Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

Centre Number | Candidate Number

Pearson Edexcel International Advanced Level

Time 2 hours

Paper reference **WEC13/01**

Economics

International Advanced Level
Unit 3: Business behaviour

You must have:
Source Booklet (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 in Section A and Section B.
- Answer **TWO** questions in Section C.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- 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.
- Check your answers if you have time at the end.

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SECTION A

Answer ALL questions in this section.

Questions must be answered with a cross in a box ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

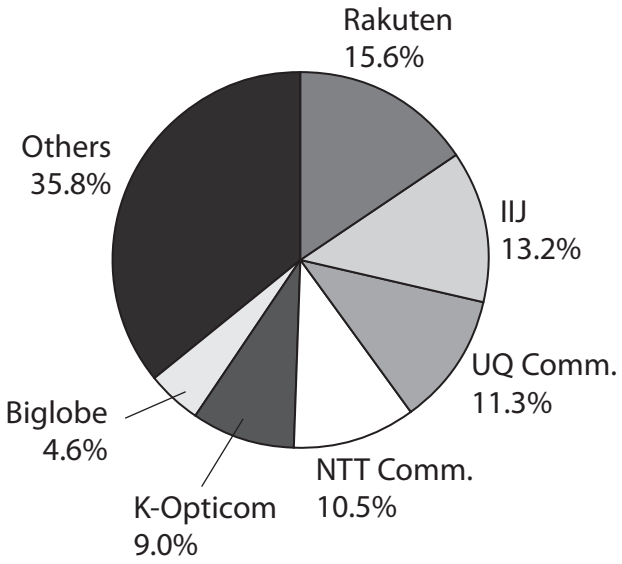
1 In December 2020 Electronic Arts, an American video game producer, agreed to take over Codemasters, the producer of Formula One racing video games.

Which **one** of the following is likely to be a benefit of this takeover for Electronic Arts?

- ☐ **A** An increase in contestability in the video games market
- ☐ **B** A decrease in total costs of production
- ☐ **C** An increase in competition in the video games market
- ☒ **D** A decrease in long-run average costs

(Total for Question 1 = 1 mark)

2 The chart shows the market share for mobile virtual network operators (MVNOs) in Japan for 2019.



What was the five firm concentration ratio for MVNOs in Japan for 2019?

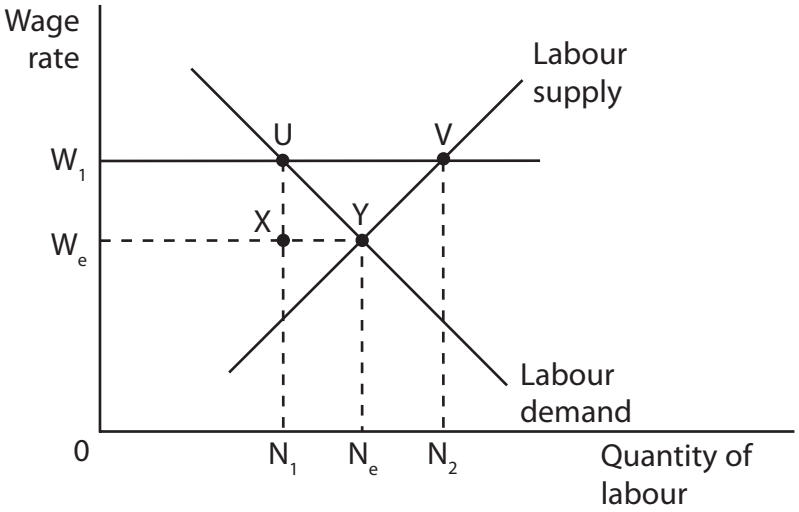
- ☐ **A** 48.6%
- ☐ **B** 50.6%
- ☒ **C** 59.6%
- ☐ **D** 86.4%

(Total for Question 2 = 1 mark)

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3 The diagram shows the effect of the introduction of a national minimum wage on the labour market for agricultural workers in South Africa.



Which **one** of the following is the most likely impact of the introduction of the national minimum wage?

- ☒ **A** There will be N_1 to N_2 more agricultural workers employed
- ☒ **B** There will be an extension of demand for agricultural workers from Y to U
- ☒ **C** There will be a contraction of supply of agricultural workers from Y to V
- ☒ **D** There will be N_1N_2 unemployed agricultural workers

(Total for Question 3 = 1 mark)

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4 The table shows the total costs of producing sports footwear by a firm in the USA.

Units of output	Total Cost ($)
0	12
1	16
2	19
3	22
4	27
5	33
6	40
7	48

Between which of the following outputs do diminishing returns start to set in?

- ☒ **A** 1–2 units
- ☒ **B** 3–4 units
- ☒ **C** 5–6 units
- ☒ **D** 6–7 units

(Total for Question 4 = 1 mark)

5 India's net migration was –2.7 million in 2017. This caused a decrease in the supply of labour.

Which other factor would also cause a decrease in India's supply of labour?

- ☒ **A** An increase in the level of welfare benefits
- ☒ **B** A decrease in the productivity of labour
- ☒ **C** An increase in the size of the population
- ☒ **D** A decrease in the price of capital

(Total for Question 5 = 1 mark)

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6 Which **one** of the following combinations best describes a profit-maximising firm operating in a monopolistically competitive market in the long-run?

		Efficiency	Profit
☒	**A**	Productively inefficient	Normal profit
☒	**B**	Productively efficient	Supernormal profit
☒	**C**	Allocatively inefficient	Supernormal profit
☒	**D**	Allocatively efficient	Normal profit

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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SECTION B

Study Figures 1 and 2 and Extracts A and B in the Source Booklet before answering Question 7.

Write your answers in the space provided on the following pages.

7 (a) With reference to Figure 1, calculate the percentage change in the average world price of coffee beans from 1 July 2017 to 1 May 2019. You are advised to show your working.

(2)

(b) With reference to Extract A (line 12), explain what is meant by 'short-run shutdown point.'

(4)

(c) With reference to Figure 2 and Extract A, analyse **two** possible reasons for the increase in supply of coffee beans between 2015 and 2019.

(6)

(d) With reference to Extract B, examine **two** barriers to entry into the US coffee shop market.

(8)

(e) With reference to the information provided, discuss the reasons for the increase in Starbucks' profits in 2019.

For **one** of these reasons, illustrate your answer with an appropriate cost and revenue diagram.

(14)

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7 (a) With reference to Figure 1, calculate the percentage change in the average world price of coffee beans from 1 July 2017 to 1 May 2019.

You are advised to show your working.

(2)

1 July 2017 price = $2.31 per kg, 1 May 2019 price = $1.57 per kg

% change = (1.57 − 2.31) ÷ 2.31 × 100

= −0.74 ÷ 2.31 × 100

= −32.03% (a fall of 32.03%)

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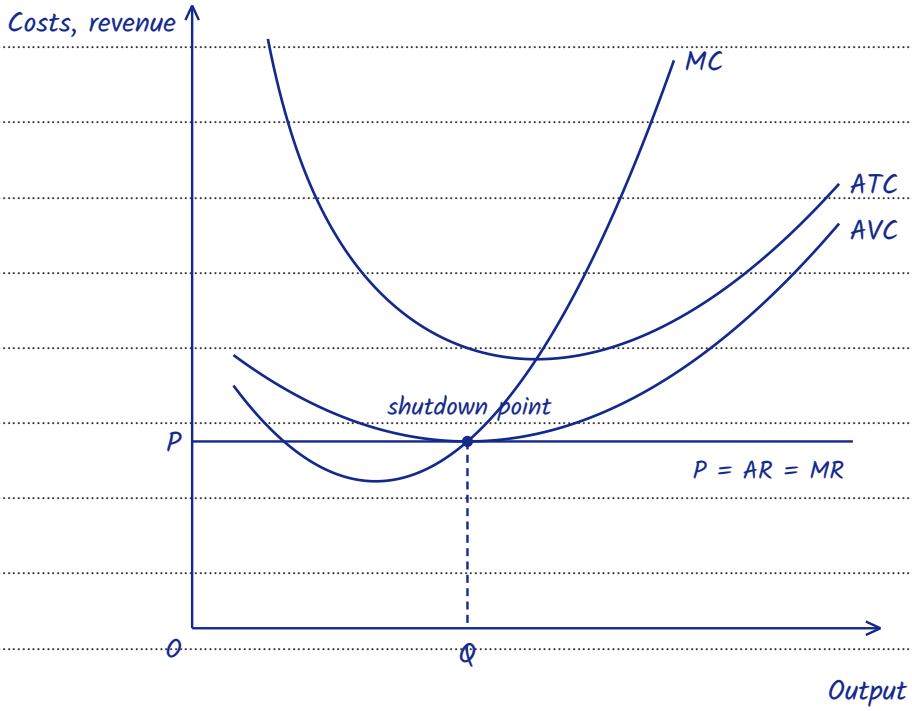
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(b) With reference to Extract A (line 12), explain what is meant by 'short-run shutdown point.'

(4)

The short-run shutdown point is the level of price (average revenue) at which a firm is just covering its average variable cost, so AR = AVC, at the lowest point of the AVC curve. In the short run at least one factor of production is fixed (eg land and machinery), so fixed costs must be paid even if output is zero. If price falls below AVC, the firm cannot even cover variable costs such as wages of farm workers, fertiliser and fuel, so every unit produced adds to its losses and it minimises losses by shutting down.



In Extract A, supply of coffee beans was greater than demand, causing a surplus of over 4 million bags, and by May 2019 the price fell to its lowest level in over 10 years. Small coffee growers in Central America and Africa made large losses, and many reached the point where the price no longer covered their AVC, so they stopped producing or switched to lower-risk crops.

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(c) With reference to Figure 2 and Extract A, analyse **two** possible reasons for the increase in supply of coffee beans between 2015 and 2019.

(6)

Supply is the quantity of a good that producers are willing and able to sell at a given price in a given time period. Figure 2 shows world coffee production rose from 150 million bags in 2015 to 171 million bags in 2019, an increase of 14%, with an 8% rise in 2019 alone (158 to 171 million bags), causing a surplus of over 4 million bags. The supply curve shifted to the right.

Reason 1: developments in farming equipment and improved methods of production. Better technology, such as modern harvesting machines, irrigation and better crop varieties, raises the productivity of land and labour, so each farm produces more coffee from the same inputs. This lowers the average and marginal cost of each bag, so farmers are willing to supply more at every price, shifting supply to the right.

Reason 2: favourable weather conditions in major coffee-producing countries such as Brazil. Coffee is an agricultural product, so good rainfall and temperatures, with no frost or drought, mean more coffee cherries grow and ripen and crop yields per hectare rise. As Brazil is the largest producer in the world, a bigger harvest there significantly increases the global quantity supplied at each price, so world supply increases.

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(d) With reference to Extract B, examine **two** barriers to entry into the US coffee shop market.

(8)

Barriers to entry are obstacles that make it difficult or impossible for new firms to enter a market and compete with existing firms. The US coffee shop market is dominated by a few large, well-known chains such as Starbucks, Tim Hortons, Dunkin' Donuts, Dutch Bros Coffee and Peet's Coffee, so it is likely to be an oligopoly.

Barrier 1: brand loyalty to well-known firms. Extract B states that it is difficult for a new firm to enter because there are already a number of well-known firms. These chains use loyalty schemes, mobile phone apps and online ordering systems to increase brand loyalty. Starbucks alone has over 27 000 stores worldwide. Because consumers are loyal and the brands are trusted, demand for a new coffee shop would be low and price elastic, so a new entrant would struggle to attract enough customers to cover its costs and make a profit.

Barrier 2: high costs of non-price competition. The existing firms compete using special offers, large advertising budgets and heavy investment in apps and social media advertising, which industry leaders believe is the most effective form of marketing. A new firm would have to match this spending to be noticed. These are sunk costs that cannot be recovered if the firm fails, and as a small firm it would have higher average costs because it cannot spread them over many stores, as the established chains gain economies of scale. This raises the risk of entry and deters new firms.

However, the barriers may not be very high. Extract B shows there are still a large number of successful, small independent coffee shops in the USA. They do not need to operate at the same scale as the big chains because they differentiate their product with alternative drinks and food and locate in out-of-town-centres, where rents are lower, to attract a different type of

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consumer. Also, social media marketing on sites such as Instagram can be almost free, so advertising costs need not be a large barrier. So barriers are high for a firm trying to compete directly with Starbucks, but low for a niche independent coffee shop.

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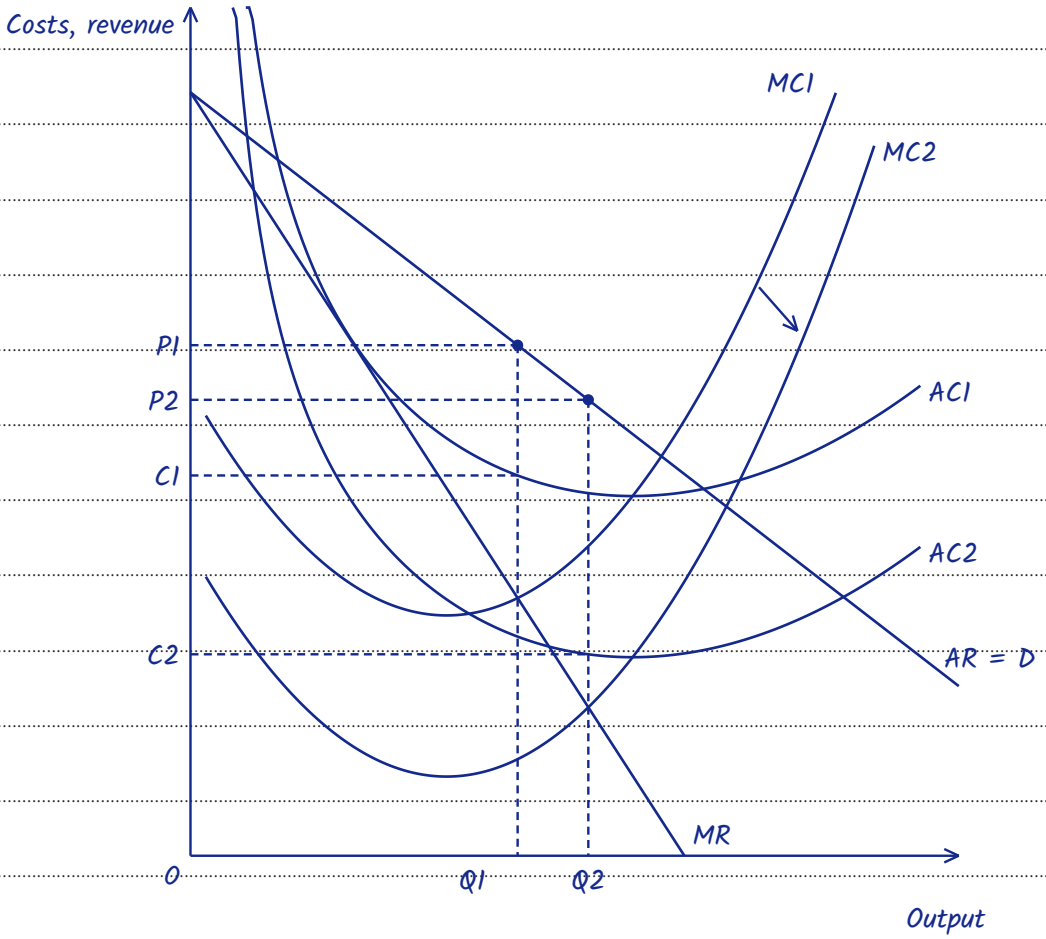
(e) With reference to the information provided, discuss the reasons for the increase in Starbucks' profits in 2019.

For **one** of these reasons, illustrate your answer with an appropriate cost and revenue diagram.

(14)

Profit is total revenue minus total cost. Extract B states that in 2019 Starbucks' revenue increased by 7.24% and its profits rose by 7.11% to $17.98 billion. Profit can rise because revenue increases, because costs fall, or both.

Reason 1: a fall in costs. Figure 1 shows the world price of coffee beans fell from $2.31 per kg in July 2017 to $1.57 per kg in May 2019, a fall of 32%, because of the global surplus. Coffee beans are Starbucks' main raw material, so lower bean prices reduce its variable costs. The diagram shows the marginal cost and average cost curves shifting down from MC1 and AC1 to MC2 and AC2.



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Starbucks has price-setting power, so it maximises profit where MC = MR. Before the fall in bean prices it produces Q1 at price P1 with supernormal profit (P1 – C1) × Q1. When costs fall to MC2 and AC2, the new profit-maximising output, where MC2 = MR, rises to Q2 and price falls slightly to P2. Average cost falls by more than price, so supernormal profit rises to (P2 – C2) × Q2.

Reason 2: an increase in demand. Coffee is the second most popular drink in the world, two billion cups are drunk every day, and global demand rose by 2% in 2019. Starbucks opened many new shops in China, a large and fast-growing market, and attracted younger drinkers with higher quality beans and cold coffee drinks. Its apps, online ordering and loyalty schemes also increase brand loyalty. This shifts AR and MR to the right, so Starbucks can sell more cups at a higher price, which is why revenue rose by 7.24%. With prices rising faster than average cost, profit per unit and total profit increase.

However, the size of the effect of cheaper beans depends on how significant they are as a proportion of total costs. A 32% fall in price is very large, but for a coffee shop chain, rent for 27 000 stores, wages and marketing are far bigger costs than the beans in each cup, so the fall in AC may be small. Also, Starbucks buys higher quality beans, often on long-term contracts at fixed prices, so it may not benefit from the lower world price straight away.

The data also suggests that costs did not fall overall. Revenue rose by 7.24% but profit rose by only 7.11%, so total costs must have risen slightly faster than revenue. Other costs, such as heavy spending on advertising, mobile apps and opening new stores in China, offset the lower bean price. This suggests the rise in demand, not falling costs, was the main reason for higher profits.

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Finally, the rise in profit may be short term. Coffee bean prices fluctuate, and as small farmers reach their shutdown point and switch to other crops, supply will fall and bean prices will rise again, increasing costs. Strong competition from Tim Hortons, Dunkin' Donuts and independent coffee shops, and supernormal profit attracting new entrants, may also reduce Starbucks' market share and revenue in the long run.

Overall, higher demand, especially from expansion in China and new products for younger consumers, is likely to be the most important reason for the rise in profits, while the 32% fall in bean prices helped but was limited because beans are a small share of total costs.

(Total for Question 7 = 34 marks)

TOTAL FOR SECTION B = 34 MARKS

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SECTION C

Answer TWO questions from this section.

8 Visinema, an Indonesian company that produces TV shows and feature films, is expanding into neighbouring countries. The company is also planning to acquire several Indonesian animation studios.

For an industry of your choice, evaluate why many businesses have growth as their main objective.

Illustrate your answer with an appropriate diagram(s).

(Total for Question 8 = 20 marks)

9 In July 2020 the mobile phone company, MTN Ghana, had a 70% market share in Ghana. The competition authorities in Ghana stated that this was preventing new firms from entering the market and was having a negative effect on the quality of service.

For an industry of your choice, to what extent is a monopoly market structure *inefficient*?

Illustrate your answer with an appropriate diagram(s).

(Total for Question 9 = 20 marks)

10 In February 2020 the Indian Government announced plans for university degrees to be fully accessed online. This was to make higher education more accessible and to increase the skills of India's young people. Previously only 20% of a degree could be studied online.

Evaluate measures to reduce the occupational and geographical immobility of labour.

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Write the answer to your FIRST chosen question here.

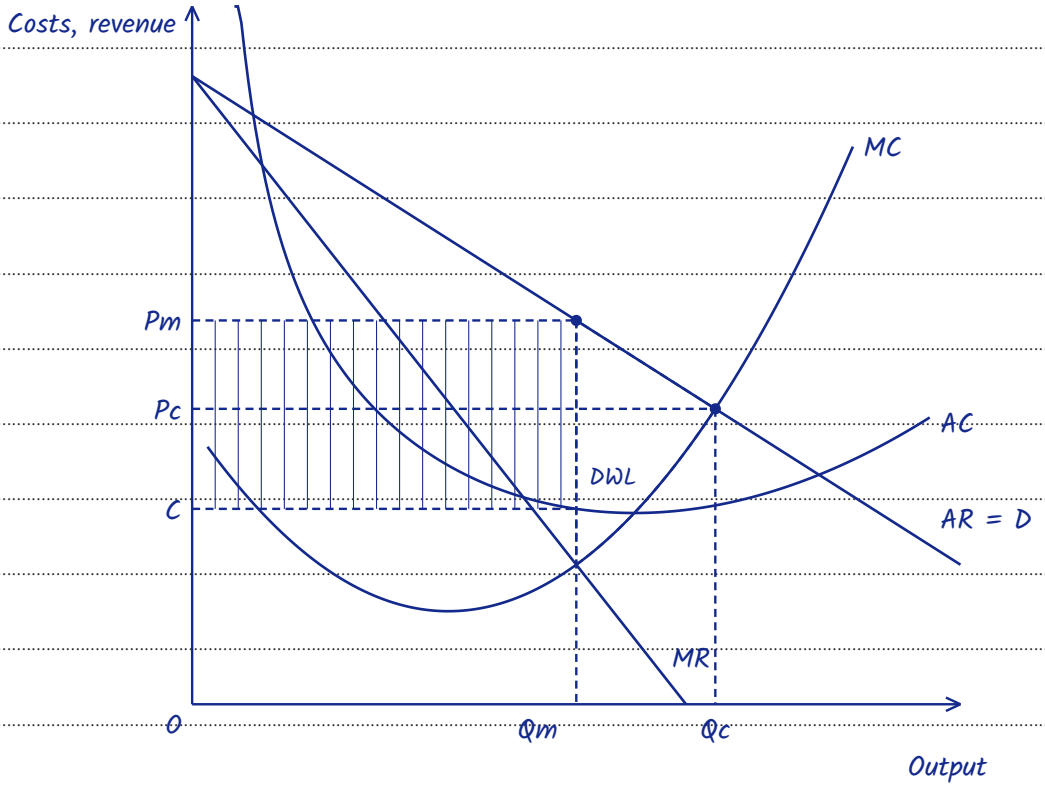
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Write the answer to your SECOND chosen question on page 22.

Chosen question number: **Question 8** ☐ **Question 9** ☒ **Question 10** ☐

A monopoly is a market structure with a single dominant seller; legally a firm with over 25% market share has monopoly power. A monopolist faces the whole market demand curve, so it is a price maker, and high barriers to entry let it keep supernormal profit in the long run. I will use the mobile phone industry in Ghana, where MTN Ghana had a 70% market share in July 2020.

Efficiency can be measured in several ways. Allocative efficiency is where price equals marginal cost (P = MC), so resources produce what consumers value most. Productive efficiency is where a firm produces at the lowest point of its average cost curve. X-efficiency means the firm is producing on its lowest possible average cost curve, with no wasted resources, and dynamic efficiency is achieved when firms invest in innovation that lowers costs and improves products over time.



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The diagram shows a profit-maximising monopolist producing where MC = MR, at output Qm and price Pm. The shaded area (Pm – C) × Qm is supernormal profit. Price Pm is well above marginal cost, so the monopoly is allocatively inefficient: consumers value extra units more than they cost to make, but output is restricted. The allocatively efficient output is Qc, where P = MC, at the lower price Pc. The triangle between Qm and Qc is the deadweight welfare loss, as consumer surplus is lost and part of it is transferred to the firm as producer surplus. Qm is also to the left of the lowest point of the AC curve, so the monopoly is productively inefficient.

With 70% of the market, MTN Ghana can charge higher prices for calls and data than in a competitive market. The competition authorities stated it was preventing new firms from entering and harming quality of service. Without the threat of losing customers, a monopolist has little incentive to control costs, so it may become X-inefficient: managers may overstaff, pay high salaries or fail to maintain networks, so its AC curve is higher than necessary. Because demand is price inelastic, it can simply pass the higher costs on to consumers through higher prices. It may also cut quality, such as dropped calls and slow data, to save costs, knowing customers have few alternatives, which reduces consumer welfare.

However, a monopoly is not always inefficient. First, large firms can gain economies of scale. A mobile network has very high fixed costs for masts, spectrum licences and fibre. Spread over millions of customers, average costs are lower than if several small firms each built their own network. If this is a natural monopoly, one firm is more productively efficient than many, and lower costs may even give consumers lower prices than in a competitive market.

Second, monopolies can be dynamically efficient. Supernormal profit gives MTN Ghana the funds to invest in research, 4G and 5G networks and new services such as mobile money, which

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benefit consumers in the long run. Small competitive firms making normal profit may not afford this. The monopolist can also cross-subsidise loss-making services, such as coverage in rural areas, using profits from busy urban areas, which increases choice.

Third, the degree of inefficiency depends on contestability. If barriers to entry are low, a monopolist may set a low price, close to average cost, to deter new entrants, earning near normal profit, so price is closer to marginal cost and allocative efficiency. In Ghana, however, the authorities believe MTN is blocking entry, so the market does not seem very contestable.

Finally, regulation can reduce inefficiency. The competition authorities can impose price caps such as RPI – X, quality of service targets with fines, or rules forcing MTN to share its network with rivals, which lowers barriers to entry. But regulation has its own problems, such as regulatory capture and lack of information about MTN's true costs, so it may not fully succeed.

In conclusion, a monopoly is likely to be allocatively and productively inefficient, and the lack of competition makes X-inefficiency likely, as the falling quality of service in Ghana suggests. However, the extent depends on whether economies of scale and investment in innovation outweigh these losses, how contestable the market is and how well it is regulated. In mobile telecoms, where fixed costs are very high, some market power can be efficient, but a 70% share protected by barriers to entry is likely to be inefficient overall unless it is effectively regulated.

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Write the answer to your SECOND chosen question here.

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

Chosen question number: **Question 8** ☐ **Question 9** ☐ **Question 10** ☒

Immobility of labour is a form of market failure where workers cannot easily move between jobs or areas, so vacancies and unemployment exist at the same time. Occupational immobility is when workers face barriers moving from one job to another, usually because they lack the skills, qualifications or experience the new job requires. Geographical immobility is when workers face costs or barriers moving from one area to another to find work, such as high housing costs, family ties or a lack of information about jobs elsewhere. Both cause structural unemployment and lower output, as the economy produces inside its production possibility frontier.

Measure 1: education and online degrees. India's plan for university degrees to be fully accessed online, rather than only 20% as before, makes higher education more accessible and cheaper, because students do not have to move to a city or pay for accommodation. More young people gain degrees, so the skill level of the workforce rises. Workers can move into higher skilled jobs, such as IT and engineering, which reduces occupational immobility, raises their marginal revenue product and wages, and fills skill shortages, raising productivity and growth.

Measure 2: training, apprenticeships and subsidies to employers. The government can fund retraining schemes for workers in declining industries, or subsidise firms that provide on-the-job training and apprenticeships for young people. Subsidies for firms that hire workers from groups with high unemployment lower labour costs, so firms take them on, and the work experience improves their skills and makes them more employable in future.

Measure 3: relocation subsidies and housing. To reduce geographical immobility the government

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can give relocation grants to workers moving from regions with low house prices and high unemployment to regions with jobs and high house prices, or build more affordable housing in cities such as Mumbai or Bengaluru. This lowers the cost of moving, so more workers move to where vacancies are.

Measure 4: better information and infrastructure. Online job centres and national job databases tell workers about vacancies across the country, reducing search costs. Better transport links allow workers to commute to jobs in other areas without moving home. Lower barriers to immigration can also bring in workers with skills that are in short supply.

However, these measures have limitations. Education and training have long time lags: a degree takes three or more years, so occupational mobility will not improve in the short run. Their success also depends on whether the courses match gaps in the labour market. If online degrees are in subjects firms do not need, or employers see them as lower quality than traditional degrees, graduates will still be immobile. Many people in rural India lack reliable internet access or a computer, so the online plan may mainly help those who are already better off, and some workers may not have the ability or motivation to train for high skilled occupations.

Geographical measures also face problems. Many people will not move even with a relocation subsidy because of family ties, friends and children in school. Grants may be too small compared with the gap in housing costs, and building homes and transport takes years. There is an opportunity cost: the money could be spent on healthcare, and it may require higher taxes or borrowing. The government may also lack information about where shortages are, so it may offer the wrong level of support or support the wrong regions, leading to government failure.

The effectiveness also depends on the magnitude of spending and on the type of unemployment.

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If unemployment is cyclical, due to low aggregate demand, improving mobility will not create jobs. Firms may also be unwilling to provide general training, as trained workers could be poached by rivals, so government funding is needed.

In conclusion, measures to reduce occupational immobility, such as India's online degrees and apprenticeships, are likely to be the most effective in the long run, because skills are the main barrier to moving between jobs and they also raise productivity. Geographical measures are useful but limited by social ties and housing costs. The best approach combines both, targeted at real skill shortages, but results will depend on the size of spending, the quality of the courses and access to the internet, and will take time to appear.

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Time 2 hours

Paper reference **WEC13/01**

Economics

International Advanced Level
Unit 3: Business behaviour

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Total Marks

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Sources for use with Section B.

The global coffee market

Figure 1 Average world price of coffee beans, $ per kg, July 2017–May 2019

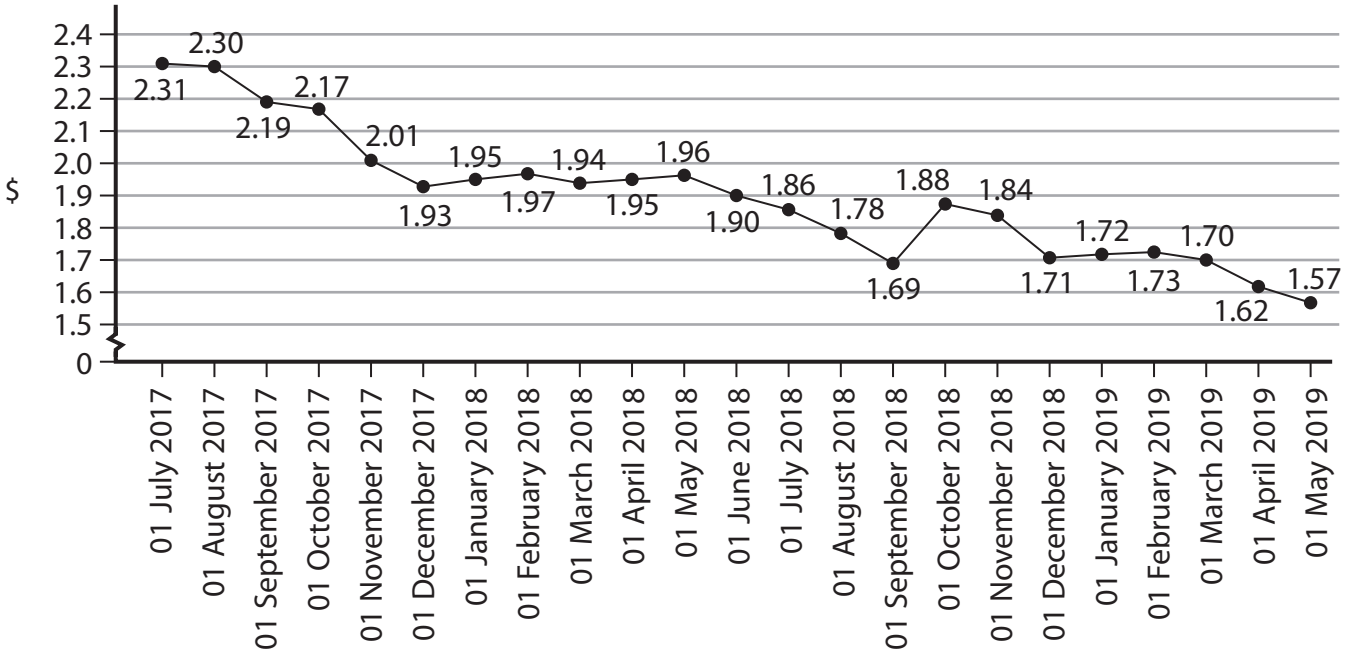
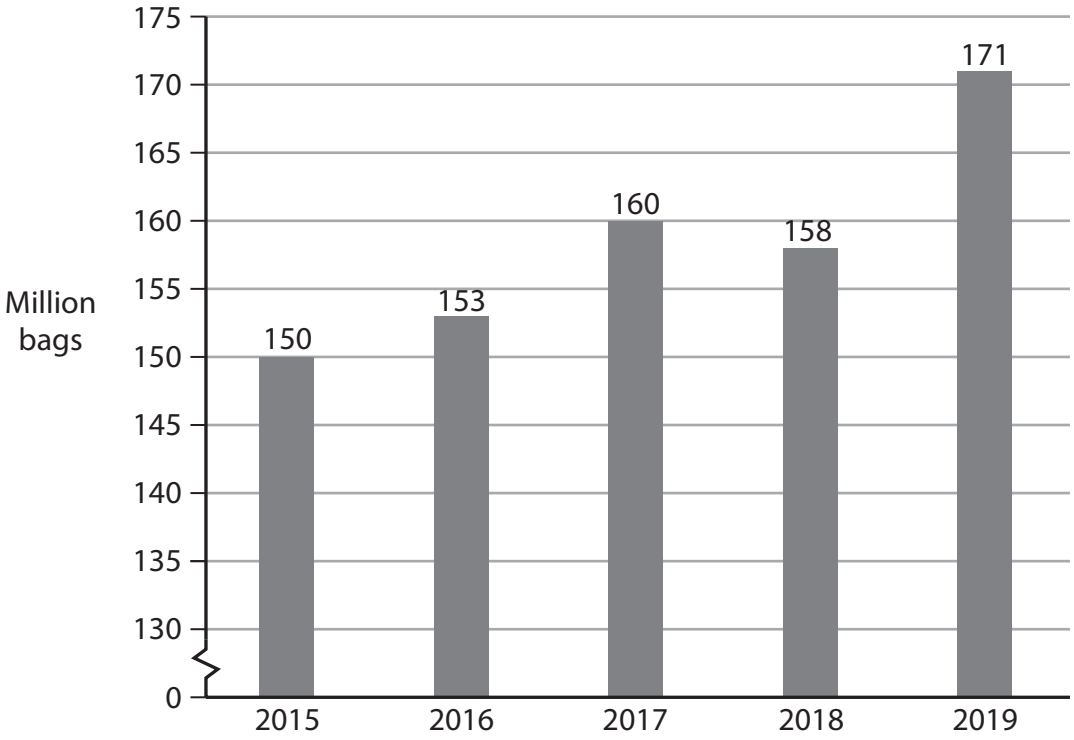


Figure 2 World coffee production, million bags, 2015–2019



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Extract A Global coffee bean production

In 2019 the supply of coffee beans was greater than the demand, resulting in a global coffee bean surplus of over 4 million bags. Coffee bean supply increased by 8% whereas demand increased by only 2%. Consequently, by May 2019, the global price of coffee beans fell to its lowest level in over 10 years.

The increase in global production was caused by developments in farming equipment and improved methods of production. Also, favourable weather conditions in major coffee-producing countries, such as Brazil, contributed to the global increase in production.

The fall in the global price of coffee beans caused serious problems for small coffee growers in Central America and Africa. These farmers made large losses and many reached their short-run shutdown point. Some farmers have switched to the production of lower-risk crops.

Extract B Coffee shop chain growth

Coffee is the second most popular drink in the world and the demand for it is increasing steadily. Globally two billion cups of coffee are consumed every day. The revenue of coffee shop chains globally is projected to reach $237.6 billion by 2025.

Starbucks is the largest coffee shop chain worldwide. In 2019 Starbucks' revenue increased by 7.24%. Its profits also increased by 7.11% to $17.98 billion. The company had over 27 000 stores worldwide, with many new shops opening in China.

In the USA it is difficult for a new firm to enter the coffee shop market because there are already a number of well-known firms. These include Starbucks, Tim Hortons, Dunkin' Donuts, Dutch Bros Coffee and Peet's Coffee. The firms compete using special offers, large advertising budgets and loyalty schemes. More recently, these firms have been using higher quality coffee beans and cold coffee drinks to attract younger coffee drinkers. They have also been investing heavily in developing mobile phone apps and online ordering systems to increase brand loyalty and market shares. Industry leaders believe that social media advertising is the most effective form of marketing for coffee shops.

However, there are still a large number of successful, small independent coffee shops in the USA. These are often very different to the larger firms, offering alternative drinks and food options. They are also located in out-of-town-centres and aim to attract a different type of consumer.

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Acknowledgements

Figure 1 https://www.indexmundi.com/commodities/?commodity=robusta-coffee&months=120

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