Please check the examination details below before entering your candidate information

Candidate surname	Other names
StemUp Model Solution	

Pearson Edexcel
International Advanced Level

Centre Number | | | | | |

Candidate Number | | | | |

Monday 13 May 2019

Morning (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.

Turn over ▶

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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 **Statement 1**: In 2017 the Kenyan Government spent Sh172.5 billion on healthcare. This is 8% of its annual budget.

Statement 2: The African Union believes African countries should spend 15% of their annual budgets on healthcare.

Which **one** of the following best describes the two statements above?

- ☒ **A** Both statements are positive
- ☒ **B** Statement 1 is positive and statement 2 is normative
- ☒ **C** Both statements are normative
- ☒ **D** Statement 1 is normative and statement 2 is positive

(Total for Question 1 = 1 mark)

2 The Chinese Government introduced a carbon emissions trading scheme. The objective of this tradeable pollution permit scheme is to reduce carbon emissions by

- ☒ **A** forcing highly polluting firms to buy permits from low polluting firms
- ☒ **B** forcing low polluting firms to buy permits from highly polluting firms
- ☒ **C** paying subsidies to firms who manage to reduce their carbon emissions
- ☒ **D** taxing firms who pollute less than their allowance

(Total for Question 2 = 1 mark)

3 Which **one** of the following is an example of market failure?

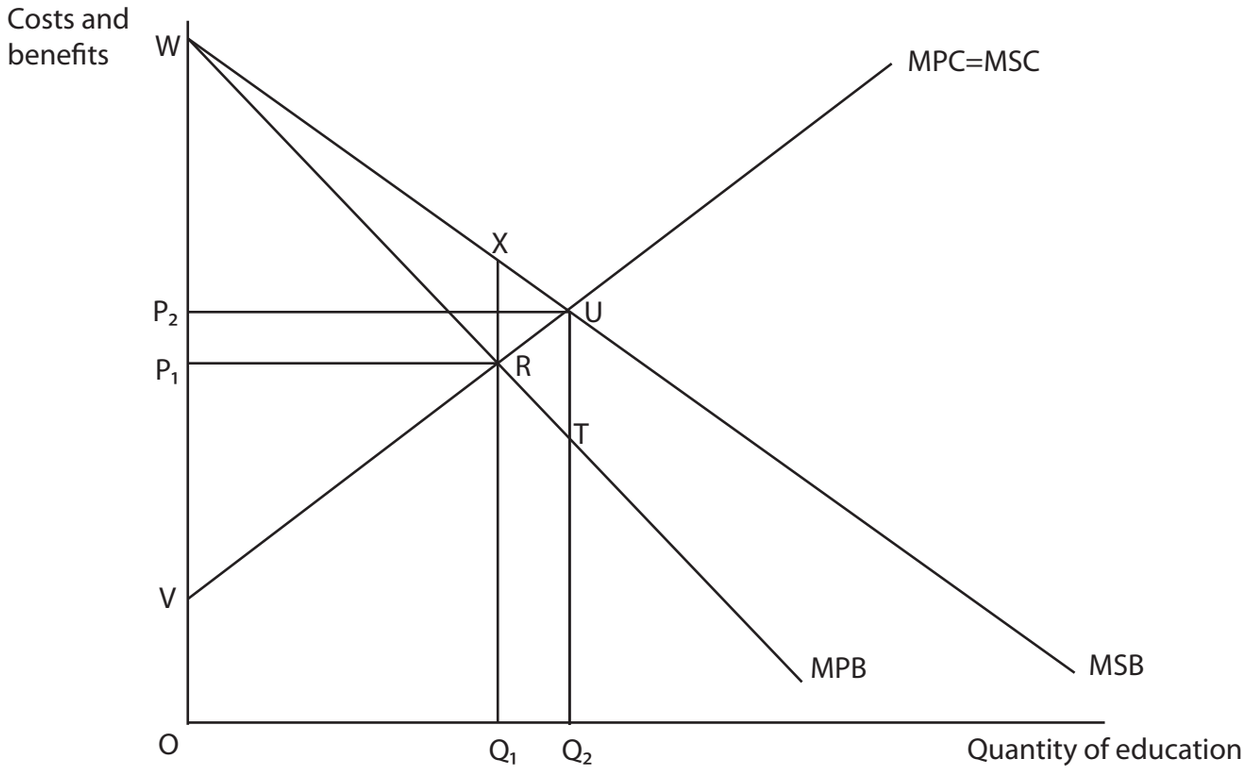
- ☒ **A** Lower prices create an incentive for firms to switch production to more profitable activities
- ☒ **B** Excessive administrative costs are involved in meeting environmental regulations
- ☒ **C** Government provision of street lights that is greater than the social optimum output
- ☒ **D** Insured consumers take more risks in the knowledge that the insurer will pay any resulting costs

(Total for Question 3 = 1 mark)

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4 The diagram shows the market for education.



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

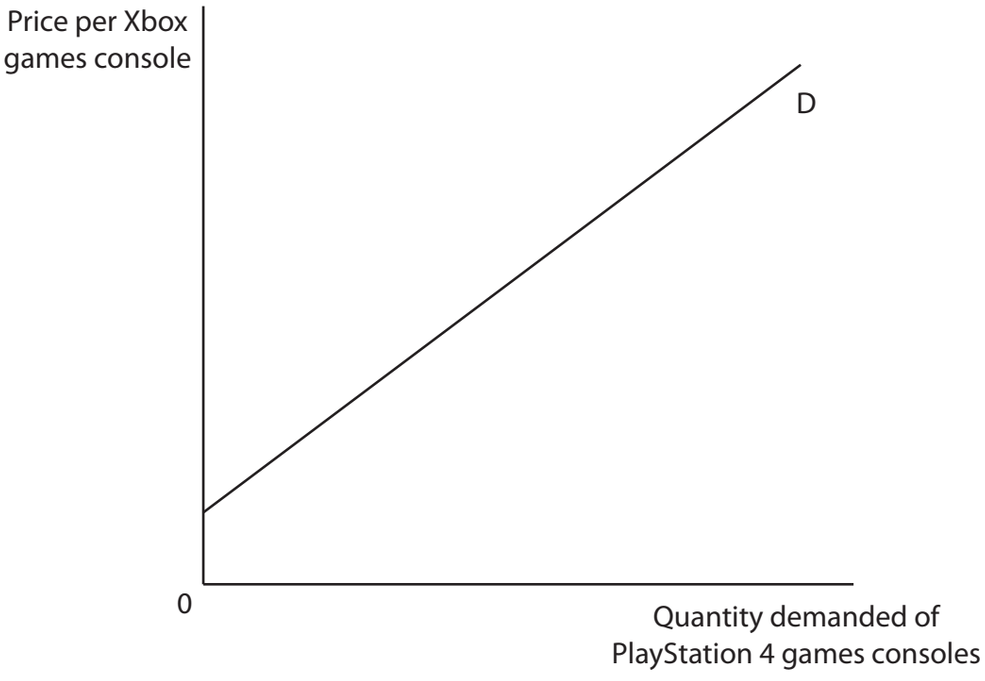
- ☒ **A** The welfare gain area is RUT
- ☒ **B** The welfare gain area is RUX
- ☒ **C** The social optimum quantity is Q_1 and price is P_1
- ☒ **D** The market equilibrium quantity is Q_2 and price is P_2

(Total for Question 4 = 1 mark)

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5 The diagram shows the relationship between the price of Xbox games consoles and the quantity demanded of PlayStation 4 games consoles.



It can be deduced from the diagram that the two goods are

- ☒ **A** complementary goods
- ☒ **B** inferior goods
- ☒ **C** substitute goods
- ☒ **D** unrelated goods

(Total for Question 5 = 1 mark)

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6 The table shows the estimated price elasticity of supply for three commodities.

Commodities	Estimates of price elasticity of supply
Corn	+0.23
Rice	+0.27
Wheat	+0.31

(Source: http://ageconsearch.umn.edu/bitstream/19267/1/sp05zh01.pdf)

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

☒ **A** Corn, rice and wheat have price elastic supply

☒ **B** A 10% increase in the price of corn will cause a 23% increase in quantity supplied

☒ **C** A 10% increase in the price of rice will cause a 2.7% decrease in quantity supplied

☒ **D** A 10% increase in the price of wheat will cause a 3.1% increase in quantity supplied

(Total for Question 6 = 1 mark)

TOTAL FOR SECTION A = 6 MARKS

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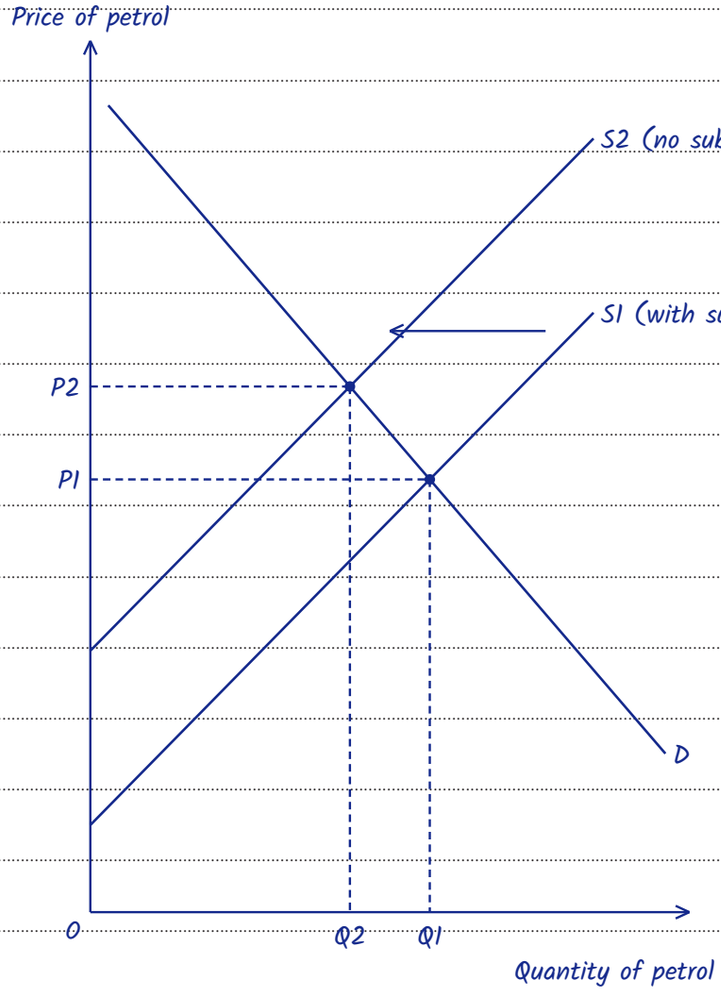
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SECTION B

Answer ALL questions in this section in the space provided.

7 In 2016 the Nigerian Government removed the subsidy on petrol.

Draw a diagram to illustrate the impact of the removal of the subsidy on the equilibrium price and quantity of petrol.



The subsidy lowered petrol suppliers' costs of production. Removing it raises their costs, so supply decreases and the supply curve shifts left from S1 to S2. At P1 there is now excess demand, so the equilibrium price of petrol rises from P1 to P2 and the equilibrium quantity falls from Q1 to Q2 (a contraction of demand).

(Total for Question 7 = 4 marks)

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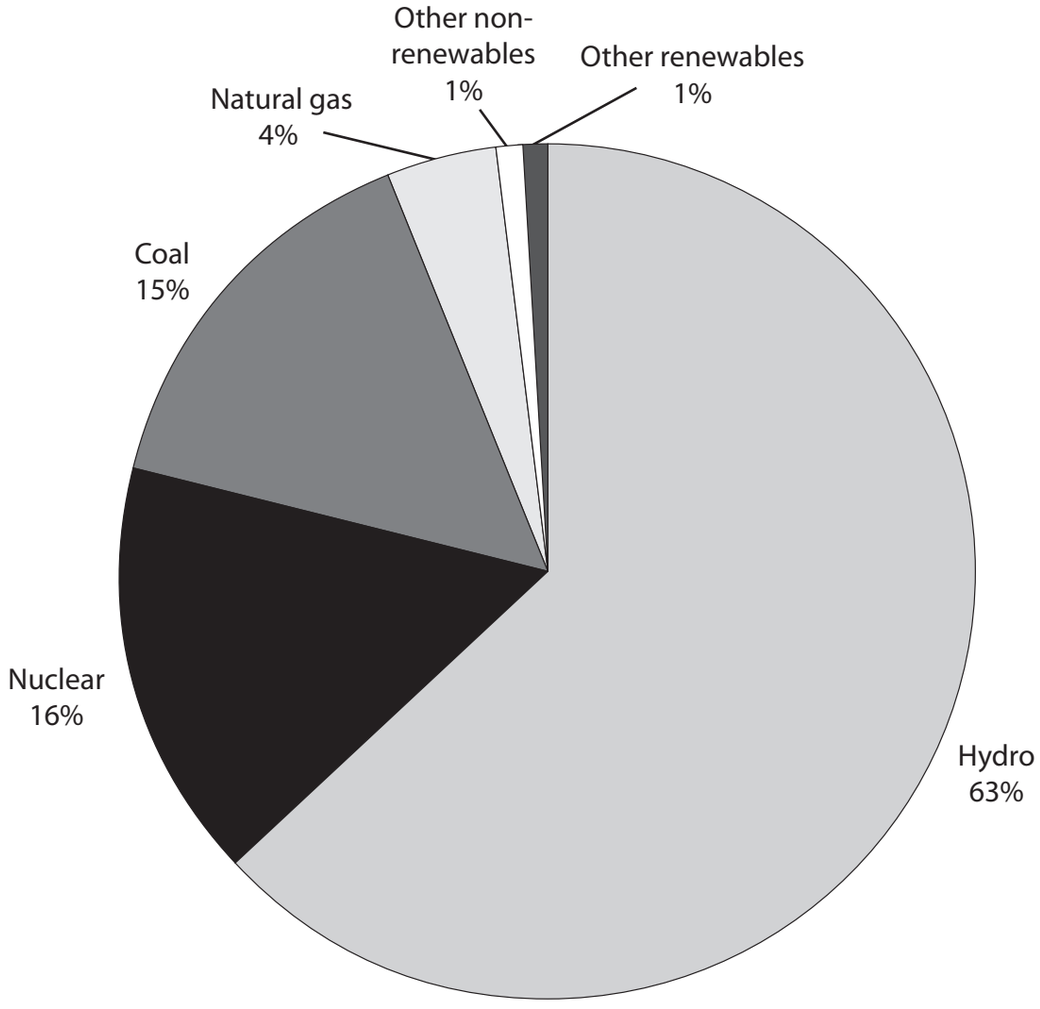
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QUESTION 8 BEGINS ON THE NEXT PAGE.

8 The chart shows how Canada's total electricity supply was generated from different resources in 2015.



(Source: http://www.theenergycollective.com/jarretadams1/2292773/canada-working-toward-decarbonizing-its-grid)

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With reference to Canada's electricity generation, explain the difference between 'renewable resources' and 'non-renewable resources'.

Renewable resources are resources that are not depleted when they are used because they replenish naturally, so they can be used again and again. In Canada, hydro power (63% of electricity generation) is renewable because the flow of water is continually replaced, as are other renewables such as wind and solar (1%).

Non-renewable resources are finite: once they are used up they cannot be replaced, so the stock falls every time they are used. In Canada, coal (15%) and natural gas (4%) are non-renewable, and nuclear (16%) relies on uranium, which is also finite.

So the difference is whether the resource is replenished after use. Most of Canada's electricity (64%) is generated from renewable resources, with about 36% from non-renewable resources.

(Total for Question 8 = 4 marks)

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9 Singapore's economy is highly dependent on trade with the rest of the world. In 2017, Singapore's exports were 173.3% of its GDP.

Explain **one** role of financial markets in such an economy.

Financial markets bring together buyers and sellers to exchange financial products such as loans, shares and foreign currencies. One role of financial markets is to make funds available to businesses by lending to them.

Singapore's exporters can borrow from banks so that they are able to buy capital goods, such as machinery, and raw materials from abroad before they have been paid by their foreign customers. With this extra capital, firms can increase their output and so sell more goods and services to customers overseas.

Because Singapore depends so heavily on international trade, with exports worth 173.3% of its GDP, access to finance is essential. As borrowing to fund production and trade becomes easier, the volume of Singapore's international trade is likely to increase, which supports its exports and economic growth.

(Total for Question 9 = 4 marks)

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10 In September 2017, Centrica increased the price of gas and electricity by 12.5%. Before the price rise Centrica had 12 800 000 customers but this fell by 800 000 after the price increase.

Ceteris paribus, calculate the price elasticity of demand for gas and electricity from Centrica. Show your workings.

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

% change in quantity demanded = (change in quantity ÷ original quantity) × 100

= (−800 000 ÷ 12 800 000) × 100 = −6.25%

% change in price = +12.5%

PED = −6.25% ÷ 12.5% = −0.5

PED = −0.5, so demand for Centrica's gas and electricity is price inelastic: the percentage change in quantity demanded (6.25%) is smaller than the percentage change in price (12.5%), because gas and electricity are necessities and switching supplier takes effort.

(Total for Question 10 = 4 marks)

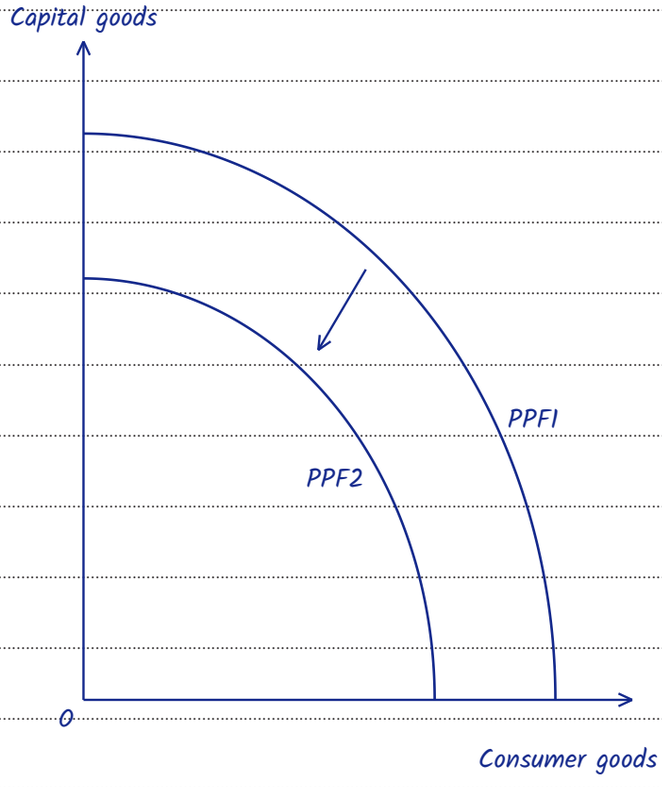
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11 Lithuania's population decreased from 3.7 million in 1989 to 2.9 million in 2015.

Ceteris paribus, explain the likely impact of this change in population on Lithuania's production possibility frontier (PPF).

Illustrate your answer with a diagram.

A production possibility frontier (PPF) shows the maximum possible combinations of two goods an economy can produce when all its resources are fully and efficiently employed.



Lithuania's population fell by 0.8 million (from 3.7 million to 2.9 million). With a smaller population there is less labour, so Lithuania has fewer factors of production. It can therefore produce fewer consumer goods and capital goods, so its production possibilities fall and the PPF shifts inwards from PPF1 to PPF2, reducing its potential output and economic growth.

(Total for Question 11 = 4 marks)

TOTAL FOR SECTION B = 20 MARKS

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SECTION C BEGINS ON THE NEXT PAGE.

SECTION C

Study Figures 1 and 2 and Extracts A and B in the Source Booklet before answering Question 12.

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

12 (a) Define the term 'free good' (Extract A, line 7).

(2)

Between 2008 and 2016 weekly household real income increased by 2.7% in Australia.

(b) With reference to Figure 1, explain the likely change in quantity demanded of lamb between 2008 and 2016.

(4)

(c) With reference to Figure 2 and Extract A, analyse **one** reason why the price of lamb increased during 2017.

Illustrate your answer with a supply and demand diagram.

(6)

(d) With reference to Extract B, examine the external costs resulting from increased meat production.

(8)

(e) With reference to Extract B, discuss the likely effects of the introduction of an indirect tax on meat.

Illustrate your answer with an appropriate diagram.

(14)

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12 (a) Define the term 'free good' (Extract A, line 7).

(2)

A free good is a good that is so abundant that it is not scarce, so it has zero opportunity cost: more can be consumed without reducing the amount available to others, so no price can be charged for it, eg the wild grass that Australian lambs graze on.

Between 2008 and 2016 weekly household real income increased by 2.7% in Australia.

(b) With reference to Figure 1, explain the likely change in quantity demanded of lamb between 2008 and 2016.

(4)

Income elasticity of demand (YED) measures the responsiveness of quantity demanded to a change in real income:

YED = % change in quantity demanded ÷ % change in income

Figure 1 shows the YED for lamb in Australia is −0.146. A negative YED means lamb is an inferior good, so as real incomes rise Australian consumers buy less lamb (perhaps switching to other meats such as beef).

% change in quantity demanded = YED × % change in income

= −0.146 × 2.7% = −0.39% (to 2 d.p.)

So quantity demanded of lamb is likely to have fallen by about 0.39% between 2008 and 2016. Since the YED is less than 1 in size (income inelastic), the fall is much smaller than the 2.7% rise in income.

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(c) With reference to Figure 2 and Extract A, analyse **one** reason why the price of lamb increased during 2017.

Illustrate your answer with a supply and demand diagram.

(6)

One reason the price of lamb increased is the rise in global incomes. Extract A states that rising global incomes led to a 28% increase in demand for Australian lamb in 2017. Globally lamb is a normal good, so as incomes rise consumers can afford to eat more meat and buy more lamb at every price. The demand curve shifts right from D1 to D2 (see the diagram on the next page).

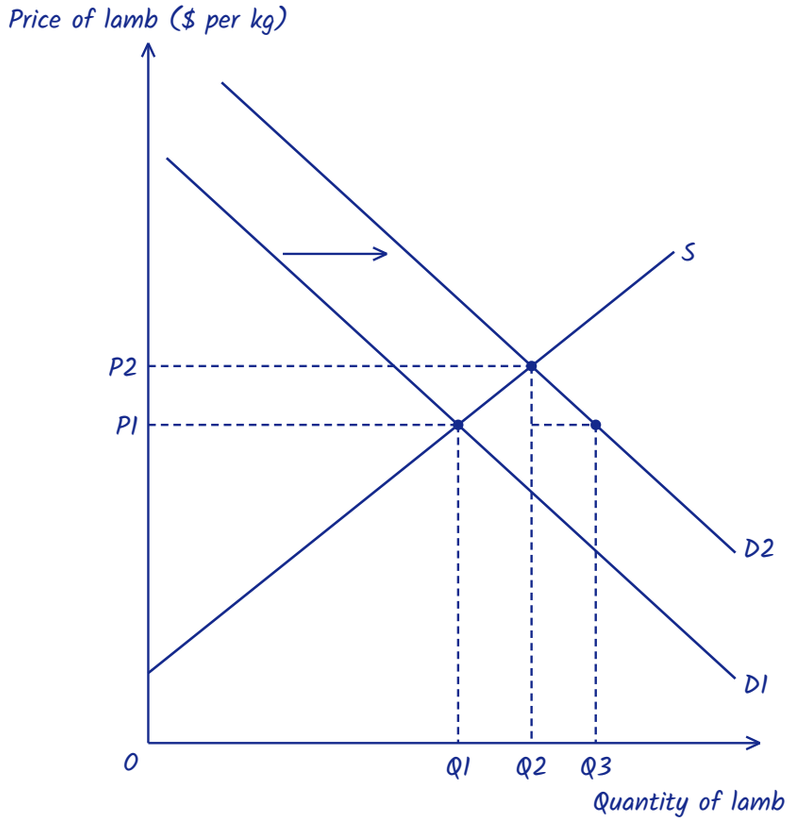
Extract A says supply is stable, so supply does not shift. At the original price P1 there is now excess demand (Q3 – Q1), as consumers in Australia, China and the USA compete for the available lamb. This pushes the price up, which gives farmers an incentive to supply more, so there is an extension of supply along S from Q1 to Q2. The new equilibrium is at a higher price P2 and a higher quantity Q2.

Figure 2 confirms this: the world price of lamb rose from about $5.05 per kg in January 2017 to about $5.75 per kg in December 2017, a rise of roughly 14%. Because supply of lamb is price inelastic in the short run (it takes time to rear more lambs), the increase in demand is mainly reflected in a higher price rather than a large rise in quantity.

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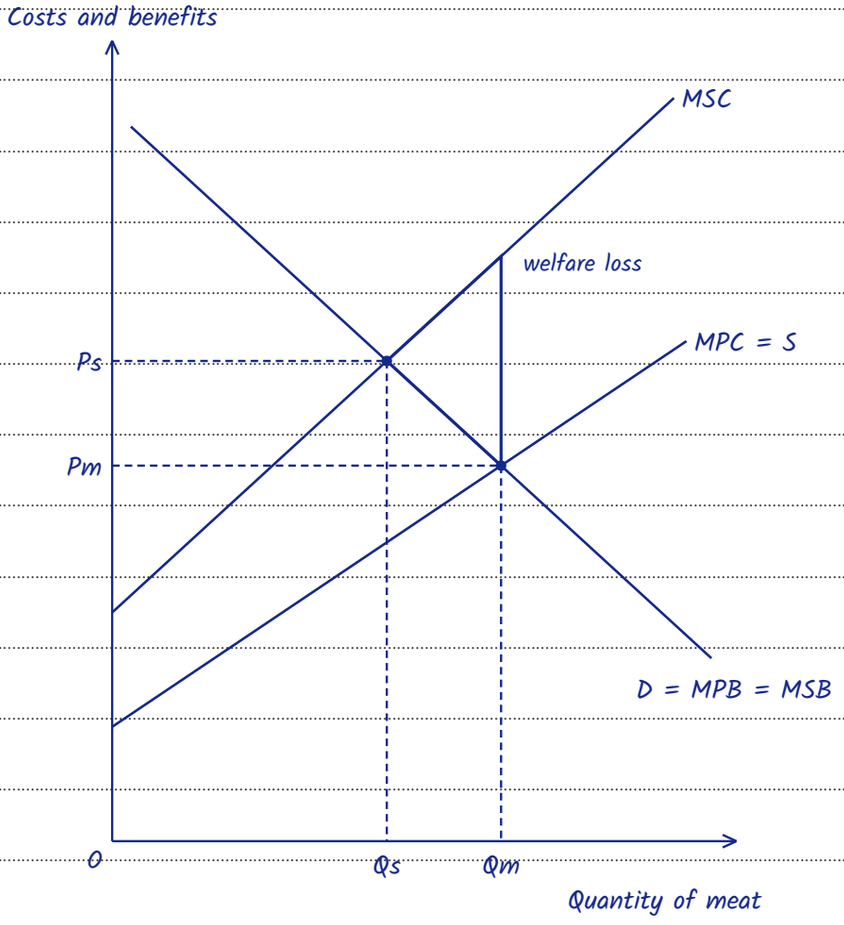
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(d) With reference to Extract B, examine the external costs resulting from increased meat production.

(8)

External costs are the negative effects of an economic activity on third parties who are not involved in the transaction and are not compensated. With external costs, marginal social cost (MSC = MPC + external cost) is greater than marginal private cost (MPC).



Meat producers only consider their private costs, so they produce at Qm where MPB = MPC, rather than the social optimum Qs where MSB = MSC. Meat is overproduced and there is a welfare loss shown by the triangle.

First, Extract B states that meat production causes 15% of all global greenhouse gas emissions. These contribute to global warming, which leads to more extreme weather that damages crops for other farmers and raises the costs of flood defences paid for by taxpayers.

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Second, meat production causes water pollution. Water companies must spend more on cleaning the water, and people who drink polluted water may become ill and lose income from days off work.

Third, the excessive use of antibiotics on animals means antibiotics become less effective in treating human illnesses. Patients take longer to recover, so health services face higher costs of treatment.

However, the size of these external costs is hard to measure and put a money value on, so we cannot be sure how large the welfare loss is. The magnitude also depends on the method of production: farmers trained to use less antibiotics and to manage waste would cause smaller external costs, so not all meat production is equally damaging. The external costs must also be weighed against the private benefits of meat production, such as income and employment for farmers. Finally, some costs in Extract B, such as obesity, diabetes and cancer, come from overconsumption of meat rather than from its production. Overall, at 15% of global greenhouse gas emissions, the external costs are significant and likely to grow as meat production rises.

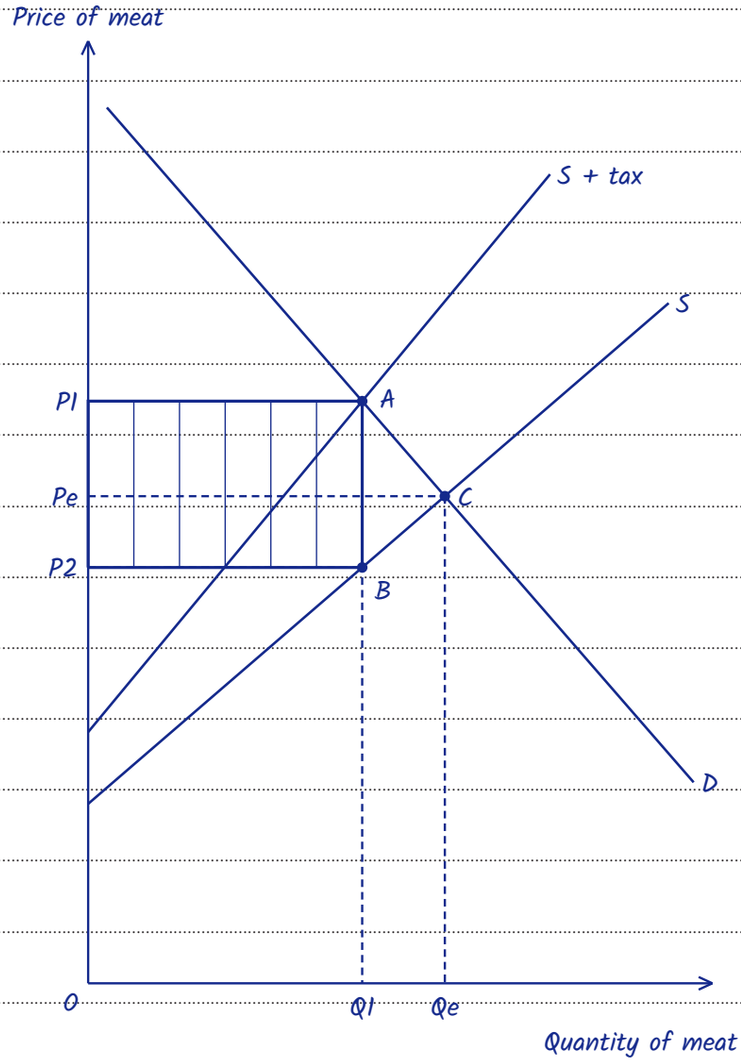
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(e) With reference to Extract B, discuss the likely effects of the introduction of an indirect tax on meat.

Illustrate your answer with an appropriate diagram.

(14)

An indirect tax is a tax on expenditure on goods and services, paid to the government by producers. The study in Extract B proposes ad valorem (percentage) taxes: 40% on beef, 20% on dairy products and 8.5% on chicken. The tax adds to the costs of meat producers, so supply decreases and shifts left from S to S + tax.



The price paid by consumers rises from Pe to P1 and the quantity of meat bought and sold falls from Qe to Q1. The government earns tax revenue shown by the hatched area P2P1AB.

Consumers pay PeP1 of the tax per unit and producers pay P2Pe, so producers receive only P2

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per unit. Consumer surplus and producer surplus both fall.

The main benefit is that the tax internalises the external costs described in Extract B. With less meat produced, there are fewer greenhouse gas emissions (meat causes 15% of the global total), less water pollution and less overuse of antibiotics. Lower consumption also improves health: eating 100 grams of red meat per day raises the risk of diabetes by 19%, so fewer cases of obesity, diabetes and cancer reduce costs to health services. The study suggests the tax would save 500 000 lives a year and help countries meet their Paris climate agreement targets. Overproduction falls towards the social optimum, reducing the welfare loss, and the tax revenue could be spent on health care or green farming.

However, the effect depends on the price elasticity of demand. Meat is a habitual part of many diets with few close substitutes, so demand may be price inelastic: quantity would fall only a little and consumers would bear most of the tax, limiting the reduction in emissions. The magnitude of the tax matters too: a 40% tax on beef is large and should have a significant effect, while 8.5% on chicken may change little. It is also hard to measure the external cost of each meat, so the tax may be set too high or too low, causing government failure.

An indirect tax on food is regressive, as it takes a larger share of the income of poorer households. Meat producers will earn lower revenue and profits, so some farmers may leave the industry and jobs may be lost, and a high tax could encourage illegal trade to evade it. As Extract B notes, the public do not know about the problems, so providing information may be a cheaper way to reduce consumption without these side effects, although it would work slowly.

Overall, an indirect tax is likely to reduce meat production and its external costs, but only by a modest amount in the short run because demand is price inelastic. Its success depends on

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setting the rate close to the external cost and combining it with information campaigns and support for low income households.

(Total for Question 12 = 34 marks)

TOTAL FOR SECTION C = 34 MARKS

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SECTION D BEGINS ON THE NEXT PAGE.

SECTION D

Answer ONE question from this section.

Write your answer in the space provided.

EITHER

13 'The HPV vaccine is recommended for all adults in the USA because it reduces the risk of cancer by 88%. If the HPV vaccine was given to all adults 925 000 cases of cancer would be prevented. However only 18.3% of adults were vaccinated between 2011 and 2014 preventing 170 000 cases of cancer.'

Evaluate why only 18.3% of adults were vaccinated.

(Total for Question 13 = 20 marks)

OR

14 '12 million consumers within the UK are on standard variable tariffs for their gas and electricity. One energy supplier, RWE npower, charged consumers on the standard variable rate £1 166 per year. However, its cheapest deal was £935 per year. Consequently the UK Government is introducing a maximum price for gas and electricity.'

Evaluate the likely impact of the introduction of a maximum price for gas and electricity.

(Total for Question 14 = 20 marks)

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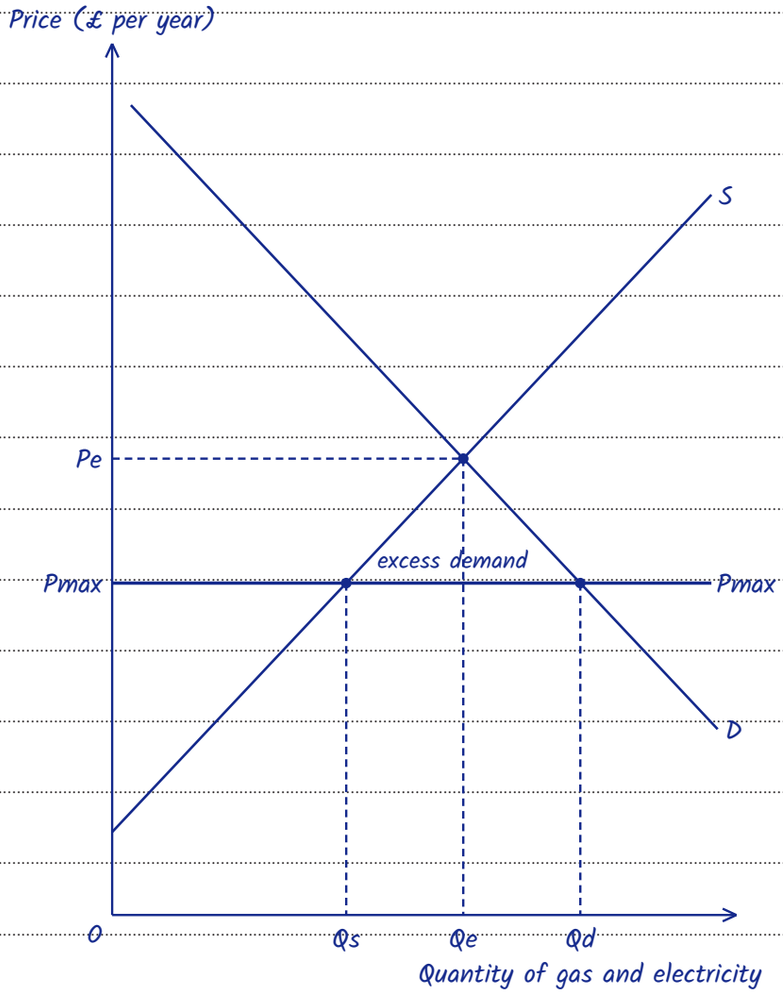
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Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

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

Write your answer here:

A maximum price is a price ceiling set by the government, above which a good cannot legally be sold. To be effective it must be set below the market equilibrium price. The aim here is to protect the 12 million UK consumers on standard variable tariffs, who pay high prices: RWE npower charged £1 166 per year on its standard variable rate, £231 (about 25%) more than its cheapest deal of £935.



In the diagram, the price falls from Pe to Pmax. Consumers benefit directly: households pay less for gas and electricity, so their real incomes rise and consumer surplus increases for those who are still supplied. This is especially important for low income households, as energy is a necessity

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and takes a large share of their spending, so the policy reduces fuel poverty. It also corrects the problem that loyal customers who do not switch supplier, perhaps because of inertia or a lack of information, are exploited by suppliers charging much more than their cheapest deals.

However, at the lower price, supplying energy is less profitable, so quantity supplied contracts from Qe to Qs, while the more affordable price causes demand to extend from Qe to Qd. This creates excess demand (a shortage) of Qd – Qs. Producer surplus falls, and energy suppliers' revenue and profits fall. Some smaller suppliers may leave the market, reducing competition and choice for consumers and making the shortage worse in the future.

In the long run, lower profits may also reduce investment in new power stations, gas storage and renewable energy, which could cause energy supply problems later. Firms may also try to get round the cap, for example by raising the prices of their cheapest fixed deals towards the maximum price, raising standing charges or reducing customer service, so the gap of £231 between tariffs would close partly by cheap deals becoming more expensive.

The impact, though, depends on several factors. First, the magnitude depends on the level at which the maximum price is set. If it is set close to the cost of supply, as the £935 cheapest deal suggests is possible, the cap mainly removes suppliers' supernormal profit, so supply would barely fall and there would be little shortage. If it is set too low, below costs, firms would make losses and could go out of business. Measurement is difficult because the regulator does not know each supplier's true costs, and wholesale energy prices change frequently, so the cap must be reviewed regularly or it may cause government failure.

Second, demand for gas and electricity is price inelastic, because they are necessities with few substitutes, so demand would extend only a little and the excess demand would be small. In

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addition, a shortage is unlikely in practice because the regulator ensures that customers whose supplier leaves the market are transferred to another supplier, so they still receive gas and electricity.

Third, the time frame matters. In the short run supply is price inelastic because power stations and networks already exist, so output would not fall much. In the long run firms can cut investment, so the negative effects on supply are more likely. The cap also takes time to introduce, so the benefits to the 12 million customers will not be immediate.

In conclusion, a maximum price is likely to benefit the 12 million consumers on standard variable tariffs by lowering their bills, and as long as it is set at a level that still covers efficient firms' costs, the shortage and loss of investment should be small because demand is price inelastic and the regulator protects supply. The most important factor is therefore the level of the cap: set too low, it could lead to firms exiting and long-term supply problems, so it should be reviewed regularly alongside measures that encourage consumers to switch supplier.

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TOTAL FOR SECTION D = 20 MARKS

TOTAL FOR PAPER = 80 MARKS

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Pearson Edexcel International Advanced Level

Monday 13 May 2019

Morning | Paper Reference **WEC11/01**

Economics

International Advanced Subsidiary
Unit 1: Markets in action

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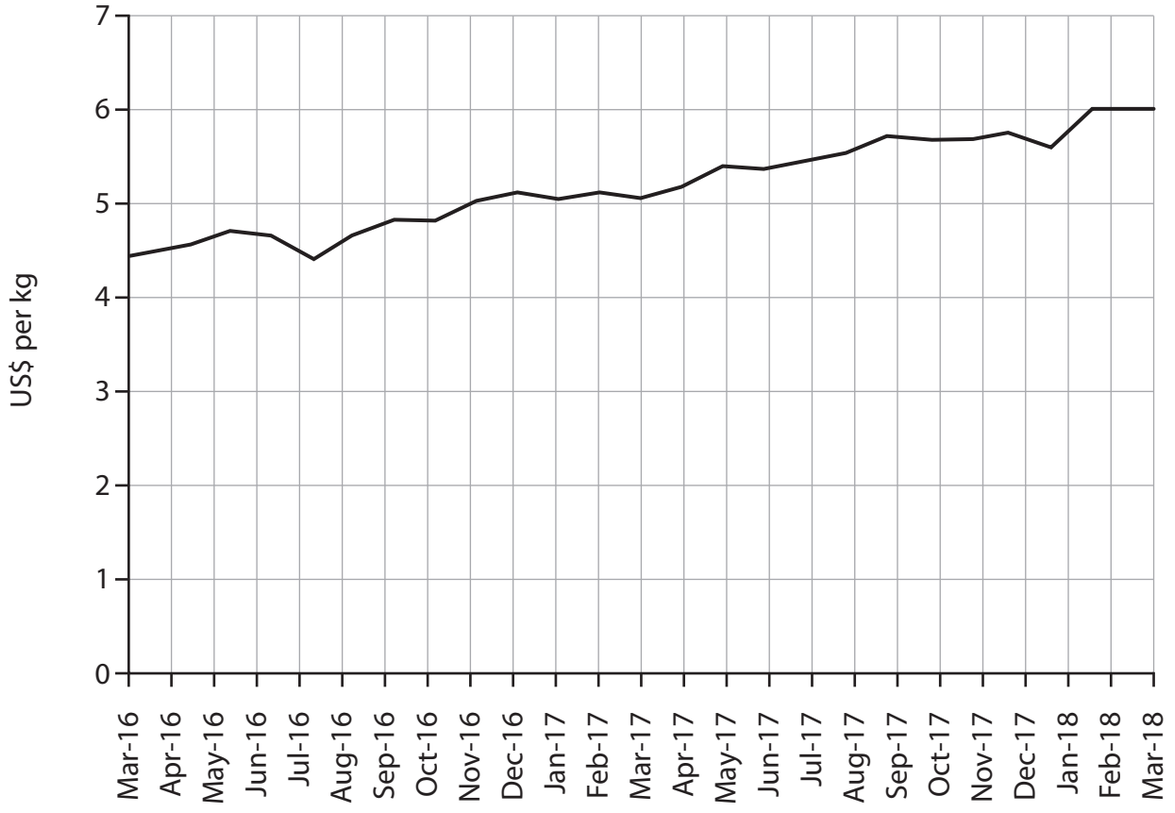
Sources for use with Section C.

The market for meat

Figure 1 Australian consumers' income elasticity of demand for lamb

	Income elasticity of demand (estimated)
Lamb	– 0.146

Figure 2 World price of lamb, US$ per kg, March 2016 to March 2018



Extract A The price of lamb

The rise in the price of lamb has come at a time when supply is stable. Higher demand for lamb has been caused by a number of factors. Rising global incomes led to a 28% increase in demand for Australian lamb in 2017. At the same time demand has risen in the USA. Successful advertising campaigns have also contributed to increased demand. 5

The lambs in Australia are often allowed to walk and graze freely and most of their food is wild grass which is considered to be a free good.

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Extract B Indirect tax on meat needed to address climate change

Meat consumption continues to increase around the world and meat production has risen in response. However, meat production has a damaging effect on the environment causing water pollution and 15% of all global greenhouse gas emissions. Excessive use of antibiotics to treat animals is also leading to a decline in the effectiveness of antibiotics used to treat human illnesses.

Many people consume too much meat, seriously damaging their health. This results in an increase in obesity, diabetes and cancer. For example, consuming 100 grams of red meat per day increases the risk of developing diabetes by 19%.

The Paris climate agreement set limits on the amount of global greenhouse gas emissions. However these targets will be missed unless taxes are used to restrict production and consumption.

One study looked at the impact of the introduction of a global meat tax. This study found a 40% tax on beef, a 20% tax on dairy products and a 8.5% tax on chicken would reduce emissions and save 500 000 lives a year.

The problems associated with meat production are not well-known by the public. One way to reduce emissions without the need for a tax would be for governments to provide the public with information on the external costs associated with meat production and consumption.

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Acknowledgements

Figure 1 'The income elasticity of meat: a meta-analysis' 28th September 2010, Craig Gallet, The Australian Journal of Agricultural and Resource Economics

Figure 2 based on data taken from https://www.indexmundi.com/commodities/?commodity=lamb&months=120

Extract A adapted from 'Is the China demand myth becoming reality?' 12 December 2017, Angus Brown, http://www.mecardo.com.au/commodities/analysis/is-the-china-demand-myth-becoming-reality.aspx

Extract B adapted from 'Meat tax 'inevitable' to beat climate and health crises, says report,' Damian Carrington, The Guardian, 11 Dec 2017, https://www.theguardian.com/environment/2017/dec/11/meat-tax-inevitable-to-beat-climate-and-health-crises-says-report

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