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Candidate surname <i>StemUp Model Solution</i>		Other names
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Pearson Edexcel Level 3 GCE

Monday 5 June 2023

Morning (Time: 2 hours)

Paper reference **9EB0/03**

Economics B

Advanced

PAPER 3: The economic environment and business

You must have:
Insert (enclosed)

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–E) before answering Question 1.

Write your answers in the spaces provided.

Extract A

Whitsuntide hirings* – 16th April, 1879

Tuesday was the half-yearly hiring for Penrith. There was a large attendance but the people seeking employment were far in excess of those requiring labour. As a necessary consequence the wage rates were lower than at previous hirings.

(Source: adapted from The Carlisle Journal April 16th 1879)

**Hirings took place twice a year in rural areas such as Cumbria. They enabled all those seeking work as servants to meet with prospective employers and negotiate wages and terms of employment.*

Extract B

Big Auto Had The Ultimate Barriers To Entry – Then *Tesla* Broke Through

Before the rise of *Tesla*, conventional wisdom held that it would be practically impossible for a start-up company to challenge the giants of the car industry. When economics professors explained the concept of barriers to entry, the car industry was usually the prime example. Selling cars in volume requires not only massive industrial resources, but a highly complex supply chain and dealer network, so a start-up could not possibly enter the industry and compete.

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Events have shown that this model was not valid – or perhaps it would be more accurate to say that it was no longer valid, considering the growing importance of software and technology in the auto industry. In retrospect, *Tesla* was in the right place at the right time with the right idea.

10

(Source: adapted from <https://cleantechnica.com/2022/03/03/big-auto-had-the-ultimate-barriers-to-entry-then-tesla-broke-through/>)



Extract C

What Is Good Global Marketing?

Red Bull

Austrian company *Red Bull* is the world's leading energy drink company, selling over 7.5 billion cans every year. Its distinctive packaging is recognised globally, as is its long running slogan "*Red Bull gives you wings*".

5

One of its most successful tactics is to host extreme sports events all over the world. From the *Red Bull* Indianapolis Grand Prix in America, to the *Red Bull* Air Race in the UK, to the *Red Bull* Soapbox Race in Jordan, the brand's universal strategy takes it here, there and everywhere.

Dunkin' Donuts

10

In the US, National Donut Day happens every year in June. While Americans get their hands dirty with a Boston crème (or two), *Dunkin' Donuts* China serves up a fresh batch of dry pork and seaweed donuts.

With over 3,200 stores in 36 countries *Dunkin' Donuts* has evolved its menu to satisfy the sweet tooth of its global customers.

15

From Korea's Grapefruit Coolata, to Lebanon's Mango Chocolate Donut and to Malaysia's Mochi Waffle, it is clear that *Dunkin' Donuts* isn't afraid to celebrate cultural differences in an effort to strengthen its international presence.

(Source: adapted from <https://blog.hubspot.com/marketing/global-marketing-and-international-business>)

Extract D

Digital markets

The emergence of the digital economy has been a powerful force bringing about increased competition across a wide range of products and services.

Digital platforms are at the forefront of innovation and disruption in various industries across the globe.

5

Some of the most valuable companies in the world – *Google*, *Amazon*, *Facebook* and *Apple* – all embraced a digital platform business model for some or all of their activities. Taxi apps such as *Uber* and *Lyft* have revolutionised the taxi business model. Hotel and restaurant booking platforms such as *Booking.com* and *OpenTable* changed the way in which we plan holidays and evenings out.

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While most consumers embrace and enjoy the 'free' services that many of these companies offer, concerns have been expressed by traditional media and retail businesses that have been negatively affected by the digital economy. Other businesses whose access to markets is increasingly reliant on digital platforms are worried about the power these platforms now wield.

15

(Source: adapted from <https://globalcompetitionreview.com/guide/digital-markets-guide/> first-edition)



Extract E**Market values of digital platform firms vs comparable traditional firms*, 2018**

Firm	Start year	Employees	Market capitalisation (billion \$)
<i>BMW*</i>	1916	131,000	51
<i>Uber</i>	2009	16,000	76
<i>Marriott Hotels*</i>	1927	177,000	39
<i>Airbnb</i>	2008	10,000	38
<i>Disney*</i>	1923	199,000	163
<i>Facebook</i>	2004	35,000	473

(Source: adapted from <https://reports.weforum.org/digital-transformation/wp-content/blogs.dir/94/mp/files/pages/files/digital-platforms-and-ecosystems-february-2019.pdf>)



- 1 (a) Discuss if wage rates in a modern labour market are always determined by supply and demand.

(8)

In a free labour market the wage rate is the price of labour, set where the demand for labour equals the supply of labour. If demand for labour exceeds supply, wage rates rise.

Labour responds to the signal of higher reward and moves into that market, increasing supply until a new equilibrium wage is reached. The opposite happens when supply exceeds demand: in Extract A the people seeking work at the Penrith hiring were far in excess of those requiring labour, so wage rates were lower than at previous hirings, and labour leaves the market until equilibrium is restored at a lower wage.

Today, specialised or skilled occupations, such as software engineers, tend to be in short supply, so wages rise accordingly, while jobs needing few if any skills, such as fruit picking, have a large supply of labour and low wages.

However, modern labour markets are not free markets, and market imperfections influence wage rates. Trade unions can negotiate higher wages through the strength of their organisation, often backed by industrial action such as strikes. Some markets face a monopsony employer, such as the NHS or state education, which can drive wage rates below the competitive level. The National Minimum Wage also sets a legal floor above the equilibrium for low-paid jobs, and public sector pay is set by government pay review bodies.

Therefore wage rates are not always determined by supply and demand alone. Supply and demand set the underlying pressure, but the final wage depends on the bargaining power of unions and employers and on government intervention.



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(b) Assess how barriers to entry affect market structure.

(10)

Barriers to entry are anything that prevents or makes it difficult for a firm to enter a market and compete. They include high start-up costs, regulation and licences, patents, the use of technology, brand loyalty and the economies of scale enjoyed by existing firms.

The higher the barriers to entry, the less contestable the market is, so there are fewer firms present and competition may be low. Extract B shows that the car industry was the prime example: selling cars in volume requires massive industrial resources, a highly complex supply chain and a dealer network, so a start-up could not possibly enter, and the market became an oligopoly dominated by a few giants. Similarly, high street banks and supermarkets are oligopolies because the barriers are large in size and scope, so few firms are capable of entering. At the extreme, a monopoly has only one firm and very high barriers, often because it is a natural monopoly, such as a rail network, where duplicating the infrastructure would be wasteful.

Where barriers are very low, there tend to be many firms and much competition. It is relatively easy to open a snack bar, so there are many such firms in this imperfectly competitive market. Having no barriers at all is one of the requirements of perfect competition, but this is a theoretical model: in reality all markets have some barriers to entry that must be overcome. Firms protected by high barriers can earn supernormal profit in the long run, while low barriers mean new entrants compete profits away.

However, barriers to entry are not permanent or insurmountable. Extract B shows that Tesla broke into a previously non-contestable market because the growing importance of software and technology changed the nature of the industry. Changes in technology can circumvent the old barriers, reducing monopoly power and increasing competition. The strength of the supermarket oligopoly has also been diluted by the emergence of Aldi



and Lidl, and although it is an oligopoly there are still many small corner shops and convenience stores alongside the big four.

Furthermore, even if barriers are low, firms will not necessarily enter a market, as this depends on other factors such as the economic climate, the level of demand and expected profitability. Market structure is also shaped by mergers and takeovers and by competition policy.

In conclusion, barriers to entry are a key determinant of market structure, since the higher they are, the more concentrated the market is likely to be. However, the relationship is not fixed: technology, innovation and regulation can lower barriers over time, so market structure is dynamic rather than permanent.



- (c) Assess the benefits for a firm of adapting its marketing strategies for global markets.

(12)

Global marketing is the act of focusing a product on the needs of potential buyers in other countries. Global localisation, or glocalisation, is a marketing strategy that adapts a global product or service to suit differing tastes and preferences in different regions. Many successful multinationals do this. McDonald's adapts its menus to local tastes, for example selling no beef in India and offering the McAloo Tikki burger. Extract C shows that Dunkin' Donuts, with over 3,200 stores in 36 countries, has evolved its menu to satisfy local customers, selling dry pork and seaweed donuts in China, a Grapefruit Coolata in Korea, a Mango Chocolate Donut in Lebanon and a Mochi Waffle in Malaysia. If a firm takes local preferences into account, many potential sales can be gained because the product and its marketing are more likely to appeal to local tastes and cultures. This builds brand loyalty and encourages repeat purchases, which gives the business a competitive advantage over rivals that have not adapted. Higher sales increase revenue and market share, helping the firm strengthen its international presence. Thinking local gives Dunkin' Donuts the best of both worlds: the power and protection of a global brand, together with the targeting of local tastes to maximise sales. Although it costs more to research and adapt to local tastes, the potential gains from increased sales may outweigh these extra costs.

However, the reverse may also be true. Not having to adapt to local differences saves time and money on market research and on adapting products to the demands of individual markets. Standardised products mean that economies of scale are more likely, such as bulk buying and long production runs. This gives a cost advantage, leading either to lower prices and a competitive advantage, or to an increase in profitability.

Extract C shows that Red Bull is confident in its approach and does not see the need to adapt to local tastes: it sells over 7.5 billion cans a year with distinctive packaging



recognised globally and one universal slogan, "Red Bull gives you wings". Its universal strategy, such as hosting extreme sports events from America to Jordan, has been very successful, with the same product selling in every country.

Some products and services are universal, so little or no adaptation to social and cultural differences is needed, for example Sony, Apple and Ferrari. Global brands may also risk diluting their identity if they adapt too much.

In conclusion, the benefits of adapting marketing strategies depend largely on the product. Food products such as donuts and burgers, where tastes are strongly shaped by culture, are more likely to benefit from adaptation, whereas technological products or strong lifestyle brands like Red Bull gain more from a standardised approach and economies of scale. The best strategy is often a mix: a consistent global brand with local adaptation only where it clearly increases sales by more than it adds to costs.



(d) Evaluate the impact of the digital economy on markets and firms.

(20)

The digital economy refers to economic activity based on digital technologies, such as the internet, digital platforms, apps and online transactions. It has made information and communication much easier for both consumers and firms, and has transformed many markets in terms of their structure and the way in which they operate. Extract D states that it has been a powerful force bringing about increased competition across a wide range of products and services.

For consumers, the digital economy gives access to a much wider range of goods and services with greater information, which has increased consumer power and reduced asymmetric information. Price comparison sites mean that many firms have had to become more price competitive and focus more on non-price factors such as quality and customer service. Markets have become more competitive and contestable, pushing prices closer to costs and improving allocative efficiency.

For firms, digital platforms have created huge opportunities. Businesses such as Amazon and eBay have thrived by offering a wide range of products to a national and global audience through a digital platform. Niche products have been able to expand their customer base by using these platforms to reach faraway customers, and supermarkets now offer online shopping and home delivery. Many firms have also reduced costs and increased efficiency by using B2B digital platforms. Extract D notes that Uber and Lyft have revolutionised the taxi business model, and Booking.com and OpenTable have changed the way we plan holidays and evenings out.

Extract E shows how valuable these new firms have become with far fewer resources. In 2018 Uber, started in 2009, had a market capitalisation of \$76bn with only 16,000 employees, compared with BMW's \$51bn with 131,000 employees. Facebook was worth \$473bn with 35,000 employees, almost three times Disney's \$163bn with 199,000



employees, and Airbnb, at \$38bn with 10,000 staff, was worth almost as much as Marriott Hotels (\$39bn) with 177,000 staff. Digital firms therefore achieve enormous scale and productivity because platforms have low marginal costs and benefit from network effects.

These activities have created structural changes in markets and labour markets.

Employment has moved from traditional workplaces to newer digital-based businesses, as Extract E shows. The rise of home shopping has created a large increase in demand for delivery drivers and vehicles, and new skills are needed, which changes labour markets and the courses offered by education providers.

However, while this process of creative destruction has brought many benefits, there has been a negative impact on many traditional firms. Extract D notes concerns from traditional media and retail businesses. Many high street shops and chains have closed as they cannot compete with the prices and range offered by digital competitors, which harms town centres and causes structural unemployment among workers whose skills are no longer needed. Print-based media is under threat from digital news and social media such as Twitter and Facebook (Meta), and cinemas and television face falling consumption because of streaming services such as Netflix and Sky.

Moreover, network effects allow a few platforms to become dominant. Extract D notes that businesses reliant on digital platforms for access to markets are worried about the power these platforms now wield. Small businesses have complained about the excessive power of platforms they depend on, such as fees charged by Amazon or app stores, and Amazon has been accused of using its power to exploit workers in terms of wages and conditions. The 'free' services enjoyed by consumers are often paid for with personal data, raising privacy concerns. So the digital economy may first increase competition but later reduce it, as markets such as search and social media become dominated by Google and Facebook, requiring new regulation.

The impact also varies between markets and stakeholders. Consumers, digital platforms and flexible small firms are clear winners, while traditional retailers, print media and some workers in the gig economy, who lack job security, are losers. The size of the impact depends on how quickly traditional firms adapt: many retailers have successfully moved online, adopting a multi-channel approach.

In conclusion, the digital economy has had a profound and largely positive impact on markets, increasing choice, information and competition and allowing highly productive firms to grow rapidly. However, all change creates winners and losers. Creative destruction is an apt term for this process, and markets and firms have always changed and evolved, whether the cause was the industrial revolution or the digital revolution.

The key long-run issue is whether competition authorities can prevent dominant platforms abusing their market power, as this will determine whether the benefits to consumers are sustained.

(Total for Question 1 = 50 marks)

TOTAL FOR SECTION A = 50 MARKS



SECTION B

Read the following extracts (F–I) before answering Question 2.

Write your answers in the spaces provided.

Extract F***Indian Oil Corporation (IOC) enters niche segment with Bikers Cafe***

As competition in fuel retailing grows, the *IOC* has launched a unique Bikers Cafe to cater to the needs of motorcycle expeditions to the Himalayas.

IOC has turned one of its most popular petrol stations at Shogi just outside Shimla, India, into a bikers' cafe. Apart from fuel, it offers a resting area, a parking area for motorcycles, clean toilets with hot water, seating areas, a cafeteria with heater, a shop and Wi-Fi.

5

The venture has increased total revenue and petrol sales are up by 17.22%. Similar projects are planned at other strategically located petrol stations on the popular Chandigarh-Manali route to the mountains.

(Source: adapted from https://www.business-standard.com/article/companies/ioc-enters-niche-segment-with-bikers-cafe-to-meet-needs-of-expedition-rides-122071700219_1.html)

Extract G**Commission opens in-depth investigation in Slovenia**

The European Commission has opened an in-depth investigation to assess the proposed takeover of *OMV Slovenija* by the *Hungarian Oil and Gas plc (MOL)* under the EU Merger Regulation. The Commission is concerned that the proposed transaction may reduce competition in the retail motor fuel markets in Slovenia.

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OMV Slovenija and *MOL* are, respectively, the second and third largest fuel suppliers in Slovenia after *Petrol*, the partially state-owned company.

OMV Slovenija has a network of 119 fuel stations and in addition, supplies bitumen and heating oil. *MOL* has a network of over 2,000 fuel stations in nine countries in Europe with 53 in Slovenia.

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(Source: adapted from https://ec.europa.eu/commission/presscorner/detail/en/ip_22_3974)

Extract H**Energy crisis: why French households are largely protected from soaring costs but British families struggle**

In 2022, British households are bracing for a winter of massive energy price increases. The average annual bill is forecast to rise above £4 000, which is more than three times what they were paying just 12 months ago.

5

French households, meanwhile, will barely see their prices increase. The French Government has limited the increase of the regulated price of electricity to 4% per year.

The difference between the two countries, both with interconnected electricity grids, is huge. By reflecting the actual market price of electricity generation, Great Britain's model forces consumers to reduce consumption and encourages investment in production.

10

In contrast, the French approach uses subsidies by the government and the monopoly state-owned producer EDF, which costs taxpayers billions and postpones big decisions on energy efficiency and investment in future production.

(Source: adapted from <https://theconversation.com/energy-crisis-why-french-households-are-largely-protected-from-soaring-costs-while-british-families-struggle-188417>)

Extract I**Emissions reduction: Address market failure**

Economic growth and energy consumption are inextricably linked. The Indian Government has set an annual economic growth rate of 8.5% between 2012 to 2047. Achieving this estimated growth rate in a sustainable fashion requires a big reduction in carbon emissions, while keeping efficiency, equity and fairness in its policies.

5

There is a consensus that the climate crisis is a feature of market failure. The economic activities by consumers (such as driving or air-conditioning) and producers (such as electricity generation and manufacturing) cause emissions, leading to pollution and global warming.

These are negative externalities not accounted for in the private costs, leading to outcomes that are not efficient. As a result, actual costs to the consumers, producers, and society are not reflected in the market interactions leading to an uncontrolled rise in emissions.

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The solution to the problem of market failure calls for government intervention.

The 2006 Stern Review on the Economics of Climate Change argues that taxation, trading of emissions permits, regulations, technology adoption, and energy-efficiency measures can be critical for emissions reduction.

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(Source: adapted from <https://www.hindustantimes.com/opinion/emissions-reduction-address-market-failure-101650377796014.html>)



2 (a) Discuss the benefits for a firm of operating in a niche market.

(8)

A niche market is a smaller segment of a larger market with special characteristics, such as specialised products or services. Firms in niche markets can often command premium prices because demand is relatively price inelastic (low PED).

Competition in niche markets is usually low, as brand loyalty and product differentiation reduce direct competition. Targeting very specific tastes, such as motorcycle travellers on expeditions to the Himalayas in Extract F, is more likely to gain customer satisfaction and loyalty and give the firm a competitive advantage over other fuel retailers. Closer relationships with customers are possible, so products and services can be more precisely targeted. IOC's Bikers Cafe offers a resting area, motorcycle parking, hot water, a heated cafeteria and Wi-Fi, which has increased total revenue and raised petrol sales by 17.22%. This differentiates IOC as competition in fuel retailing grows.

However, businesses in niche markets can rely too much on one product or customer group, which can be adversely affected by changes in tastes. For example, the Himalayas may lose their appeal as a destination if they become too popular, or bikers' numbers may fall in a recession. Barriers to entry are low, so other petrol stations may copy the idea once they see its success, reducing IOC's advantage. Over time, niche markets can expand into mass markets, and the firm loses the benefits of being a niche producer. Small scale also limits economies of scale.

Overall, a niche strategy brings clear benefits, as IOC's 17.22% rise in petrol sales shows, but these may only last in the short run unless the firm keeps innovating, as it plans to do along the Chandigarh-Manali route.

- (b) Assess the likely impact of the proposed takeover of OMV Slovenija by MOL on the market for fuel in Slovenia.

(10)

A takeover occurs when one firm gains control of another by buying a majority of its shares. This is a horizontal integration, as OMV Slovenija and MOL are at the same stage of production in the retail motor fuel market. Extract G shows they are the second and third largest fuel suppliers in Slovenia, after Petrol, so the merged firm would have $119 + 53 = 172$ fuel stations, making the market more concentrated and closer to a duopoly.

The European Commission is concerned that the takeover will reduce competition in the market for fuel. Once MOL and OMV no longer need to compete with each other, fuel prices may rise. This would reduce motorists' remaining disposable income, and because fuel demand is price inelastic, consumers have little choice but to pay. Higher fuel prices would also raise costs for firms such as hauliers, which may be passed on in higher prices elsewhere in the economy.

Some petrol stations may close as the enlarged company cuts costs by getting rid of surplus outlets where OMV and MOL stations are close together. This has implications for staff, who may lose their jobs, and for customer choice and convenience. As competition falls there is also less need to innovate or provide good quality products and services. The market power of the new larger firm would act as a barrier to entry, discouraging new entrants that might have increased competition.

However, MOL, with over 2,000 fuel stations in nine countries, may be able to take advantage of economies of scale, such as bulk buying fuel and lower distribution costs, reducing average costs. This may stabilise or even reduce pump prices and benefit the consumer. If MOL closes surplus outlets, this may also benefit consumers if the savings are passed on in lower prices. With increased market power, MOL may be able to compete more effectively with Petrol, the largest and partially state-owned supplier, so



the market could become more balanced, with two strong rivals rather than one dominant firm.

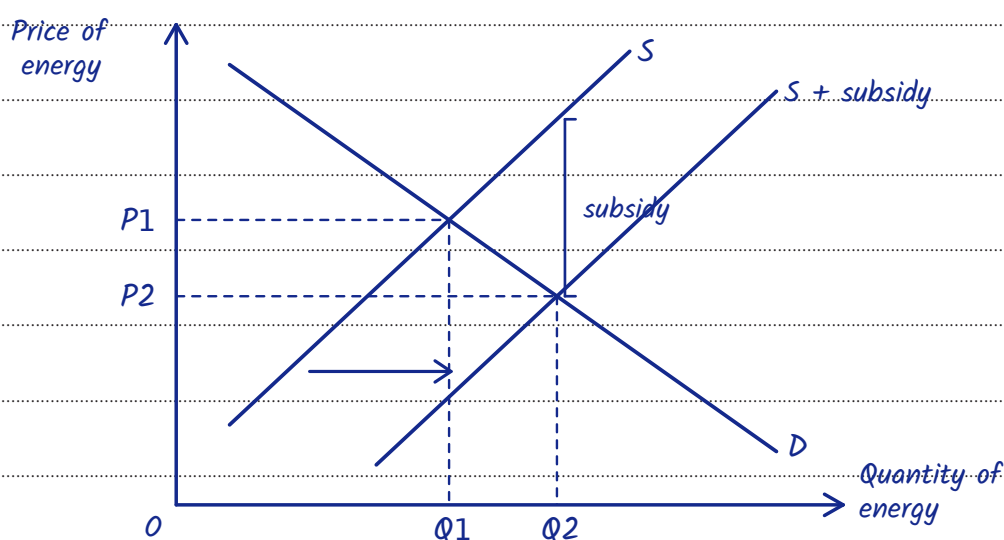
The overall impact will depend on whether the Commission allows the takeover and what restrictions it imposes. For example, it might force MOL to sell some of its fuel stations to a smaller rival to maintain competition. It also depends on whether cost savings are passed on to consumers or kept as higher profits. Since Petrol and the merged firm would control most of the market, there is a real risk of tacit collusion, so on balance consumers are likely to lose unless strict conditions are applied.



(c) Using a suitable diagram, assess the benefits of a subsidy in a market such as the French energy market.

(12)

A subsidy is a payment from the government to producers to reduce their costs of production, as with the French Government and the state-owned producer EDF in Extract H.



As shown in my diagram, a subsidy shifts the supply curve down and to the right by the amount of the subsidy, from S to $S + \text{subsidy}$. This creates a new lower equilibrium price at P_2 and an increase in quantity consumed from Q_1 to Q_2 . The size of the increase depends on PED: energy demand is price inelastic, so the subsidy mainly lowers the price rather than raising quantity, which is exactly what helps households.

For consumers, a subsidy maintains or even increases, depending on its size, their remaining disposable income. Extract H shows that British households face an average annual bill forecast above £4,000, more than three times the level 12 months earlier, while French households will barely see prices rise because the regulated electricity price increase is limited to 4% a year. In the French energy market this ensures consumers do not suffer from fuel poverty or a fall in real income, which protects living standards, especially for low-income households that spend a larger share of income on energy. Lower energy prices also keep inflation lower and reduce firms' costs, protecting jobs and

competitiveness.

However, the subsidy has to be paid for. If it is funded from taxation, there is a trade-off with other areas of government spending such as health or education, and Extract H states that it costs taxpayers billions. If it is funded by extra government borrowing, it increases national debt, incurs interest payments and ultimately requires repayment at a later stage.

Extract H also suggests that the subsidy postpones big decisions on energy efficiency and investment in future production. In Great Britain, prices reflect the actual market cost of generation, which forces consumers to reduce consumption and encourages investment in production, whereas the French price signal is distorted. If consumers are not paying the true cost of energy, more will be consumed, which may increase negative externalities such as carbon emissions from fossil fuel generation. The subsidy also benefits all households, including rich ones, so it is poorly targeted compared with direct payments to the poorest.

Overall, the benefits of a subsidy depend on the size of the subsidy needed and the length of time it is in place. As a short-term response to a sudden energy price shock it can protect consumers and the economy, but if it lasts for years the cost to taxpayers and the lack of investment in efficiency may outweigh the benefits.



- (d) Evaluate government policies that can be used to deal with market failure in an economy caused by emissions.

(20)

Market failure occurs when the free market leads to a misallocation of resources. Extract 1 explains that emissions from consumers, such as driving or air-conditioning, and producers, such as electricity generation and manufacturing, are negative externalities not accounted for in private costs. Because marginal social cost exceeds marginal private cost, the good is overproduced and overconsumed and the price is too low, leading to an uncontrolled rise in emissions. Governments have a choice of policy options, and the Stern Review lists taxation, emissions trading, regulation, technology adoption and energy efficiency.

Firstly, tradable pollution permits can be issued which limit the total amount of emissions allowed and give individual firms a right to pollute up to a set level, as in the EU Emissions Trading System. More efficient producers can sell their excess permits, increasing profitability, which is an incentive for firms to become cleaner. The cap gives certainty about the total quantity of emissions and can be reduced over time. However, setting the right level of permits is difficult, as is policing their use: if too many are issued, the price falls and firms have little incentive to change, as happened in the early years of the EU scheme.

Secondly, indirect taxes placed on fuel and energy increase their price and reduce consumption. Ideally the tax equals the external cost, internalising the externality so that the polluter pays and output falls to the socially optimal level. Vehicles that pollute carry a higher tax to discourage their purchase, and the revenue can be used to subsidise research into more efficient methods of transport. Tax can also be reduced or abolished on greener forms of transport, such as electric vehicles. However, taxation can be unpopular and regressive. People in rural areas may have little choice but to continue using cars and fuel if no public transport is available, and because demand for fuel is



price inelastic, consumption may fall only a little. It is also hard to measure the external cost accurately.

Thirdly, regulation and legislation can set more efficient standards. Exhaust emission standards have become much stricter in recent years, and in the UK the sale of new petrol and diesel cars will be banned by 2030. New houses have to conform to standards of thermal efficiency. Regulation is simple to understand and gives a direct limit on harmful behaviour. However, it can cause protests from individuals and interest groups, it adds to the cost of producing regulation-compliant products, which may be passed on in higher prices, and it requires monitoring and enforcement.

Fourthly, government information campaigns can promote public understanding of the problems caused by market failure and the need to accept policy solutions. Awareness of climate change is much greater now than a decade ago, so consumers increasingly choose greener products. However, it takes time to change people's minds and habits, and information alone may not change behaviour.

Finally, governments can actively promote greener technologies such as wind and solar power, through subsidies and funding for research and development into alternative technologies for future benefit. This addresses the problem at its source and can create new industries and jobs. However, this is long term and requires funding which has an opportunity cost, as the money could have been spent on health or education.

The choice of policy also depends on the economy. Extract 1 shows that India aims for annual growth of 8.5% between 2012 and 2047, and since economic growth and energy consumption are inextricably linked, very high carbon taxes could slow growth and hit the poor, conflicting with the aim of efficiency, equity and fairness. A developing economy may therefore prefer subsidies for renewable energy and efficiency standards, while richer economies can afford higher carbon prices. There is also the risk of government failure, as policies may have unintended consequences, and emissions are a

global problem, so if one country acts alone, production may simply relocate to countries with weaker rules.

In conclusion, there is no one solution, as all government policies have both advantages and drawbacks. Market-based policies such as permits and taxes are usually the most efficient because they use the price mechanism, but they work best when combined with regulation, information and investment in green technology. The policies used will depend on the needs of a particular economy, its resources, its political persuasion and public opinion, and effectiveness is greatest when countries cooperate internationally.

(Total for Question 2 = 50 marks)

TOTAL FOR SECTION B = 50 MARKS
TOTAL FOR PAPER = 100 MARKS



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Morning (Time: 2 hours)

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Economics B

Advanced

PAPER 3: The economic environment and business

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Investigating the Economic Environment and Business

Context

This year the context is **markets** or **the market** at the local, regional, national and global level.

Research

To prepare for this year's context, you should research:

- market forces and the different types and characteristics of markets
- how individuals and firms respond to changing market conditions
- market structure and the impact on economic agents
- market power and market regulation
- market failure and market intervention.

You **cannot** take any of your research or investigation data carried out as part of the pre-release into the examination.

