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Pearson Edexcel
Level 3 GCE

Centre Number

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Economics B

Advanced

Paper 2: Competing in the global economy

Tuesday 12 June 2018 – 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 value of tourism in England

England's tourism sector is vibrant and vital. Tourism works hand-in-hand with a wide range of sectors across England, including farming, transport, retail, sport, museums and the arts.

Taking into account direct and indirect impacts, tourism in England contributes £106bn to the British economy and supports 2.6 million jobs. Looking at direct impacts only, tourism still contributes £48bn, supporting 1.4 million jobs. In 2011, there were 208,880 VAT registered businesses in England's tourism sectors, including accommodation, food and drink, transport, travel agencies and cultural activities. 5

In 2015, overseas visitors to England spent £19.4bn, making 31.8 million trips and staying for 241 million nights in accommodation in England. In addition, England's tourism sector is expected to benefit from the depreciation of the pound following the decision, in June 2016, to leave the European Union. 10

The VisitBritain website is a valuable hub of information for potential tourists and achieved over 22 million page views in 2015/2016. 15

(Source: adapted from © British Tourist Authority 2016)

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Extract B**Number of Chinese tourists visiting UK increases**

The number of Chinese tourists visiting the UK increased by 37% in the first nine months of 2015, taking the total to more than 200,000 visitors.

VisitBritain, which is hoping to double the spending from Chinese visitors to £1bn by 2020, said they were already among the highest spenders at £2 688 per person. Chinese visitors already account for almost 25% of tourist spending in the UK.

5

Higher incomes have allowed millions of Chinese to start taking holidays outside of China. The World Tourism Organization estimates 100 million Chinese will leave China to go on holiday in 2016. While Asian countries make up the top five destinations, France, Italy, Switzerland and Germany are also in the top 10.

10

The UK has proved less popular, as it is outside the EU's Schengen single-visa bloc. In a bid to boost visitor numbers ahead of Chinese New Year on 8 February 2016, the UK introduced a new two-year visitor visa for Chinese nationals. The new visa costs £85, the same as the previous six-month visa, and enables holders to make multiple trips to the UK.

15

"China is the world's largest outbound market and a huge tourism opportunity for Britain," said a VisitBritain Director.

(Source: adapted from © 2017 Guardian News and Media Limited)

Extract C**London 'one of the most unethical tourist destinations in the world'**

London hotel workers are being exploited with low pay and "shameful" employment practices, a trade union has claimed.

According to the union, many migrants are employed in London's hotels and are being left exhausted after their shifts because of long hours and staff shortages. Chefs have suffered accidents caused by tiredness and hotel staff do not have time to eat or have a break.

5

The union's regional secretary for London said "the London hotel sector is failing its workforce. It has become an example of low pay and exploitation. If these stories tell us anything, it is that shameful work practices, similar to those exposed in the retail sector, have no place in 21st-century Britain. Low pay, zero-hour contracts and open hostility to trade unions have become standard practice, making London one of the most unethical tourist destinations in the world. It is a sad fact that hotel workers in less developed countries are often shown more respect when it comes to their basic human and trade union rights, than workers in London, the capital of the world's fifth largest economy."

10

15

(Source: adapted from <http://www.standard.co.uk/news/london/london-one-of-the-most-unethical-tourist-destinations-in-the-world-a3326541.html>)



- 1 Average wages in China increased from ¥29 229 per year in 2008 to ¥62 029 per year in 2015.

In the same period, there was an increase of 161% in outbound tourists from China.

- (a) Using this information, calculate, to 1 decimal place, the income elasticity of demand for outbound tourism from China. You are advised to show your working.

(4)

$$YED = \% \text{ change in quantity demanded} \div \% \text{ change in income}$$

$$\text{Change in income} = ¥62\,029 - ¥29\,229 = ¥32\,800$$

$$\% \text{ change in income} = (32\,800 \div 29\,229) \times 100 = 112.2\%$$

$$YED = 161\% \div 112.2\% = 1.43$$

$YED = +1.4$ (to 1 decimal place), so outbound tourism from China is income elastic:

it is a normal, luxury good.



(b) Using Extract B, explain **one** impact of the increase in tourists from China on the UK Balance of Payments.

(4)

Spending by Chinese tourists in the UK counts as an export of services, so it is a credit (an inflow of income) on the trade in services part of the current account of the UK Balance of Payments.

Extract B shows Chinese visitors are among the highest spenders at £2 688 per person, spent on accommodation, shopping, food and transport, and with over 200,000 visitors (up 37%) this is worth over £500m.

Chinese tourists must buy pounds with yuan to spend in the UK, so this inflow of foreign currency adds to the current account and improves it, helping to reduce the UK's current account deficit.



P 5 2 3 2 0 A 0 5 2 4

(c) Explain **one** way in which the digital economy may boost UK tourism.

(4)

The digital economy makes it much easier for overseas tourists to find information about the UK and to compare and book accommodation and flights online across a range of platforms and apps.

For example, the VisitBritain website is a hub of information for potential tourists and achieved over 22 million page views in 2015/2016, increasing consumer knowledge of the UK as a tourist destination.

Lower search and transaction costs make the task of visiting Britain much easier, which increases demand for UK holidays and so increases tourist numbers and spending in the UK tourism industry.



(d) Analyse the impact a trade union could have on the London hotel industry.

(6)

A trade union is an organisation of workers that uses collective bargaining to negotiate with employers on behalf of its members over pay and working conditions.

Extract C reports low pay, zero-hour contracts and long hours with staff shortages in London hotels, so that chefs have suffered accidents caused by tiredness and staff do not have time to eat or have a break. A recognised union could negotiate with hotel management to bring about improvements in pay and conditions, for example a living wage, guaranteed hours and proper breaks. This would have a positive impact on workers' welfare and safety and could reduce exploitation.

However, higher wages and better conditions increase labour costs for the London hotel industry. Hotels may respond by raising room prices for consumers, which could reduce demand from price-sensitive tourists, or by absorbing the costs, which reduces their profitability. If the union pushes wages above the market equilibrium, hotels may employ fewer workers or replace staff with technology such as self check-in, causing some unemployment.

On the other hand, better-treated workers are likely to be more motivated and productive, with fewer accidents and lower staff turnover, which cuts recruitment and training costs and improves service quality and the reputation of London as a tourist destination. The overall impact depends on the bargaining power of the union, since many hotels show open hostility to unions and many migrant workers may be reluctant to join.

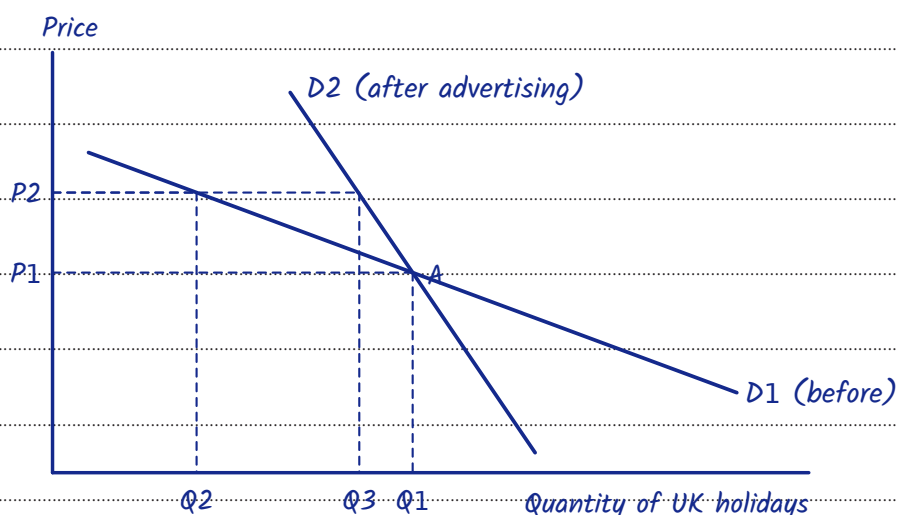


- (e) Using a suitable diagram, discuss the likely impact of advertising and other promotional methods on the price elasticity of demand for UK holidays.

(8)

Price elasticity of demand (PED) measures the responsiveness of quantity demanded to a change in price. Advertising and other promotional methods, such as VisitBritain campaigns and social media, aim to increase demand for UK holidays at all price levels, shifting the demand curve to the right.

More importantly, by improving the brand image of the UK in the minds of consumers and stressing what is unique (such as its history, culture and the Royal Family), promotion makes consumers see fewer close substitutes for a UK holiday. Consumers become more loyal and less sensitive to price increases, so demand becomes more price inelastic.



In the diagram, the demand curve pivots from the elastic D1 to the steeper, more inelastic D2. If the price rises from P1 to P2, quantity demanded falls from Q1 to Q2 on D1, but only from Q1 to Q3 on D2. UK tourism firms can therefore raise prices and increase total revenue.

However, holidays are a normal, luxury good with high YED, so changes in income may affect demand more than advertising. Price may be more important than promotion for some types of holidays, such as budget breaks, where price comparison websites make consumers very price sensitive. The impact will also depend on other factors such as

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freedom of movement between countries, visa rules and currency changes, as well as the quality of competitors' promotion. Overall, effective advertising is likely to make demand for UK holidays somewhat more price inelastic, but only for consumers who are attracted to the UK's unique features.



P 5 2 3 2 0 A 0 9 2 4

- (f) Assess the claim that China represents 'a huge tourism opportunity for Britain' (Extract B)

(10)

China can be seen as an emerging market, with rapidly rising GDP and GDP per capita, rising disposable incomes and an unsaturated market for overseas holidays. Extract B shows the World Tourism Organization estimates 100 million Chinese will go on holiday abroad in 2016, making China the world's largest outbound market.

Demand for outbound tourism from China is income elastic (YED of 1.4 from part (a)), so as Chinese incomes keep rising, demand for foreign holidays will rise more than proportionately. Chinese visitors to the UK rose by 37% in the first nine months of 2015 and already spend £2 688 per person, almost 25% of tourist spending in the UK. VisitBritain hopes to double this spending to £1bn by 2020.

This spending is an injection into the circular flow and creates a multiplier effect: hotels, restaurants, retailers and transport firms receive extra income and employ more workers, who in turn spend more, increasing AD, employment and economic growth. The new two-year visa at the same £85 price as the old six-month visa lowers the cost of repeat trips, which should boost numbers further.

However, the opportunity may be more costly to exploit than anticipated. Cultural differences and consumer tastes may require the UK tourist experience to be modified, for example Chinese-speaking guides, menus and payment systems such as mobile payment apps, which raises costs for the industry. Marketing must be appropriate for the emerging Chinese market, and there is a lack of Chinese language skills in the UK labour force to take advantage of the opportunity.

The UK is also outside the Schengen single-visa bloc, so other European countries such as France, Italy, Switzerland and Germany, which are already in China's top 10 destinations, may be better placed to attract Chinese tourists who can visit several countries on one visa. Asian countries make up the top five destinations, so the UK is



competing with nearer, cheaper rivals.

In addition, the UK may be vulnerable to changes in restrictions on the movement of people and money into and out of China and the UK, for example capital controls by the Chinese government or a slowdown in Chinese growth, which would hit income-elastic demand hard. A large increase in tourists, mostly concentrated in London, may create negative externalities such as congestion and pollution.

Overall, China does represent a huge opportunity because of the sheer scale of its outbound market and its high spending per visitor, but at about 200,000 visitors the UK has captured only a tiny share. Whether the opportunity is realised depends on the UK industry investing in tailored products and marketing and on further easing of visa rules, so in the short run the gains are likely to be modest but in the long run they could be large.

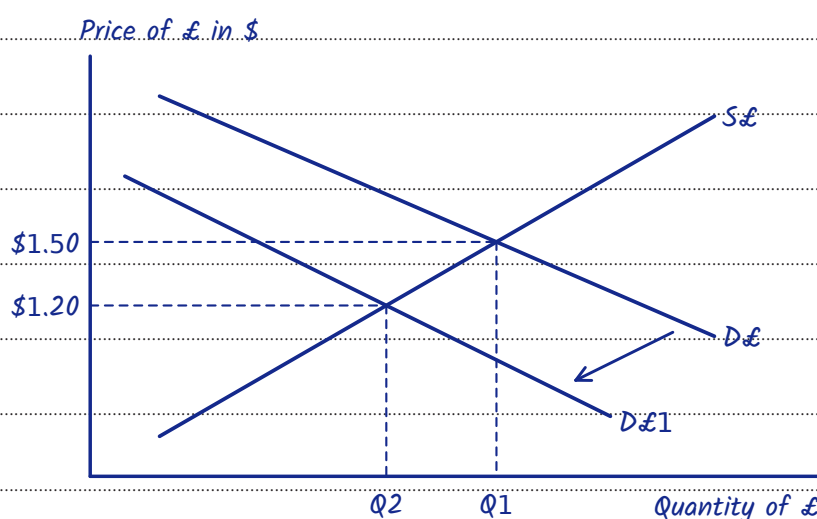


- (g) Assess the likely impact of the depreciation of the pound on the UK tourism industry.

(12)

An exchange rate is the value of one currency expressed in terms of another, determined by the demand for and supply of the pound on the foreign exchange market. After the decision to leave the EU in June 2016, demand for the pound fell ($D_{\text{£}}$ to $D_{\text{£1}}$), so the pound depreciated, for example from about $\text{£}1 = \$1.50$ to $\text{£}1 = \$1.20$.

A depreciation makes the UK more price competitive for international tourists. A \$3 000 holiday budget now buys £2 500 of UK services instead of £2 000, so hotels, meals and attractions are cheaper for overseas visitors. Extract A notes England's tourism



sector is expected to benefit, and with overseas visitors already spending £19.4bn on 31.8 million trips in 2015, even a 10% rise in spending would add almost £2bn of export revenue. Demand from fast-growing markets such as China, where visitor numbers were already up 37%, should rise further.

At the same time, foreign holidays become more expensive for UK citizens, so many may switch to domestic holidays ('staycations'), increasing demand for UK hotels, attractions and transport. Through the multiplier, this extra spending supports the 2.6 million jobs linked to tourism in England.

However, the weaker pound increases the cost of imported goods, including food and



energy, so tourist businesses face higher costs which may be passed on as higher prices, partly cancelling the price advantage. The depreciation is also not good for UK airlines, tour operators and the overseas rental sector, which may see a fall in demand from UK citizens. UK travel and hotel firms, whose assets are priced in pounds, may become cheaper takeover targets for foreign buyers.

The size of the impact depends on the PED for UK tourism: if demand is price inelastic, because visitors choose the UK for its unique culture and history, a fall in price will have little impact on demand. Other factors such as income growth abroad, security and visa rules may matter more than price. The depreciation may also be short-term, so any benefits may be short-term.

Overall, the depreciation is likely to benefit inbound and domestic tourism in the short run, as shown by rising visitor numbers, but outbound travel firms lose out and rising import costs and uncertainty may erode the gains in the long run.



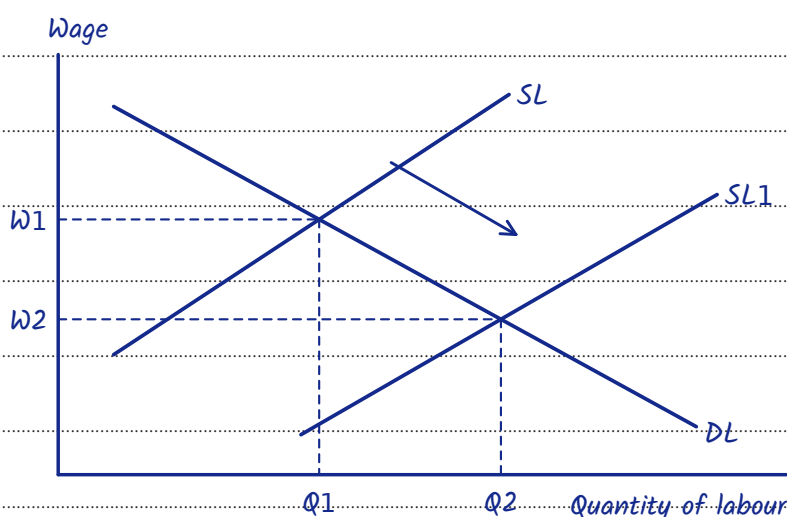
The low wages and poor working conditions of staff in the London hotel industry are entirely due to the factors influencing the demand and supply of labour.

(h) Assess the accuracy of this statement.

(12)

The supply of labour is the willingness and ability of workers to offer themselves for employment at each wage level, and the demand for labour is the willingness and ability of firms to employ workers at each wage, derived from demand for hotel rooms. The equilibrium wage is set where they meet: a surplus of labour forces wages down and a shortage forces them up.

Hotel work such as cleaning and kitchen work is low-skilled, so the supply of labour is large and elastic. Extract C says many migrants are employed in London's hotels, and the plentiful supply of cheap labour from free movement within the EU shifts supply



right from SL to $SL1$, forcing the wage down from $W1$ to $W2$. Low productivity limits the demand for labour, and high property costs in London mean hotels cut variable costs such as wages to maintain profit margins. To this extent, low wages are the outcome of demand and supply.

However, the statement is not entirely accurate. Poor conditions also reflect a lack of regulation and labour market failure: zero-hour contracts, long hours without breaks and staff shortages leave chefs suffering accidents caused by tiredness. Extract C reports open hostility to trade unions, so without union recognition workers lack bargaining

power. Large hotel chains may act as monopsony employers, able to exploit their position to maximise profits; with little choice of employment, workers are wage takers while firms are wage makers, so wages are pushed below the competitive level.

Information failure and immobility also matter: migrant workers may not know their rights, and some may be reluctant to complain, so the market is not working as the simple model assumes. If staff shortages exist, competitive theory predicts rising wages, yet wages remain low, which suggests institutional factors rather than pure demand and supply.

In conclusion, demand and supply explain much of the low pay, since the sector relies on a large pool of low-skilled labour, but they cannot entirely explain the poor conditions, which owe more to employer power, weak unions and lack of enforcement.

Pay and conditions are therefore likely to improve only through government intervention, such as enforcing the National Living Wage, limiting zero-hour contracts and supporting union recognition.

(Total for Question 1 = 60 marks)

TOTAL FOR SECTION A = 60 MARKS



SECTION B

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

Write your answer in the space provided.

Extract D

***Britvic* to cut costs amid inflation concerns**

Britvic has announced cost-cutting plans as it warned that 2017 would be another 'challenging' year amid rising inflation from the Brexit-hit pound.

Britvic, which also bottles Pepsi in the UK, announced it will attempt to cut another £5m off its annual costs. It posted a better-than-expected 10% rise in pre-tax profits to £151.9m for the year ending October 2016, but gave a cautious outlook for the year ahead. The Chief Executive of *Britvic* said: "2017 will be another challenging year, with difficult trading conditions and an increase in input costs for the first time in several years." 5

The vote to leave the EU and the sugar drinks tax from April 2018 have "created additional uncertainty," he said. Large consumer goods firms have been under pressure from the weaker pound and rising commodity prices, with *Unilever*, the maker of Marmite, entering a high-profile dispute with *Tesco* in October 2016 after seeking unsuccessfully to push through a reported 10% price increase. 10

(Source: adapted from © Belfast Telegraph)

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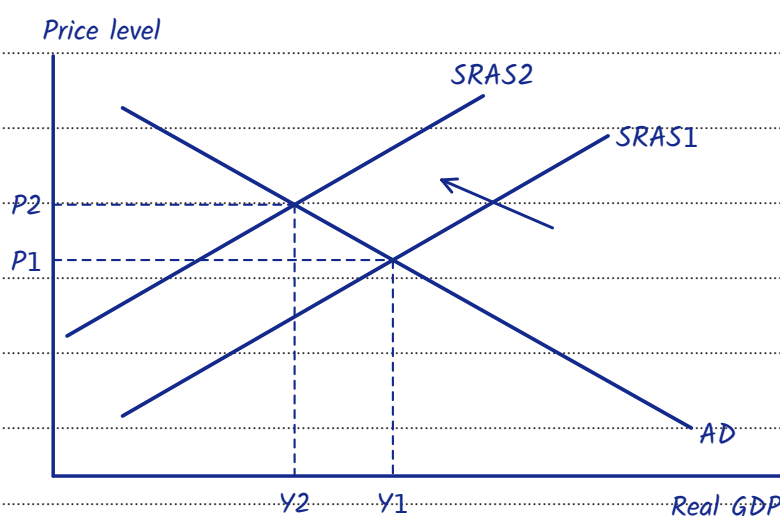
2 Evaluate the impact of rising inflation on UK-based firms such as Britvic.

(20)

Inflation is a sustained increase in the average price level, measured in the UK by the CPI (or RPI). Low and stable inflation, a CPI target of 2% +/- 1%, is a government macroeconomic objective. Inflation may be demand-pull or cost-push.

In Britvic's case inflation is cost-push. The 'Brexit-hit pound' has raised import prices, and with rising commodity prices this increases input costs such as sugar, fruit concentrate and packaging for the first time in several years. As shown in the diagram, higher costs shift SRAS1 left to SRAS2, raising the price level from P1 to P2 and reducing real GDP from Y1 to Y2.

Higher input costs squeeze profit margins. Firms may have to cut costs elsewhere: Britvic plans to cut another £5m off its annual costs, which may mean lower wages,



less investment, or cuts in marketing and product development. Lower investment may reduce productivity, raising unit costs further and harming long-term competitiveness.

Alternatively, firms may increase prices to maintain profitability. The effect on sales depends on PED. Strong brands such as Pepsi or Robinsons may have inelastic demand, allowing Britvic to pass on costs and keep revenue, but supermarket own-label drinks are close substitutes, and powerful retailers resist price rises, as when Tesco refused Unilever's reported 10% price increase in October 2016. Firms with weak bargaining

power may have to absorb the costs.

Inflation also reduces the real incomes of consumers if wages rise more slowly than prices, so they may reduce consumption of non-essential goods such as soft drinks.

Higher prices may lead workers to demand higher wages, creating a wage-price inflationary spiral that raises costs further.

Higher costs and prices may make UK goods less competitive internationally. Rising inflation also increases uncertainty, which, together with the EU vote and the sugar drinks tax from April 2018, may cause firms to postpone or cancel investment.

However, there are some benefits. Inflation reduces the real value of debts, giving firms an incentive to borrow and invest, and it reduces the real return on savings, encouraging firms to spend retained profits on capital expenditure and product development. Consumers who receive above-inflation pay rises may increase demand for UK firms' products. Mild inflation makes it easier for firms to raise prices without losing customers.

The competitiveness of UK firms depends on relative inflation rates: if inflation in other countries is similar, UK firms lose little. For UK exporters, the weaker pound lowers export prices, although increased import costs may offset this advantage. Britvic still posted a 10% rise in pre-tax profits to £151.9m, which suggests large firms can cope with moderate inflation.

The impact also depends on the type of firm. Firms that rely heavily on imported inputs, such as drinks and food manufacturers, are hit hardest, whereas firms using mainly domestic inputs or selling abroad may benefit. Large firms with strong brands and economies of scale are better able to absorb costs than small firms.

Overall, the impact of rising inflation on UK-based firms such as Britvic depends on its magnitude and time period. If inflation rises only modestly above the Bank of England's 2% target and is temporary, firms can manage it through cost-cutting and modest



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price rises. If it is high and persistent, falling real incomes, rising wage demands and uncertainty are likely to reduce sales, profits and investment, so the most significant impact will be on firms with elastic demand and weak bargaining power.

(Total for Question 2 = 20 marks)

TOTAL FOR SECTION B = 20 MARKS



P 5 2 3 2 0 A 0 1 9 2 4

SECTION C

Read the following extracts (E and F) and Figure 1 before answering Question 3.

Write your answer in the space provided.

Extract E

The economy of Madagascar

Madagascar is an island off the east coast of Africa. It is the 131st largest export economy in the world with 75% of employment in the agricultural sector.

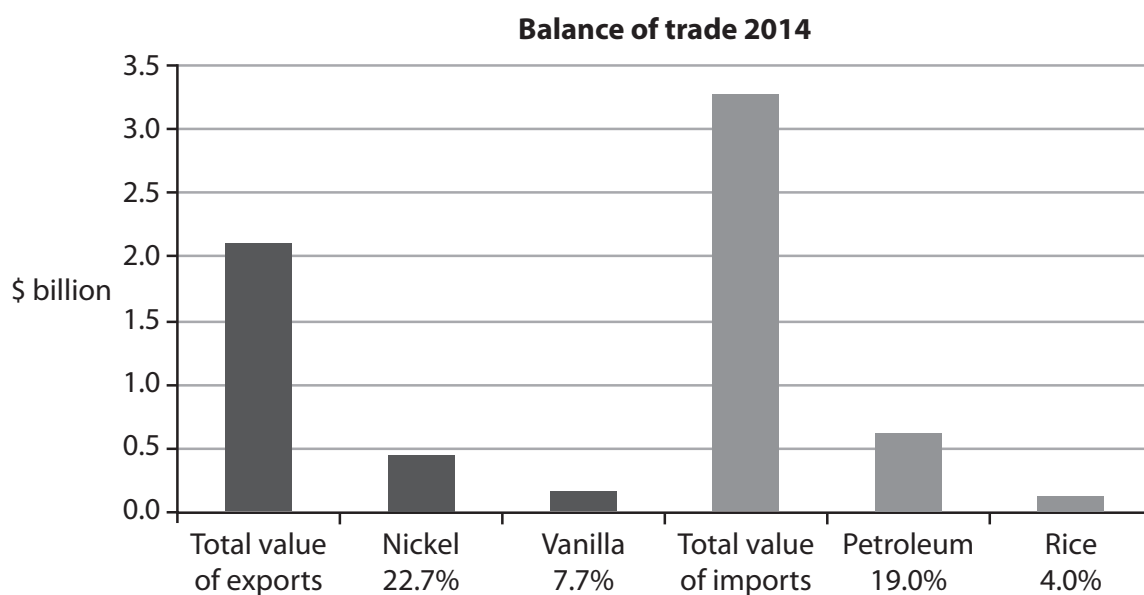


Figure 1

The top export destinations in terms of value are France, the United States, Belgium, Luxembourg, Germany and South Africa.

5

The top import origins are China, the United Arab Emirates, France, India and South Africa.

(Source: adapted from <http://atlas.media.mit.edu/en/profile/country/mdg/>)



Extract F**Overcoming the shameful paradox in Madagascar's vanilla sector**

There is absolutely no reason why small-scale farmers producing the world's most used flavouring and the second most expensive spice in the world – vanilla – should live in absolute poverty. This is, however, currently the case in Madagascar. About 80,000 small-scale farmers produce Madagascar's vanilla, the majority of whom live on less than \$1 a day and suffer extreme income insecurity. Meanwhile, Madagascar is the world's top producer of natural vanilla. 5

Recent research indicates that a handful of food and beverage multinationals are the most powerful stakeholders in the Madagascar vanilla supply chain. These companies can, and should, help small-scale farmers to break out of the cycle of poverty by ensuring that they are paid a fair price for their vanilla. A fair price covers, among other things, a living wage for farmers, any other labour either from family members or hired labourers, plus all costs and risks involved in the production. 10

Earning a fair price will give farmers an opportunity to take better care of their families, invest in insurance to recover from unexpected events, invest in new and diverse crops, and have savings to fall back on. This is the main topic companies should be focusing on in order to ensure a fair system for these farmers and to contribute to sustainable vanilla production. 15

(Source: adapted from <http://www.fairfood.org/wp-content/uploads/2015/02/Overcoming-the-shameful-paradox-in-Madagascars-vanilla-sector-Deep-Roots-FAO.pdf>)



- 3 Madagascar specialises in the production of primary commodities such as nickel and vanilla.

Evaluate the impact of specialisation as a source of economic growth for developing economies such as Madagascar.

(20)

Specialisation is when an economy focuses its resources on producing a narrow range of goods or services in which it has a comparative advantage, such as agriculture or mining. Madagascar's factors of production and climate allow it to specialise in valuable primary commodities: it is the world's top producer of natural vanilla, the second most expensive spice in the world, and nickel makes up 22.7% of its exports, with 75% of employment in agriculture.

Exports of primary commodities are an important source of foreign exchange. Figure 1 shows exports of about \$2.1bn, which allow Madagascar to pay for essential imports such as petroleum (19.0% of imports) and rice (4.0%), as well as capital goods needed for development.

Net exports are a component of AD ($C + I + G + X - M$), so higher export revenue increases AD and, through the multiplier, raises economic growth, incomes and wealth.

Demand for vanilla is likely to be income elastic, so growth in rich export markets such as France, the United States and Germany may increase demand and revenues for producers. Demand may also be price inelastic, as vanilla has few natural substitutes, so high prices can be charged without quantity demanded falling very much.

When the prices of primary products are rising, the exchange rate is likely to appreciate, making imports such as energy and capital goods cheaper. Specialisation may also allow economies of scale in mining and processing, leading to competitive advantage, and may attract foreign direct investment.

However, primary commodity prices are very volatile, because supply is price inelastic in the short run and affected by weather, so producers find it difficult to plan investment and output, and export earnings and government revenue fluctuate. Madagascar also has



a trade deficit: imports of about \$3.3bn exceed exports of \$2.1bn, a gap of around \$1.2bn, so specialisation has not generated enough export earnings.

Much of the value added takes place in the export markets: vanilla is processed and sold by food and beverage multinationals, the most powerful stakeholders in the supply chain, so little of the final value stays in Madagascar and the impact on AD is limited.

Extract F shows that the majority of the 80,000 small-scale vanilla farmers live on less than \$1 a day and suffer extreme income insecurity, so growth does not reduce poverty or improve development.

Changing patterns of demand can significantly reduce market size and limit growth. If the price of vanilla is high, other countries may enter the market, increasing supply and reducing prices and growth for Madagascar. The development of substitutes, such as synthetic vanillin, may reduce the demand for natural vanilla, reducing prices. In the long run, the terms of trade for primary products have tended to decline relative to manufactures (the Prebisch-Singer hypothesis).

A lack of diversification means there is no balanced growth across sectors, leaving the economy at risk from unexpected events such as a cyclone causing a failed vanilla harvest or a fall in world nickel prices. Mining also depletes non-renewable resources and may cause environmental damage, so growth may not be sustainable.

On the other hand, the impact depends on how export revenue is used. If the government invests commodity revenues in education, infrastructure and processing industries, specialisation could fund diversification. If farmers receive a fair price, as Extract F argues, they can invest in new and diverse crops and insurance, spreading the benefits of growth more widely.

In conclusion, specialisation in primary commodities can provide a valuable source of foreign exchange and short-term growth for developing economies such as Madagascar, particularly when commodity prices are high. However, because of price volatility, low



value added, the power of multinationals and the risks of narrow specialisation, it is unlikely to deliver sustainable long-term growth without diversification and structural change.

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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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