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**Pearson Edexcel
Level 3 GCE**

Centre Number

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Candidate Number

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Economics B

Advanced

Paper 2: Competing in the global economy

Tuesday 13 June 2017 – Afternoon
Time: 2 hours

Paper Reference

9EB0/02

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **all** questions.
- Answer the questions in the spaces provided
– *there may be more space than you need.*

Information

- The total mark for this paper is 100.
- The marks for **each** question are shown in brackets
– *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Try to answer every question.
- Check your answers if you have time at the end.

Turn over ►

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Answer ALL questions.

SECTION A

Read the following extracts (A to C) before answering Question 1.

Write your answers in the spaces provided.

Extract A

The UK balance of trade in 2013

Component	£m
Export of goods	306 810
Import of goods	417 006
Export of services	204 465
Import of services	126 369

(Source: © Office for National Statistics / Crown Copyright)

Extract B

Frozen yogurt firm takes on the world

The Bristol based firm *AngelBerry* was founded in September 2011. The frozen yogurt retailer has only two UK stores, both in Bristol. There are currently six international franchised stores across the UAE, Mauritius and South Africa.

Its franchising model has helped the firm expand into warmer climates where frozen products sell well all year round. The firm now has deals in place for 80 stores across the Gulf States by 2018, with further expansion planned in South Africa and the UAE. There are a number of other potential deals, including one with a cinema chain to roll out a kiosk version and further expansion into Europe and Asia.

The firm's founders explained: "We both took a trip to the US to research every aspect of the frozen yogurt business. This trip gave us invaluable insight into how the US market is growing and operating. It's essential to carry out thorough research before you start exporting. It will help prevent costly mistakes, boost your chances of choosing the right market and show you how to sell your products and services in that market."

(Source: adapted from Frozen yogurt company takes on the world © exportbritain.org.uk)



Extract C

Teesside docks largest cargo vessel in history

In December 2015, the largest cargo vessel in history to ever pass under Teesside's Transporter Bridge set sail for overseas markets, demonstrating the continued strength of exports from the region. The cargo vessel, which is 172 metres long and 28 metres wide, docked at the deep-water quay of the firm *AV Dawson* before loading 21,000 tonnes of cargo. The cargo vessel was fully loaded within just six days. It then set off for export markets in Europe. The huge size of the ship allows exporters to benefit from economies of scale.

5

The Managing Director (MD) at *AV Dawson* said: "The work that we've done over the last three years to dredge the river and develop our quayside is part of a multi-million pound plan. It is now enabling us to attract multinational customers, and to transport more raw materials and finished products through Teesside and out to global markets. The investment programme included the purpose-built £3.4m deep-water quay, providing us with greater capacity to support larger and more economical vessels, effectively opening up Teesside to more export opportunities."

10

The MD continued to explain that, "Nowhere is the phrase 'time is money' more apt than when referring to shipping, so we employed two 100-tonne cranes simultaneously to speed up the loading process, reducing time in port and creating substantial savings for our customers, whilst enabling the vessel to be on its way as quickly as possible."

15

(Source: adapted from Teesside exports largest cargo vessel in history, Jamie Hardesty © bdaily.co.uk 2016)



P 5 2 1 4 0 A 0 3 2 4

- 1 (a) Using the data from Extract A, calculate the balance of trade in goods for the UK in 2013. You are advised to show your working.

(4)

Balance of trade in goods = export of goods – import of goods

= £306 810m – £417 006m

= –£110 196m

So the UK had a deficit on its balance of trade in goods of £110 196m in 2013.

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(b) Explain how exporters may benefit from economies of scale. (Extract C, Lines 6-7)

(4)

Economies of scale are the cost advantages a firm gains by expanding its scale of production, so that long run average total cost falls as output rises.

In Extract C the vessel is huge (172 metres long) and can carry 21,000 tonnes of cargo in one trip. Because the fixed costs of the voyage, such as crew, fuel and port charges, are spread over far more cargo, the cost of transporting each tonne falls (a technical economy of scale).

This lower average cost per unit means exporters can either cut their export prices, making them more price competitive in European markets, or keep prices the same and earn a higher profit margin.



P 5 2 1 4 0 A 0 5 2 4

(c) Using data from Extract A, explain **one** reason why the UK economy can be described as developed.

(4)

A developed economy usually has a large tertiary (service) sector that generates more wealth than its industrial sector, so it specialises in and exports services.

Extract A shows the UK exported £204 465m of services but imported only £126 369m, giving a surplus on trade in services of £78 096m, while it has a large deficit in goods.

This surplus shows the UK has a comparative advantage in high value services such as finance, insurance and education, which require a skilled, educated workforce. This specialisation in services is a key characteristic of a developed economy.

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(d) Analyse why the owners of AngelBerry advise that it is 'essential to carry out thorough research before you start exporting'.

(6)

Research is essential because consumer tastes and local culture differ between countries, so a product that sells in Bristol may not sell in the same way abroad. Research also lets the firm assess the feasibility of doing business in a new market, for example local competition, laws, costs and the likely demand.

For AngelBerry, research showed that frozen yogurt sells well all year round in warmer climates such as the UAE and South Africa, so demand is less seasonal than in the UK.

Research may also identify new locations and formats, such as the possible kiosk deal with a cinema chain.

As a result, flavours, prices and marketing can be tailored to local tastes, which increases sales and maximises revenue in each market. It also reduces risk, because costly mistakes such as choosing the wrong market or the wrong product are avoided, saving time and money before stores are opened.

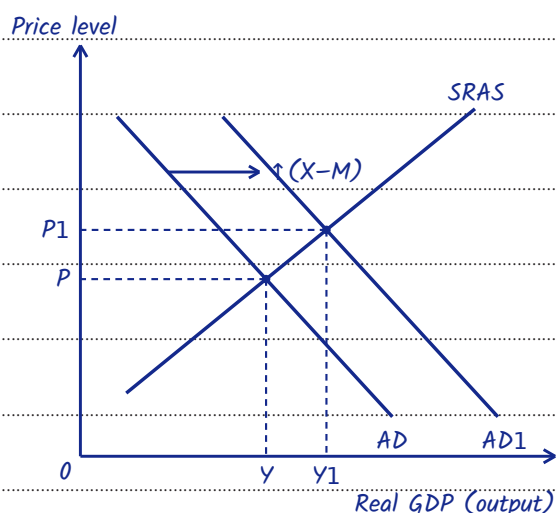
This is especially important for a small firm with only two UK stores, which could not easily survive a failed overseas expansion.



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- (e) Using a suitable diagram, discuss the likely impact of increasing net exports on the UK economy.

(8)



Net exports ($X - M$) are a component of aggregate demand, where $AD = C + I + G + (X - M)$.

An increase in net exports therefore shifts AD to the right from AD to AD1, increasing real output from Y to $Y1$ and raising the average price level from P to $P1$.

Higher real output (GDP) means firms need more workers, so demand deficient (cyclical) unemployment falls. The rise in exports also boosts incomes, which are partly spent, giving a multiplier effect, and it reduces the UK current account deficit, which in 2013 included a £110 196m deficit on goods.

However, higher net exports increase demand for the pound, so the currency may appreciate. A stronger pound decreases the cost of imports, which lowers the cost of imported raw materials and components for UK firms, reducing costs and cost push inflation.

On the other hand, the appreciation makes UK exports more expensive and imports cheaper, so imports may rise and net exports may fall again, partly reversing the increase in AD. The long term effect on the economy therefore depends on the relative PED of imports and exports: if demand for UK exports is price inelastic, net exports remain high.

The impact also depends on spare capacity. If the economy is near full capacity, the AD shift mainly causes inflation rather than higher output, so the benefit to growth and jobs is greatest when there is a negative output gap.



- (f) Assess the merits of AngelBerry's decision to focus upon developing economies for its growth.

(10)

Developing economies typically have rising GDP and GDP per capita, rising disposable incomes and relatively unsaturated markets, so they offer AngelBerry strong growth potential.

Because these markets are relatively unsaturated, there is less competition than in the UK, so AngelBerry can build brand awareness and gain market share early. Frozen yogurt is likely to be a luxury good, so its YED may be elastic (greater than 1): as incomes rise, demand rises proportionately more, so sales could grow quickly.

Many of its markets, such as the UAE and the Gulf States, have warm climates, so there are fewer seasonal fluctuations in demand than in Bristol, giving more stable revenue all year. Ingredients may also be sourced locally, reducing ingredient and transport costs. Franchising means local partners provide the capital, so the firm can expand rapidly, with deals for 80 stores by 2018, at low cost and risk.

However, developing economies can be risky due to political instability, which may disrupt trade or threaten the franchises. Cultural differences and consumer tastes may require flavours and marketing to be modified, which increases costs, and there may be language problems and a lack of skills and education in the local labour force.

Franchising means AngelBerry may not be in control of quality throughout the business, so a poor franchisee could damage its reputation. Rapid expansion to remote outlets could also lead to diseconomies of scale through communication problems, supply chain problems, and the need to know local labour laws.

Overall, the decision has strong merits because the potential growth in demand is large and franchising limits the financial risk. The success depends on how thorough its market research is, how carefully it selects and monitors franchisees, and on choosing politically stable markets such as the UAE. In the long run it may be wise to balance



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these markets with Europe to spread risk.

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- (g) Part of the £3.4m investment in the Teesside deep-water quay was provided by the UK Government.

Assess the likely impact of the investment on the local economy.

(12)

Government support helps to subsidise infrastructure, allowing the AV Dawson quay development to take place when it might not have been profitable for the firm alone.

The investment in construction creates direct employment in the local economy, for example jobs dredging the river and building the £3.4m deep-water quay. These workers spend their wages in the local economy, providing revenue for local firms such as shops and restaurants. Through the multiplier effect, the initial injection of £3.4m may bring about an increase in final income of a higher magnitude, as each round of spending becomes someone else's income.

In the long run, as the quay develops, new jobs may be created in associated firms, such as haulage, logistics and the operation of the two 100-tonne cranes, reducing unemployment in Teesside. The improved communication and transport infrastructure lets larger, more economical vessels be used, lowering costs for local exporters and attracting other firms, including multinationals, to the region. Specialist suppliers may then locate nearby, giving local firms external economies of scale, and higher exports raise local incomes.

However, the impact will depend upon the number of jobs created for local residents. If skilled workers are brought in from outside the region, much of the income leaks away. The impact will also depend upon the proportion of income spent upon local goods and services: if leakages into savings, taxes and imports are high, the multiplier will be small. Jobs may be low skill, temporary or part time, which reduces the value of the multiplier, especially once construction ends.

There may also be a negative environmental impact. Dredging can damage the river ecosystem, and more shipping creates negative externalities such as pollution, noise and



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congestion for local residents. Inward investment may increase asset prices such as land and property, crowding out existing local firms. The government money also has an opportunity cost, as it could have been spent on other projects.

Overall, the investment is likely to have a positive impact on the local economy, especially in an area such as Teesside with relatively high unemployment, as it is part of a multi-million pound plan that is already attracting multinational customers. The size of the impact depends on the size of the multiplier and how many jobs go to local people, so it is likely to be greater in the long run than the short run, provided externalities are managed.

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- (h) Assess the likely effectiveness of using fiscal policy to reduce the deficit in the UK balance of trade in goods.

(12)

A deficit in the balance of trade in goods means the value of imported goods exceeds the value of exported goods. In 2013 the UK goods deficit (−£110 196m) exceeded the services surplus (£78 096m) by £32 100m, so the overall balance of trade was −£32 100m.

Fiscal policy is the alteration of government spending and/or taxation to achieve macroeconomic objectives, such as reducing the trade deficit, by changing the level and composition of AD. Taxes can be direct (income and corporation tax) or indirect (specific and ad valorem taxes such as VAT).

Higher direct and indirect taxes reduce consumers' disposable income, so demand for imported consumer goods falls, reducing the deficit. This is likely to work in the UK, where consumption is a large component of AD and a high percentage of consumer goods are imported. Higher taxes may also reduce business investment, cutting demand for imported capital goods. Lower government spending has a negative multiplier effect, which also reduces demand for imports.

Alternatively, lower taxes on firms, such as cuts in corporation tax, may reduce costs, making UK exported goods more competitively priced and reducing the deficit.

However, lower taxes may attract inward investment, increasing demand for the pound and causing it to appreciate. This worsens the deficit, as exports become more expensive and imports cheaper. Contractionary fiscal policy also reduces growth and raises unemployment, a conflict of objectives.

The effectiveness depends on elasticities. If PED for exports is inelastic, lower export prices will not raise export revenue much, but if it is elastic they will. If YED for imports is inelastic, higher taxes may not reduce imports much, but if it is elastic they will. As the UK deficit is structural, reflecting a weak manufacturing base, fiscal policy



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is likely to be only partly effective in the short run; supply side policies to raise competitiveness are needed in the long run.

(Total for Question 1 = 60 marks)

TOTAL FOR SECTION A = 60 MARKS

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SECTION B

Read the following extract (D) before answering Question 2.

Write your answer in the space provided.

Extract D

Selection of Economic Development Indicators 2013

	GDP per capita (US\$ current)	HDI	Income GINI coefficient
UK	41 776	0.89 Rank 14	0.36
Brazil	11 711	0.74 Rank 79	0.54
Russian Federation	14 487	0.77 Rank 57	0.40
India	1 455	0.58 Rank 135	0.33
China	6 991	0.71 Rank 91	0.42

(Sources: <http://hdr.undp.org/en/content/human-development-index-hdi-table>,
<http://hdr.undp.org/en/content/income-gini-coefficient> and
<http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>)



P 5 2 1 4 0 A 0 1 5 2 4

- 2 Using Extract D, evaluate the effectiveness of GDP per capita in comparing living standards between countries.

(20)

GDP per capita is a country's GDP divided by its population, so it measures the average output or income per person. Real GDP per capita takes inflation into account, whereas nominal GDP per capita, such as the current US\$ figures in Extract D, does not. It is widely used as an indicator of economic development and relative wealth.

Extract D shows UK GDP per capita of US\$41 776, compared with US\$6 991 in China and only US\$1 455 in India. This suggests that the average person in the UK has far higher living standards, with income around 29 times that of India, so people can afford more goods, services, housing and healthcare. GDP per capita is also easy to calculate and data is available for most countries, which makes comparison simple. The ranking also broadly matches the HDI ranking, with the UK highest (0.89, rank 14) and India lowest (0.58, rank 135), suggesting it is a reasonable guide.

However, total GDP can be misleading without considering population. China has a much higher total GDP than the UK, but its GDP per capita is lower because its population is far larger, so dividing by population is essential.

A key weakness is that GDP per capita is an average, so it does not show the distribution of income or wealth. The Income GINI coefficient measures inequality: the closer it is to zero, the more evenly income is distributed. Brazil has GDP per capita of US\$11 711, but a GINI of 0.54, the highest in Extract D, so many people may have much lower living standards than the average suggests. In contrast, India's GINI of 0.33 shows income is more equally distributed than in the UK (0.36), despite the huge disparity in GDP per capita. Yet a low income that is equally distributed still means low living standards for the majority of the population.

Another weakness is that GDP per capita only measures income, not other aspects of living standards. The HDI is a composite index of GNI per capita, education (years of

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schooling) and health (life expectancy), so it may be more useful in comparing living standards between countries. Russia has higher GDP per capita (US\$14 487) than Brazil (US\$11 711), and also a higher HDI (0.77 against 0.74), but the gap in HDI rankings (57 against 79) can differ from the income gap. HDI rankings are useful for comparison, for example China (91) against India (135), and a rising ranking may indicate improving living standards.

HDI also has limitations: data may be inaccurate, time in education is not the same as quality of education, and life expectancy does not necessarily measure quality of life.

Furthermore, GDP per capita ignores the informal economy and non-marketed output, such as subsistence farming, which is large in India, so living standards there may be understated. Comparisons in current US\$ also ignore differences in the cost of living, so purchasing power parity (PPP) figures would give a fairer comparison.

None of the measures in Extract D looks at sustainability or the environmental impact of economic activity. China's rapid growth has caused severe air pollution, so high GDP, HDI and equal income distribution may mask environmental costs that reduce living standards. GDP per capita also ignores leisure time, working hours, political freedom and happiness.

More useful measures may include infant mortality, the number of people working in agriculture, access to clean water, gender imbalances, the occurrence of obesity and literacy rates.

In conclusion, GDP per capita is effective as a starting point for comparing living standards, especially when the differences are very large, such as between the UK and India, because income strongly affects access to goods, health and education. However, it is less effective for countries with similar incomes, such as Brazil and Russia, or where inequality is high. Its effectiveness depends on using real, PPP adjusted figures and combining it with the HDI and GINI coefficient, as these together give a much fuller



picture of living standards than any single indicator.

(Total for Question 2 = 20 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C

Read the following extracts (E and F) before answering Question 3.

Write your answer in the space provided.

Extract E

Norway running short of options as it tries to improve ties with China

Norway has paid a high price since Chinese dissident Liu Xiaobo was awarded the Nobel Peace Prize in 2010. In September 2014, China announced a ban on salmon infected with ILA, a virus that is harmless to humans but prevalent in European waters. While the Chinese body that regulates food safety claims that the new ban was in response to its discovery of a batch of contaminated Norwegian salmon, experts suspect it has more to do with politics.

5

Norwegian salmon has been at the centre of Chinese trade restrictions since 2010. Norway has made ongoing efforts to placate the Chinese Government – most notably its having recommended China as a permanent observer on the Arctic Council – an intergovernmental forum in which northern states discuss shipping and security issues. But Norwegian exporters continue to meet unforeseen obstacles and diplomatic contact between the two countries remains limited.

10

Norway is not a member of the European Union but is an oil-rich country, with large gas reserves and a large budget surplus. It can exist economically independent of China. However, it is missing out on a potentially large market. Norway's share of the Chinese salmon market, for example, has dropped from 90% to 30%.

15

(Source: adapted from Norway running short of options as it tries to improve ties with China, Sarah Karacs © 2016 South China Morning Post)

Extract F

Marine Harvest pursues net gains in Scotland

Marine Harvest, a Norwegian registered firm which operates 38 fish farms in Scotland supporting around 460 jobs, is the world's largest producer of farmed salmon, operating in 22 countries. Its Scottish business unit was highlighted as the firm's best-performing in 2011, with high production, good price achievement and good operational performance. Scotland is currently the largest producer of farmed Atlantic salmon in the European Union and third largest globally, accounting for more than one-third, by value, of Scotland's food exports.

5

Exports are now reaching emerging markets such as China, where there was an agreement with the Government in Beijing to enable direct exports to the country. While mean annual nominal incomes in China rose from ¥29 229 in 2008 to ¥56 339 in 2014, total farmed salmon sales increased nearly 900% to a record 6,779 tonnes, demonstrating the growing demand from new marketplaces for Scottish seafood.

10

(Source: adapted from Marine Harvest pursues net gains in Scotland © hie.co.uk)



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3 Evaluate the likely impact of trade restrictions upon multinational firms, such as Marine Harvest.

(20)

Trade restrictions are measures that limit international trade, including tariffs (taxes on imports), quotas (limits on the quantity imported) and non-tariff barriers, such as regulations and food safety standards. Multinational firms (MNCs) operate in more than one country, like Marine Harvest, which operates in 22 countries.

Trade restrictions may reduce MNCs' access to large emerging markets such as China.

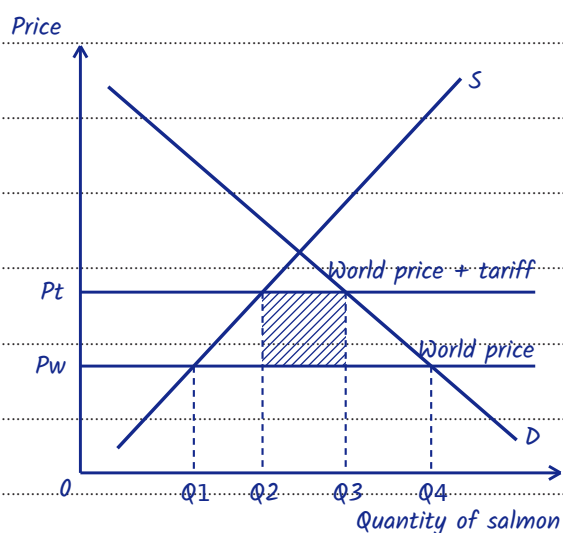
In Extract E, China banned salmon infected with ILA, and Norway's share of the Chinese salmon market fell from 90% to 30%. This results in a fall in sales revenue and profit for Norwegian firms such as Marine Harvest, and they lose economies of scale from serving such a large market.

A tariff raises the price of imports from the world price (P_w) to the world price plus the tariff (P_t), as shown in the diagram. Imports fall from Q_1 to Q_4 to only Q_2 to Q_3 , so the exporting MNC sells less, and the shaded area is tariff revenue going to the importing government rather than the firm.

Trade restrictions also create risk, as they can be introduced suddenly for political reasons; experts suspect China's ban was linked to the Nobel Peace Prize award rather than food safety. This uncertainty makes MNCs reluctant to invest in market development, so opportunities for MNCs may be limited. Some countries, such as China and India, also require MNCs to accept joint ventures and loss of control as the price for entering the market.

However, many MNCs will make every effort to get round trade restrictions because the potential rewards are so great. Extract F shows that mean annual nominal incomes in China rose by about 93% (from ¥29 229 to ¥56 339) between 2008 and 2014, while farmed salmon sales increased by nearly 900%. This gives a YED of about $+900 \div +93 = 9.7$, so salmon is highly income elastic and demand will keep growing quickly as





Chinese incomes rise.

Firms can overcome trade restrictions by relocating production. Marine Harvest, a

Norwegian registered firm, operates 38 fish farms in Scotland, and Scottish salmon has an agreement for direct exports to China.

Exporting from Scotland rather than Norway allows it to avoid China's restrictions against

Norway. MNCs may also locate production in China itself or in ASEAN countries to get inside the barrier.

The impact of a tariff also depends on PED. If demand is price inelastic, as for premium brands, consumers continue to buy despite the higher price: Jaguar cars face a 100% tariff in China but are still successful. Impact may also depend on Chinese exchange rate policy, as an undervalued ¥ makes imports more expensive. Some MNCs are so large and powerful that they can lobby governments and are often able to overcome trade restrictions.

In conclusion, trade restrictions can significantly reduce sales and raise risk for MNCs in the short run, as Norway's fall in market share shows. However, the impact on large MNCs such as Marine Harvest is likely to be limited in the long run, because they can relocate production, and the potential rewards of a highly income elastic market like China outweigh the costs of avoiding restrictions. Smaller firms based in one country face a much greater impact.



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(Total for Question 3 = 20 marks)

TOTAL FOR SECTION C = 20 MARKS
TOTAL FOR PAPER = 100 MARKS



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