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 1 hour 45 minutes

Paper reference **WEC11/01**

Economics

International Advanced Subsidiary
UNIT 1: Markets in action

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 Sections A, B and C.
- Answer **ONE** question in Section D.
- 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 Which **one** of the following is a function of the price mechanism?

- ☒ **A** An increase in the price of hand sanitisers, caused by an increase in demand, will ration them to those who are most able to pay
- ☒ **B** A decrease in the price of carrots, caused by excess supply, provides farmers with the incentive to increase supply
- ☒ **C** A decrease in the price of tinned meat is a signal to producers that demand for it is increasing
- ☒ **D** An increase in the price of petrol is a signal to the government to impose a maximum price

(Total for Question 1 = 1 mark)

2 A clothing manufacturer originally organised production so that each worker made a garment from start to finish. However, in 2020, the manufacturer introduced the division of labour to garment production.

Which **one** of the following is a likely advantage of introducing the division of labour?

- ☒ **A** An increase in boredom
- ☒ **B** An increase in the cost of making each garment
- ☒ **C** An increase in output per worker
- ☒ **D** An increase in the time required for training

(Total for Question 2 = 1 mark)

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3 The table shows the estimated income elasticity of demand for four items.

Item	Income elasticity of demand
Caribbean holidays	+2.02
Healthcare	+0.70
Electricity	+0.40
Bus travel	–0.70

Which **one** of the following can be deduced from the table?

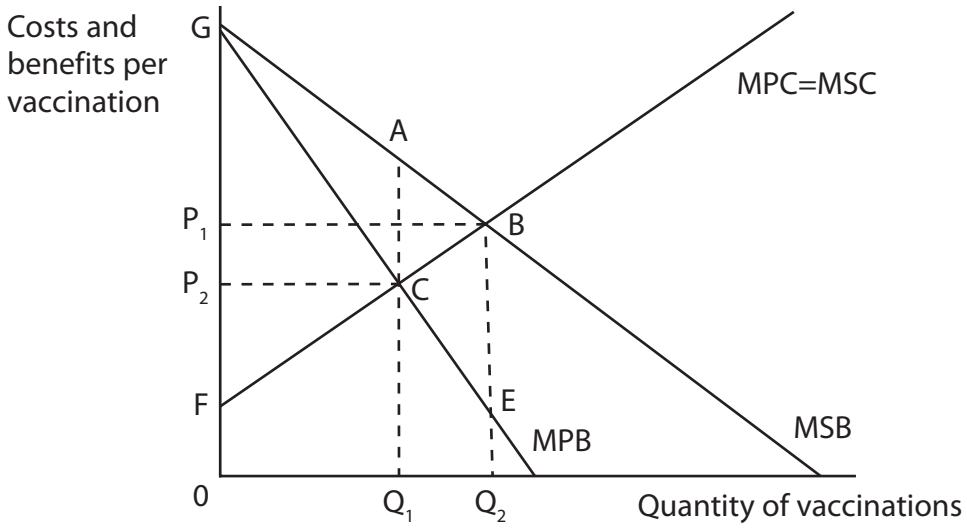
- ☒ **A** Caribbean holidays are an inferior good
- ☒ **B** Demand for healthcare is income elastic
- ☒ **C** Electricity is a normal good
- ☒ **D** Demand for bus travel is price inelastic

(Total for Question 3 = 1 mark)

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4 The diagram shows the market for vaccinations against measles.



Which **one** of the following can be deduced from the diagram?

- ☒ **A** The social optimum output is Q_1
- ☒ **B** The market equilibrium output is Q_2
- ☒ **C** Welfare gain is shown by the area BCE
- ☒ **D** Welfare gain is shown by the area ABC

(Total for Question 4 = 1 mark)

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5 The European Union (EU) has a tradeable permit scheme for carbon emissions. The price of a carbon permit was below €5 in 2013 and increased to €25 in 2019.

Which **one** of the following is the most likely reason for the increase in the price of carbon permits?

- ☒ **A** The EU issued too few permits in 2013
- ☒ **B** The EU issued too many permits in 2019
- ☒ **C** The demand for permits decreased between 2013 and 2019
- ☒ **D** The supply of permits was reduced between 2013 and 2019

(Total for Question 5 = 1 mark)

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6 The table shows the total utility received by a consumer from consuming glasses of fruit juice.

Glasses of fruit juice	Total utility
1	2
2	5
3	8
4	9
5	7
6	3

Which **one** of the following can be deduced from the table?

☒ **A** Utility is maximised when three glasses of fruit juice are consumed

☒ **B** Diminishing marginal utility sets in with the consumption of the fourth glass of fruit juice

☒ **C** Diminishing marginal utility sets in with the consumption of the fifth glass of fruit juice

☒ **D** Utility is maximised when six glasses of fruit juice are consumed

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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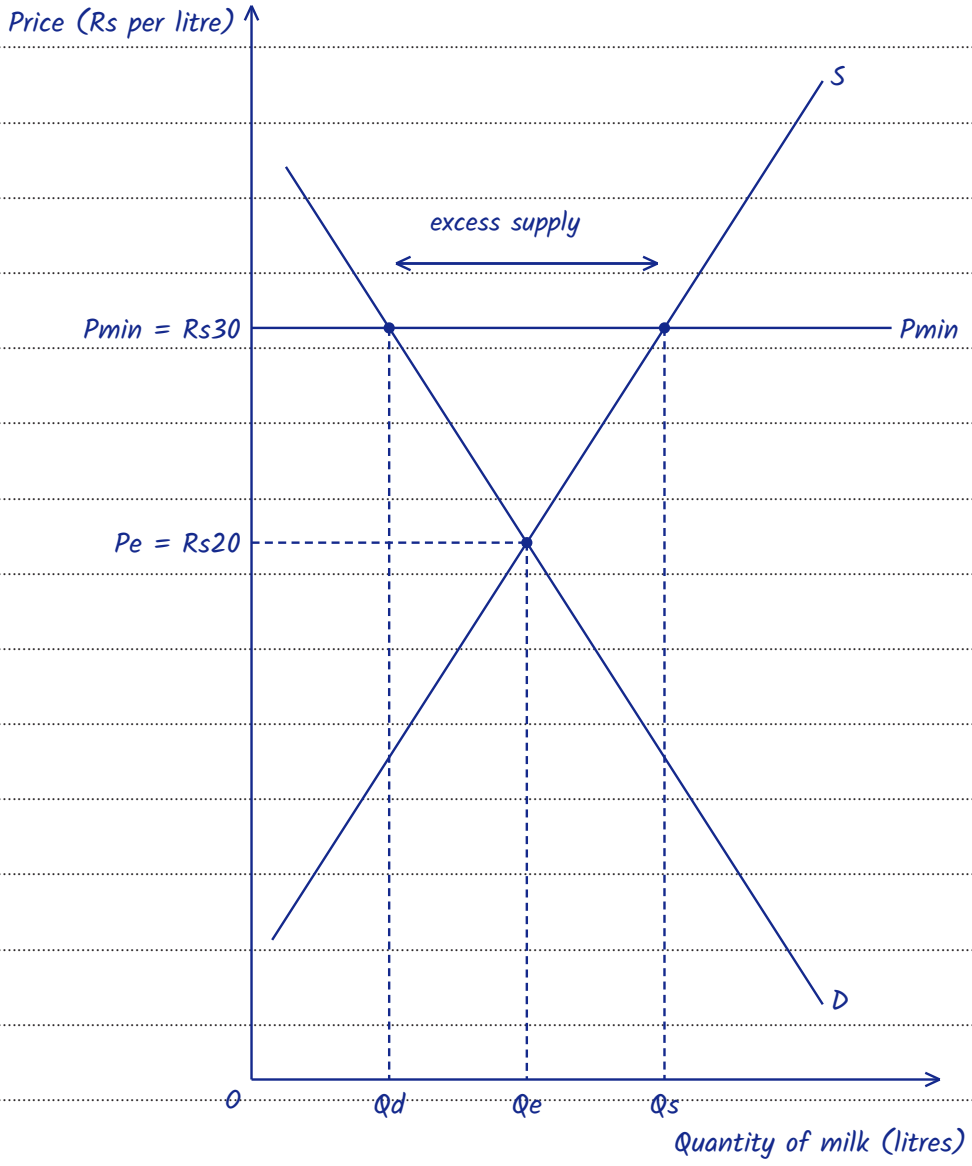
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SECTION B

Answer ALL questions in this section in the spaces provided.

7 In 2020 dairy farmers in India sold milk at a market equilibrium price of Rs20 per litre. This price resulted in many farmers making a loss. Therefore, dairy farmers asked the Indian Government to introduce a minimum price of Rs30 per litre.

Draw a diagram to illustrate the impact of the introduction of a minimum price for milk in India.



The minimum price of Rs30 is set above the equilibrium price of Rs20, so it is binding. Farmers supply Qs but consumers only demand Qd, leaving an excess supply of milk of Qs – Qd.

(Total for Question 7 = 4 marks)

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8 In 2020 the German city of Munich had the highest risk of a housing market bubble in the world. Between 2010 and 2020 the average price of a house more than doubled.

With reference to Munich's housing market, explain what is meant by a 'market bubble'.

A market bubble is when the price of an asset, such as housing, rises rapidly to a level well above its true or real value. It is driven by speculation: buyers purchase in the expectation that prices will keep rising so they can sell later at a higher price, which pushes demand and prices up even further. The price is therefore unsustainable, and the bubble is a form of market failure.

In Munich the average house price more than doubled between 2010 and 2020, and the city had the highest risk of a housing market bubble in the world. If buyers lose confidence that prices will keep rising, or can no longer borrow enough to buy, demand will fall and the bubble may burst, causing house prices in Munich to fall sharply.

(Total for Question 8 = 4 marks)

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9 In the USA the price elasticity of demand for residential natural gas is –0.1.

Explain **one** reason why the price elasticity of demand for residential natural gas is only –0.1.

Demand is price inelastic when a change in price leads to a proportionately smaller change in quantity demanded, so PED lies between 0 and –1. A PED of –0.1 means demand for residential natural gas is highly price inelastic: a 10% rise in price only reduces quantity demanded by 1%.

One reason is that households see natural gas as a necessity with few close substitutes. It is used for heating homes, hot water and cooking, and switching to an alternative such as electric heating requires buying new boilers or cookers, which is expensive and takes time. So even when the price of gas rises, households cannot easily reduce their consumption and continue to buy almost the same quantity, which is why PED is only –0.1.

(Total for Question 9 = 4 marks)

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10 The table shows the average world price of sugar and world sugar consumption in 2019 and 2020.

	Average sugar price, per kg	Quantity of sugar consumed, million kg
2019	$11.28	172 620
2020	$15.06	171 600

Ceteris paribus, calculate the price elasticity of demand for sugar. Show your workings.

PED = % change in quantity demanded ÷ % change in price

% change in quantity = (171 600 − 172 620) ÷ 172 620 × 100

= −1 020 ÷ 172 620 × 100 = −0.59%

% change in price = (15.06 − 11.28) ÷ 11.28 × 100

= 3.78 ÷ 11.28 × 100 = +33.51%

PED = −0.59 ÷ 33.51 = −0.0176 (to 3 s.f.)

Demand for sugar is highly price inelastic; a 33.51% rise in price reduced quantity demanded by only 0.59%.

(Total for Question 10 = 4 marks)

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11 The cross elasticity of demand for meat with respect to fish is estimated to be +0.13 in Bangladesh.

Explain the likely impact of a 10% increase in the price of fish on the demand for meat in Bangladesh.

Cross elasticity of demand (XED) measures the responsiveness of the quantity demanded of one good to a change in the price of another good: XED = % change in quantity demanded of meat ÷ % change in price of fish.

The XED is positive (+0.13), so meat and fish are substitutes. When fish becomes more expensive, some consumers in Bangladesh switch from fish to meat, so the demand for meat increases (shifts to the right), raising the equilibrium price and quantity of meat.

% change in quantity demanded of meat = XED × % change in price of fish

= +0.13 × 10% = +1.3%

So demand for meat rises by only 1.3%, much less than the 10% price rise, because the XED is close to zero: meat and fish are weak substitutes, so few consumers switch.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C

Study Figure 1 and Extracts A, B and C in the Source Booklet before answering Question 12.

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

12 (a) Define the term 'indirect tax' (Extract B, line 20).

(2)

(b) With reference to the **titles** of Extract A and Extract B, explain the difference between positive statements and normative statements.

(4)

(c) With reference to Figure 1 and Extract A, analyse **two** reasons why between 1 April 2020 and 1 January 2021 the world price of cotton increased.

Illustrate your answer with a supply and demand diagram.

(6)

(d) With reference to Extract B, examine **two** external costs associated with the production of clothing.

(8)

(e) With reference to Extract C, discuss the impact of the removal of the subsidy paid to Indian clothing manufacturers on consumers and manufacturers.

Illustrate your answer with an appropriate diagram.

(14)

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12 (a) Define the term 'indirect tax' (Extract B, line 20).

(2)

An indirect tax is a tax on expenditure (spending on goods and services), such as VAT, that is paid to the government by the producer or seller, a third party, and so increases firms' costs of production and reduces supply.

(b) With reference to the **titles** of Extract A and Extract B, explain the difference between positive statements and normative statements.

(4)

A positive statement is objective and based on facts, so it can be tested and proven true or false using evidence. A normative statement is subjective and based on value judgements about what ought to happen, so it cannot be proven with evidence.

The title of Extract A, "World cotton price rises", is a positive statement, because Figure 1 shows the price rising from $0.54 to $0.80 per lb, so it can be checked against the data.

The title of Extract B, "Clothing manufacturers should reduce environmental costs", is a normative statement, because the word "should" shows it is an opinion about what ought to happen, which cannot be proven right or wrong.

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(c) With reference to Figure 1 and Extract A, analyse **two** reasons why between 1 April 2020 and 1 January 2021 the world price of cotton increased.

Illustrate your answer with a supply and demand diagram.

(6)

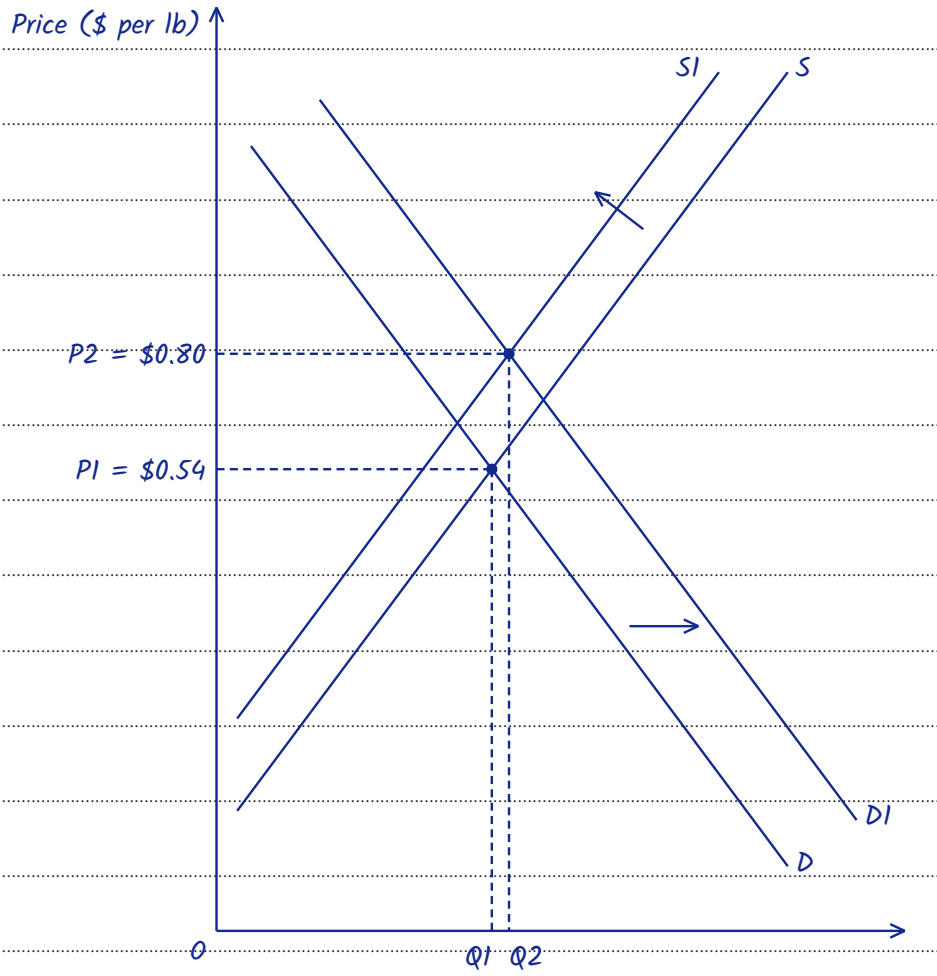


Figure 1 shows the world price of cotton rose from about $0.54 per lb on 1 April 2020 to $0.80 per lb on 1 January 2021, an increase of about 48%.

First, demand for cotton increased. During the pandemic the demand for face masks, bedsheets and surgical gowns rose, and all of these use cotton in their production. Cotton is a derived demand, so manufacturers needed more cotton, shifting demand from D to D1.

Second, the supply of cotton decreased. High temperatures reduced the cotton crop in Pakistan, the world's fourth largest supplier, so less cotton was produced at every price and supply shifted

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left from S to S1.

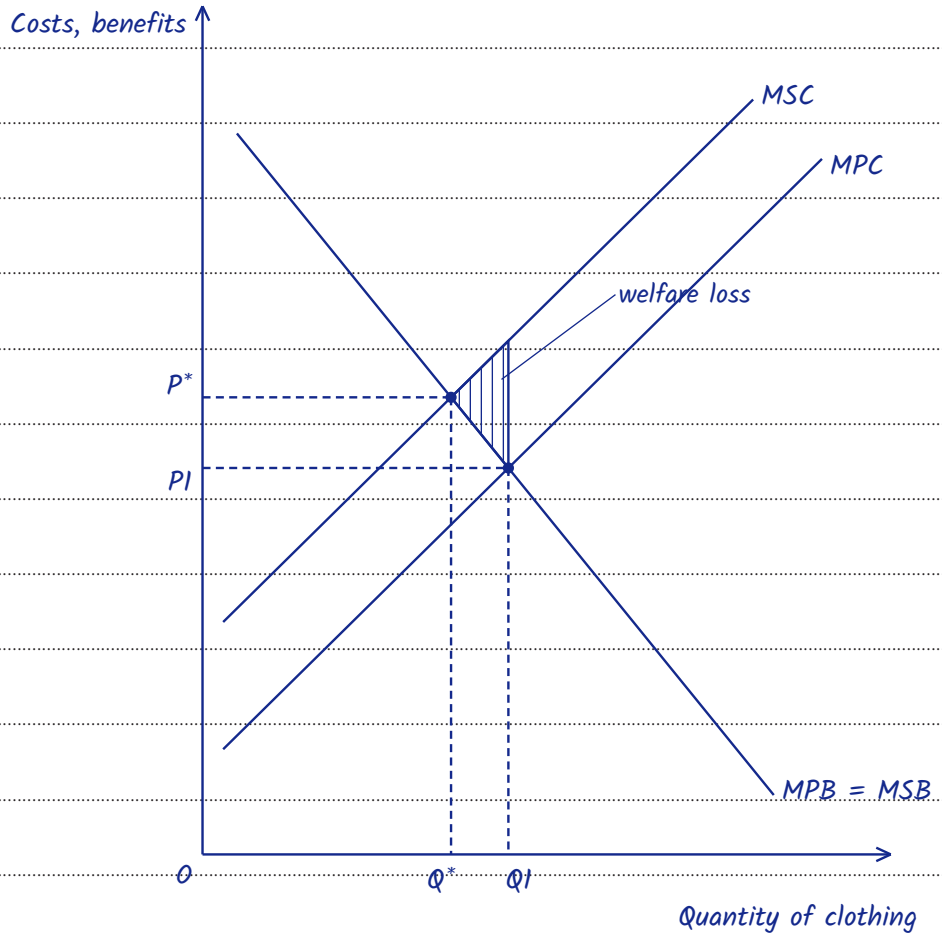
At the original price P1 there is now excess demand, so buyers compete for the limited cotton and the price is bid up until a new equilibrium at P2. Both changes push the price up from P1 ($0.54) to P2 ($0.80); the quantity traded changes only slightly from Q1 to Q2, depending on the relative size of the two shifts.

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(d) With reference to Extract B, examine **two** external costs associated with the production of clothing.

(8)

External costs are the negative spillover effects of production that fall on third parties outside the transaction, who are not compensated, so marginal social cost (MSC) is greater than marginal private cost (MPC).



Clothing manufacturers only consider private costs, so they produce at Q1 where MPC = MPB, but the social optimum is Q^* where MSC = MSB. Q^*Q1 is overproduction and the shaded triangle is the welfare loss.

One external cost is water use and pollution. Producing one pair of jeans needs 3 781 litres of water and clothing manufacturers use 93 billion cubic metres each year, while clothes dyeing creates 20% of all wastewater. This leaves less clean drinking water for local households and

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farmers, so water companies must spend more on treating polluted water. These costs are passed on to consumers as higher water prices, and people may suffer health problems from contaminated water.

A second external cost is carbon emissions. One pair of jeans creates 33.4 kg of carbon emissions and clothing manufacturers produce 10% of annual global carbon emissions, more than all international flights and shipping combined. These greenhouse gases contribute to global warming, which leads to rising sea levels, flooding and extreme weather, damaging homes and making it harder to farm crops for people around the world who did not buy the clothes. In addition, 87% of clothing is burnt or sent to landfill, so burning causes air pollution and breathing problems, raising costs for health services.

However, the size of these external costs is hard to measure, because it is difficult to put a monetary value on clean water or air, so we cannot be sure how large the welfare loss is. The magnitude is still likely to be significant: 93 billion cubic metres of water and 10% of global emissions are very large figures, and with production doubling from 50 billion to 100 billion items between 2000 and 2020 these costs are growing.

The external costs also fall unevenly: the countries where clothing is made will suffer most from water shortages and pollution, while carbon emissions affect everyone. They should also be weighed against the benefits of the industry, which directly employs 75 million people whose spending boosts local economies.

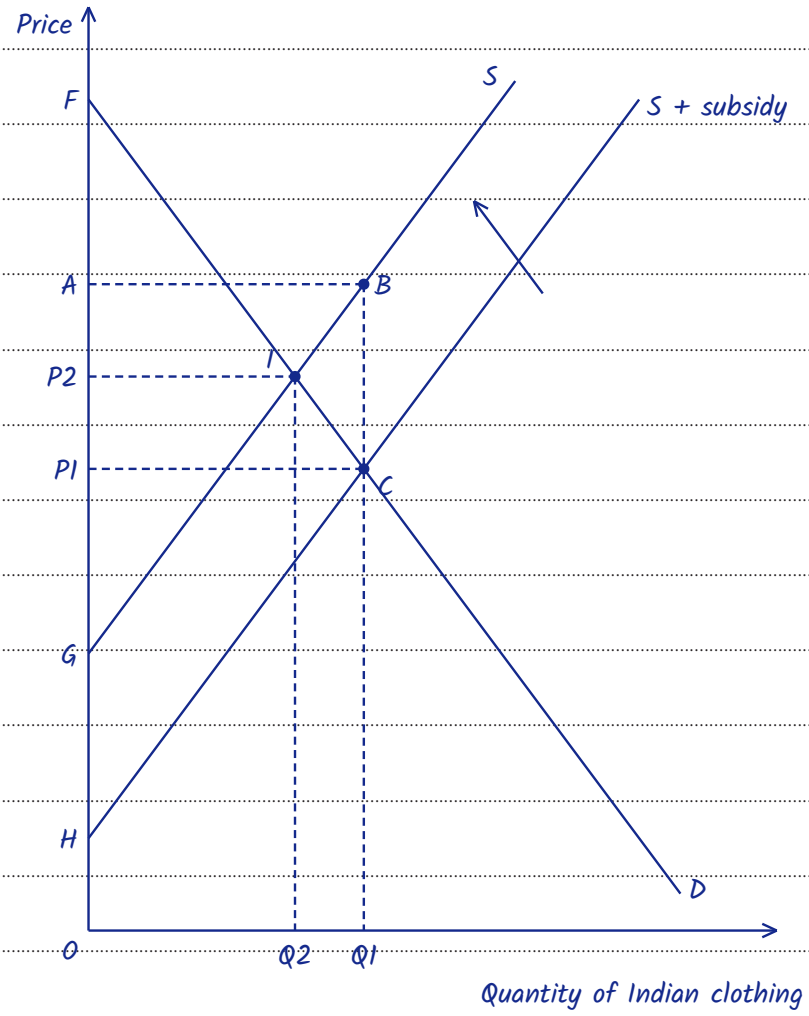
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(e) With reference to Extract C, discuss the impact of the removal of the subsidy paid to Indian clothing manufacturers on consumers and manufacturers.

Illustrate your answer with an appropriate diagram.

(14)

A subsidy is a payment from the government to producers to reduce their costs of production and encourage output. India removed its subsidy to clothing manufacturers in 2018 after the USA and Turkey argued it gave Indian firms an unfair advantage.



Removing the subsidy raises manufacturers' costs of production, so supply shifts left from S + subsidy to S. The price of Indian clothing rises from P1 to P2 and the quantity falls from Q1 to Q2. The government saves the subsidy spending ABCP1, which it could reallocate to health or education.

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For consumers, the higher price means consumer surplus falls from FCP1 to FIP2, so buyers of Indian clothing pay more and buy less. Because 12% of India's exports are clothing, many of these consumers are in other countries, so foreign buyers may switch to cheaper clothing from the USA or Turkey.

For manufacturers, the price they receive falls from A (P1 plus the subsidy) to P2, so producer surplus falls from CHP1 to GIP2. With higher costs and lower sales, revenue and profits fall, making Indian firms less price competitive against US and Turkish manufacturers. Some firms may cut output or close, putting at risk the jobs of the 35 million workers in Indian clothing manufacturing, and clothing exports may fall from 12% of total exports.

However, the size of the impact depends on the magnitude of the subsidy, and Extract C gives no data on how large it was. If the subsidy per unit was small, the shift in supply and the rise in price will also be small, so consumers and manufacturers are hardly affected.

It also depends on price elasticity of demand. If demand for Indian clothing is price inelastic, for example because buyers value its quality or brand rather than its low price, manufacturers can pass most of the cost increase on to consumers, so consumers bear more of the burden and output and jobs fall only a little. If demand is price elastic, because there are many close substitutes from other countries, consumers lose little as they switch, but sales and employment in India fall sharply.

Indian manufacturers may still be competitive without the subsidy, because labour costs in India are likely to be much lower than in the USA and Turkey, and the industry is very large, employing 35 million workers, so it benefits from economies of scale. Losing the subsidy may also give firms an incentive to become more efficient, since protected firms are often inefficient.

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Time matters too: in the short run manufacturers may struggle with higher costs, but in the long run they may cut costs or invest in new technology, so the impact on jobs could be temporary.

Overall, consumers face higher prices and manufacturers lower profits, but the impact is likely to be modest because India keeps a strong cost advantage. The most significant effect is probably on lower-margin manufacturers and their workers, while the government gains from lower spending.

(Total for Question 12 = 34 marks)

TOTAL FOR SECTION C = 34 MARKS

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SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 In 2007 Ireland's Government spending as a percentage of GDP was 35.9% and by 2019 it had fallen to 25.1%.

Evaluate the possible benefits of an economy moving closer to being a 'free market economy'.

(Total for Question 13 = 20 marks)

OR

14 In Australia 50% of consumers are still with the bank they first joined. Banking with one of the 4 largest banks is costing consumers about AUD1 500 per year. In the UK consumers loyal to their broadband supplier pay 12% more than those who switch to better deals.

Evaluate ways that would encourage and enable consumers to make rational decisions.

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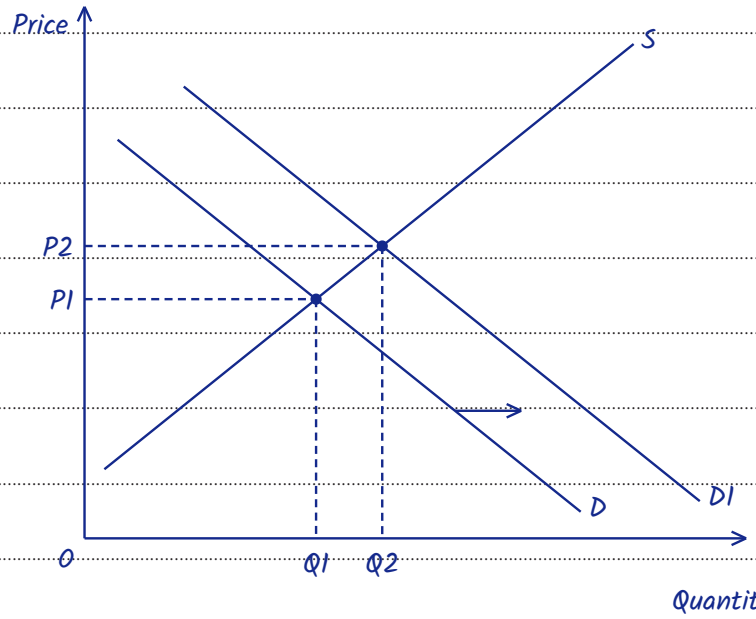
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Chosen question number: **Question 13** ☒ **Question 14** ☐

Write your answer here:

A free market economy is one where resources are allocated by the price mechanism, through the forces of supply and demand, with little or no government intervention. A mixed economy allocates resources through both the price mechanism and the government. Ireland is a mixed economy, but government spending fell from 35.9% of GDP in 2007 to 25.1% in 2019, a fall of 10.8 percentage points, so Ireland has moved closer to being a free market economy.

The first benefit is more efficient allocation of resources. In a free market, prices act as a signal, an incentive and a rationing device. If consumers demand more of a good, demand shifts from D to D1 on the diagram and the price rises from P1 to P2. This signals to firms that the good is wanted, and the higher expected profit gives them an incentive to move resources into producing it, so quantity rises from Q1 to Q2. Resources are therefore allocated according to the pattern of consumer demand rather than by the government, so consumer sovereignty and allocative efficiency are increased.



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Second, competition between firms benefits consumers. To keep their customers, firms must lower their prices and improve quality, and the profit motive encourages them to invest in research and development to create new and better products. This leads to greater choice, lower prices and dynamic efficiency, which raises living standards.

Third, there is less risk of government failure. Governments may lack information about what consumers want, and spending can be wasted on expensive administration or on projects chosen for political reasons. With government spending falling to 25.1% of GDP, fewer resources are allocated by the state, so less is wasted. Lower government spending may also allow lower taxes, which increase the incentive to work and to start businesses, because workers and entrepreneurs keep more of what they earn.

However, these benefits depend on markets working well, and there are significant risks. Free markets can lead to large inequality of income and wealth, because rewards depend on what people own and the skills they have, and with less government spending there are fewer benefits and public services to support those on low incomes.

Markets also fail. Public goods, such as street lighting and defence, would not be provided at all because of the free rider problem. Goods with external benefits, such as education and healthcare, would be underprovided, and goods with external costs, such as polluting production, overprovided, so there is a welfare loss. Some firms may grow large enough to gain monopoly power and raise prices, which reduces consumer surplus rather than increasing it.

Free markets can also be unstable. Ireland suffered badly in the 2008 financial crisis, and events such as the pandemic lockdowns show that the government may need to intervene to

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support firms and workers when markets collapse.

The data should also be treated with caution. Government spending fell as a percentage of GDP, but if Ireland's GDP grew strongly between 2007 and 2019, the actual amount of government spending may not have fallen at all, so the move towards a free market may be smaller than it appears. At 25.1%, just over 1 euro in every 4 is still spent by the government, so Ireland remains a mixed economy that can still provide public goods and key services such as health and education. We would also need data on other factors, such as growth, unemployment and inequality, to judge whether Ireland has actually benefited.

In conclusion, moving closer to a free market can bring real benefits through more efficient allocation of resources, competition and less government failure. However, a completely free market would lead to market failure and inequality. The greatest benefits come from a mixed economy that relies mainly on the price mechanism, as Ireland now does, while the government still corrects market failures and provides public goods, so the benefits depend on how far the economy moves and whether the government keeps these key roles.

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TOTAL FOR SECTION D = 20 MARKS

TOTAL FOR PAPER = 80 MARKS

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Time 1 hour 45 minutes

Paper reference **WEC11/01**

Economics

International Advanced Subsidiary
UNIT 1: Markets in action

Source Booklet

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Sources for use with Section C

Cotton and clothing

Figure 1 World price of cotton, $ per lb, April 2020 to January 2021



Extract A World cotton price rises

Between 1 April 2020 and 1 January 2021 the demand for face masks, bedsheets and surgical gowns increased. All require cotton in their production. During the same period there was a reduced cotton crop in Pakistan, the world's fourth largest supplier. High temperatures resulted in a decrease in the amount of cotton produced. Both these factors caused an increase in the price of cotton. 5

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Extract B Clothing manufacturers should reduce environmental costs

Clothing retailers and manufacturers earn $2.4 billion globally and directly employ 75 million people. The clothing industry is the world's third largest manufacturing sector.

The manufacture of clothing involves significant environmental costs. For example, on average, producing one pair of jeans requires 3 781 litres of water and creates 33.4 kg of carbon emissions. This includes the production of the cotton through to the delivery of the final product to stores.

According to the United Nations, each year:

- clothing manufacturers use 93 billion cubic metres of water
- 20% of all wastewater comes from clothes dyeing by manufacturers
- after use, 87% of clothing is burnt or disposed of in landfill
- clothing manufacturers produce 10% of annual global carbon emissions. This is more than all international flights and shipping combined.

Clothing retailers used to have four seasonal clothing ranges per year. However, many clothing stores now offer new ranges weekly. Between 2000 and 2020 the number of clothing items produced yearly increased from 50 billion to 100 billion. In 2019 a person bought, on average, 60% more clothing than in 2000 and more items of clothing are thrown away. Less than 1% of used clothing is recycled into new garments.

In response to the environmental damage caused by the clothing industry, Ireland's Government is considering the introduction of an indirect tax on clothing.

Extract C Indian Government to remove clothing subsidy

India employs 35 million workers in clothing manufacturing. Clothing accounts for 12% of India's exports. To protect this important industry the Indian Government used to pay a subsidy to clothing manufacturers. However, the US Government and the Turkish Government argued that this gave Indian manufacturers an unfair advantage. Consequently the Indian Government removed this subsidy in 2018.

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Acknowledgements

Figure 1 based on data taken from https://markets.businessinsider.com/commodities/cotton-price

Extract A adapted from 'Masks, surgical gowns & export boost the prices of organic cotton', Madhvi Sally, The Economic Times, 9 September 2020, https://economictimes.indiatimes.com/markets/commodities/news/masks-surgical-gowns-export-boost-sales-price-of-organic-cotton/articleshow/78019804.cms

'Pakistan: Cotton area to decrease in 2020/21', Sibylle Michel, Textile Network, 22 June 2020, https://textile-network.com/en/Technical-Textiles/Fasern-Garne/Pakistan-Cotton-area-to-decrease-in-2020-21

Extract B adapted from 'How Much Do Our Wardrobes Cost to the Environment?' The World Bank, 23 September 2019 https://www.worldbank.org/en/news/feature/2019/09/23/costo-moda-medio-ambiente

Extract C 'India textile export subsidy under WTO scanner', Arun S and Banikinkar Pattanayak, The Indian Express, 3 January 2020, https://indianexpress.com/article/business/economy/india-textile-export-subsidy-under-wto-scanner/