of high inflation rates in African countries such as Ghana who's inflation is 9.1%; ~~interest rates~~ lower than most African countries but still relatively high is a worsening of their current account deficit. This is because high inflation worsens international competitiveness and increases the price of goods relatively - this will mean demand for exports will decrease and there will be more demand for imports → more money going out of the economy than coming in, worsening the deficit. Consequently, the net exports component of AD

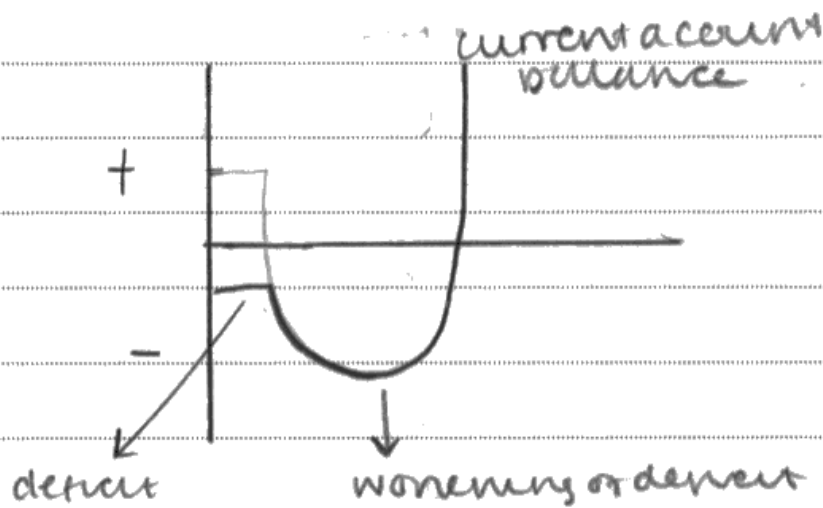
will decrease, decreasing AD to AD<sub>1</sub>, and meaning that less output is produced - output goes from y to y<sub>1</sub>. Reflecting less economic growth.



This will result in lower incomes for citizens of countries and a lower living standards - As the economy is not producing at full output<sup>(y<sub>1</sub>)</sup>, there will be less employment, further worsening living standards.

However, it could be argued that this effect on the current account will only occur in the long run when inflation increases significantly, it takes time for countries to

adjust their spending patterns ~~and so~~ <sup>and so</sup> ~~there~~ <sup>there</sup> can be ~~an~~ <sup>an</sup> ~~improvement~~ <sup>improvement</sup> in the ~~deficit~~ <sup>deficit</sup> in the ~~short run~~ <sup>short run</sup> as shown by ~~the~~ <sup>the</sup> ~~curve~~ <sup>curve</sup>.



As well as this it depends on the Marshall-Lerner condition, that states that the current account deficit will only be negatively affected if there is ~~elasticities~~ <sup>elasticities</sup> ~~greater~~ <sup>greater</sup> than 1 of both imports and exports. This depends on how much of a proportion of income these goods take up and also depends on alternative goods.

On the balance of the arguments ~~to conclude~~, as a result of high inflation, the current account deficit will worsen because more money will be going out.



of the economy than coming in, this will consequently negatively affect economic growth. However, this does depend on other factors such as inflation rates elsewhere and the elasticity of demand for these goods.



**ResultsPlus**  
Examiner Comments

The answer does reach L4 twice, and the mistakes are ignored (positive marking). The evaluation is generic or under-developed, and this is the area in which the answer should be worked on to improve L2e. 14KAA + 5eval.



**ResultsPlus**  
Examiner Tip

Links to diagrams must be made explicit and used in the argument. Otherwise the examiner will tend to find it hard to credit the diagram.



Some very poor answers on this essay were read, and the mean on the essay was two raw marks lower than the other three 25-mark questions. A surprising number of candidates could not form coherent chains of reasoning on the effects of high inflation. Many candidates confused inflation and interest rates, assumed that inflation caused unemployment or AD to fall (without any valid chain of reasoning), and many failed to contextualise answers to African countries.

Chosen question number: **Question 2(d)**  **Question 2(e)**

Write your answer here:

A micro economic impact of high inflation would be; ~~the~~ high prices. Inflation is the ~~general~~ rise in general prices of goods and services. Mozambique would presumably have a very poor GDP per capita, this would have a massive consequence on those living in absolute poverty. High prices would lead to a significant price discrimination, which in a position of an underperforming economy could be ~~considered as~~ not in a secure financial position to be able to support those in poverty with periods of inflation. With skilled workers moving away, this would decrease the competitiveness of Mozambique, with high rates of inflation, there may be an increase in ~~unemployment~~ which would decrease the economic output of Mozambique which would therefore ~~may not benefit Mozambique~~ see a deterioration of the value of Mozambique's economy.

However, inflation may not ~~always~~ be always be a long-term problem it could be a recession, where it can be a short term problem. Mozambique could attract FDI as a result of the exchange rate fall of the Mozambique currency, which would also fall or may attract FDI which may be able to use for investment or bring down ~~prices~~ prices stopping the price discrimination or those who are in ~~the~~ poverty may be more able to afford basic goods.

A macroeconomic problem may be government ~~policy~~ policies. These policies may include; fiscal policy, this would clash with their inflation target. Changing any demand side policy may ~~be~~ introduce unwanted consequences of absolute poverty, if the government were to fund any projects, the government would need to loan money from other economies which may increase ~~and~~ their budget deficit after ~~costs~~ debt or may ~~also~~ cause a ~~supply~~ Demand-pull inflation of basic goods as more than half the population live in absolute poverty. Mozambique is not in a position to solve ~~it~~ any inflation, this would cause cost to firms to rise or may significantly reduce the competitiveness of the ~~economy~~ economy as a whole or would reduce growth or may increase the level of poverty.

to closer to full population, which could be a consequence  
to a poorly forest economy.



This is typical of an E-grade response. Points are generic, and the analysis under-developed. Terms such as competitiveness and unemployment are not considered carefully, and connections with inflation are just assumed.



Use as much economic analysis as possible in your reasoning. Never make logical leaps.

## Section A

Many candidates forgot to state whether they have chosen (d) or (e) in the essay. This means the essays are marked in a separate pool, but has no significance in terms of the mark scored. Teachers can reassure their candidates that they will not be affected by this.

Poor handwriting, poor timing, and poor judgements about people or countries were once again a major issue for candidates.

Chosen question number:      **Question 1(d)** ✕      **Question 1(e)** ✕

Write your answer here:

Increased government spending on education to promote healthy eating in the UK could benefit the UK as it can decrease the government expenditure on healthcare because as <sup>these</sup> ~~these~~ kids grow up less likely to become obese, ~~and therefore~~ the government won't have to spend as much on healthcare for obese people.



This type of answer was worryingly common.



Be clear, pace yourself, and never make assumptions.

## Section B

Many candidates forgot to state whether they have chosen (d) or (e) in the essay. This means the essays are marked in a separate pool, but has no significance in terms of the mark scored. Teachers can reassure their candidates that they will not be affected by this.

Running out of time, many candidates resort to making many under-developed points.

Chosen question number: **Question 2(d)**  **Question 2(e)**

Write your answer here:

One microeconomic effect of relatively high inflation rates in African countries is the decrease in real income. Millions of people may see a cut in their wages as a result of increased costs of production. Increased costs of goods means less disposable income.

Regressive effects come from inflation as essential goods/services increase in price poorer families cannot pay.

Costs of borrowing will rise - micro-financing relatively increases in interest.

Macro - African countries' costs of production will increase with inflation, if others don't experience as severe inflation then that country will lose its

international competitiveness for its exports. This results in more imports and a deficit.





It is better to use a few points or just two, one micro and one macro.



Avoid listing points.

The effects of high inflation should be a well-rehearsed area for someone who has studied economics for two years.

**EITHER**

- (d) Evaluate the microeconomic and macroeconomic factors, apart from access to credit and banking, influencing growth and development in Mozambique. (25)

**OR**

- (e) Evaluate the likely microeconomic and macroeconomic effects of relatively high inflation rates in many African countries. (25)

Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number: **Question 2(d)**  **Question 2(e)**

Write your answer here:

- high inflation rate ~~means~~ can result in large-scale migration as ~~work~~ prices are higher compared to wages. This means that African countries would suffer from a loss of skilled workers that would go abroad to find jobs.
- Because of higher prices <sup>of basic products</sup>, a large number of the population would be in poverty (live



Save 30 minutes for the essays.

## Paper Summary

Based on their performance on this paper, candidates are offered the following advice:

- Timing. Allow a minute per mark, and this gives 20 minutes reading or correction time. You can achieve all the marks in this time, and you do not need to fill all the space available.
- Question spotting does not help. Candidates who think they know how to answer a certain type of question tend to give generic responses and do not read the data available.
- Explain every step in your chain of reasoning. It is most important in the micro/macro essays as it was here that the links were most often broken this year.
- Stick to either micro or macro in the non-25-mark questions. The questions are based on the separate four themes and you do not need to mix up your answers. Synoptic answers are of course valid, but the safest and most reliable option is to 'keep it simple'.
- Structure your answers around the material provided, rather than trying to pin the data onto a pre-learned theoretical answer.
- In your 25-mark essays, write an informed, critical conclusion weighing up your argument, **not** a summary. Return to the question, and answer it - avoiding the personal pronoun is preferred in an informed and reasoned framework.

## Grade Boundaries

Grade boundaries for this, and all other papers, can be found on the website on this link:

<http://www.edexcel.com/iwantto/Pages/grade-boundaries.aspx>





