Examiners' Report
Prinicipal Examiner Feedback

October 2020

Pearson Edexcel GCE
In Economics B (9EB0)
Paper 3: The Economic Environment and Business

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October 2020
Publications Code 9EB0_03_2010_ER

Introduction

Entries were extremely limited for this paper and as a result it is hard to reach any meaningful judgements as to its overall performance. For many of the candidates it did prove to be a testing paper with some topics such as speculative bubbles, the role of the central bank and market changes proving particularly challenging. Several candidates did not attempt to answer some of the questions.

However, there were some very good responses from the more able candidates who demonstrated the ability to apply wide understanding and knowledge to the context of the questions.

As mentioned in previous years, many answers were wholly generic, not even bothering to use the extracts. Once again, it is worth stressing that the 'use of relevant evidence' is a key part of the level descriptors in the mark scheme. Without this, candidates will struggle to reach the higher levels.

Question 1 (a)

Those candidates who understood the nature of a bubble were able to use the evidence appropriately and explain why the UK housing market could be seen as one. They were able to add balance by contrasting the difference in the rise of house prices between London and the rest of the UK.

Weaker responses seemed unsure as to just what a bubble was, most knew it had something to do with high or rapidly rising prices but could not go further. Some students are still not including balance in their answers, despite the command to 'Discuss'

In the response below the candidate understands the nature of a bubble and attempts to connect this to the UK housing market. It does wander off the point slightly but does attempt some balance towards the end. This response reached L2 and 4 marks.

1 increased borrowing 2

1 (a) Discuss the extent to which the UK housing market can be described as a market bubble.

(8) Q01a

A market bubble is a situation when prices rise far beyond the real value of a good and eventually the bubble bursts, creating a crisis. ~~The UK housing market's current tradjectory will lead to a debt crisis akin to a market bubble~~. The increase in house price to earnings ratios and housing prices will lead to a debt crisis. This is due to the increased levels of borrowing needed for buyers, who will often be first time buyers with little credit history, making the loan's higher risk. As well as this, the UK's ~~are~~ low interest rate of 0.75% allows for more reckless loans to be taken as there is lower incentive to pay back quicker. This has been seen before in 2008, with Extract A showing the deflation of housing prices in 2008, and leading to an entire financial crisis. However whilst the UK's house price to earnings ratio is increasing, most of it is in London meaning the market bubble is moreso ~~in~~ within the London housing market rather than the UK housing market.

Question 1 (b)

Supply-side policies were widely understood in the general sense and many answers tended to the generic. Some failed to fully address the question by talking about reducing unemployment by using these policies, which is not the same as reducing a skills shortage. Only a few were able to specifically address the issue of skills shortages as per the question. Balance was usually achieved by looking at the time taken for the policies to be effective. More perceptive responses considered the type of skills that might be scarce and how they could best be addressed.

The response below is a good one and looks at migration and education/training with some balance and good contextualised evidence. It reached L3 and 7 marks.

(b) Assess the effectiveness of supply-side policies to ease skills shortages in the labour market.

(10)

One supply-side policy that could ease skill shortages would be to increase ~~the~~ and incentivise migration. The government could add in benefits like an easier path to citizenship to try and persuade more skilled workers to come live in the UK. ~~However~~ Due to Brexit there is a lot of uncertainty around the position of EU citizens in the UK, based on whether these workers will still have a place in the country, and as a result migration from the EU has fallen significantly. However, migration from the rest of the world is still increasing, and those people never had EU benefits. If the UK can get the message out that EU citizens will still be protected post-Brexit then it could reduce uncertainty and encourage migration again, potentially increasing the number of skilled labourers.

Another supply-side policy would be to ~~start off~~ reform the education system to promote the learning of valuable skills in the UK. This could be done by reducing or eliminating the cost of tuition fees for certain university courses, or by having companies in these areas offer apprenticeships. This would incentivise more people to pursue careers in these areas, due to decreased financial risk, and the decreased uncertainty of knowing there are jobs available in that area when you finish education. However, ~~these benefits~~ benefits of these policies would take a minimum of 4 years to come into effect, ~~the~~ but most likely longer than that, and it could be damaging to just wait that long, so this would have to be combined with short term policies like migration to be successful.

~~In conclusion~~, In conclusion, the government will have to use both long and short term supply side policies to be successful.

These are all demand side policies aren't they?

Question 1 (c)

The relationship and potential trade-off between unemployment and inflation was widely understood but many answers lacked sophistication and saw it as an either/or situation. Sweeping generalisations were common across this question and a mark in L2 was a frequent score here. Despite being told to do so, only a few responses used the evidence in extract C.

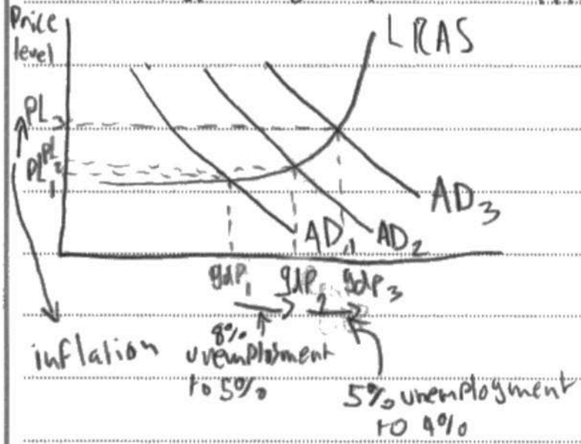
Good answers showed real understanding by comparing the predictions of theory to the actual trends and figures shown on the graphs in extract C. These responses reached the higher levels.

The response below starts by explaining the trade-off and uses a diagram to support the idea that the extent of the trade-off is dependent on the level of output. It is a shame that the AD curve is taken to show the level of unemployment but there is some merit here. The evidence is used and an assertion leads to some balance which is a little confused. This response is a borderline L2/L3 but just reached L3 and 6 marks.

(c) Using Extract C, assess the extent of the trade-off between unemployment and inflation.

(12) Q01c

It is Generally Considered fact by classical and Keynesian economists that when unemployment is reduced to certain Point, that inflation will begin to rise. A ~~Keynesean~~ Keynesian approach can explain why unemployment did not ~~affect~~ increase inflation until a certain point.



As we can see a decrease in unemployment is good for GDP and has minimal impact on inflation. However, past a certain point the increased supply of jobs means that workers have more power in the Labour market and can hence demand higher wages, increasing costs and raising inflation. ~~Also~~ Although, it is clear that this explanation has flaws, such as why the initial decrease in unemployment was matched by a similar decrease in inflation instead of slightly increasing as the model suggests.

Moreover, it can be argued that factors such as money supply and interest rates play a far greater role in determining inflation when compared to unemployment. The decrease in both unemployment and inflation (from 2013 to 2015 leads one to believe that other forces were at play. The UK government expenditure was decreasing and the Bank of England were easing off the Quantative easing scheme that was increasing money supply.

Question 1 (d)

Whilst most candidates knew something about the role of the central bank they were unable to develop their response beyond the control of interest rates and inflation. Many assumed that this would be enough to reduce risk and uncertainty on its own. Some responses copied the evidence out without developing the points.

Only a few went further and discussed the bank's role in regulating the banking industry and acting as the lender of last resort. One very good answer even brought in QE as a way of reducing uncertainty.

The response below was a good one that used the idea of moral hazard by way of balance, it also covers the role of the base rate leading to a conclusion. It could have widened its arguments further but it did reach L3 and 14 marks

(d) Evaluate the role of the central bank in reducing economic risk and uncertainty.

(20)

In this case, the central bank is important in reducing risk and uncertainty as it can ~~bail out failing banks. This is because when banks run out of provide~~ bail out failing banks. This is because when banks run out of cash or fail as we seen in the 2008 financial crisis, the central bank can provide cash so they do not go bankrupt. As a consequence, depositors ~~and [illegible]~~ have reduced risk as ~~a result~~ of banks are more likely to be able to give them their money if they collapse. This may mean that uncertainty within the economy is reduced as there is some form of a 'plan B'.

However, the central bank may not help to reduce economic risk and uncertainty due to banks ~~believing they have~~ acting with moral hazard. This is because they believe that if something goes wrong, they will be bailed out and so act irresponsibly, ~~[illegible]~~ giving sub-prime loans. As a consequence, there may be a much greater risk of banks not getting ~~[illegible]~~ returns on their loans as they take more risky loans such as the £38bn worth of high-risk loans in 2017. This may mean that ~~[illegible]~~ banks ~~[illegible]~~ who believe they are 'too big to fail' may actually increase risk

as a result of the central bank.
The Central bank does reduce economic risk and uncertainty by changing the base rate to allow stable inflation. ~~As a co~~ This is because they ~~manipulate the base rate~~ change the base rate to hit their target of 2% inflation. ~~and~~ As a consequence, if an economic shock does ~~occur~~ occur, ~~the Bank of England~~ such as the 2020 pandemic, the Bank of England changed the base rate so interest rates are at 0.1%. This may mean that there is less uncertainty for firms as ~~they~~ there is a structure if anything unexpected occurs and therefore less risk in investments.
However, the central bank may not be able to reduce risk and uncertainty due to time lags ~~associated with these policies~~ as a result of changing the base rate. This is because it can take up to 2 years for the effects of a change in interest rate to ~~occ~~ take place. As a consequence, there may be a lot of ~~risk of~~ uncertainty during an economic shock as firms and individuals ~~and not~~ resulting in less investments and less consumer spending. This may mean that the central bank does not have an effect in the short term ~~on~~ to reduce risk and uncertainty.

Question 2 (a)

This question was generally answered well with many candidates being able to describe the way a forward market worked and by way of balance pointing out that it was possible to gain or lose depending on the way prices moved. Once again, few candidates bothered to use the evidence from extract F to illustrate the uncertainty of potato prices and the merits, or otherwise of forward markets. Despite this, it proved to be a good question for most candidates, many were able to reach L3 comfortably.

The response below shows clear understanding and develops its arguments well with good balance and well supported by evidence and example. It reached L3 and 7 marks.

2 *Walkers* buys 350,000 tons of potatoes each year.

(a) Discuss the benefits to *Walkers* of using forward markets to buy potatoes.

(8)

In this case, Walkers can benefit from using forward markets to buy potatoes as there may be lower costs. This is because Walkers can set a price at a certain time when prices appear to be low for a future shipment of potatoes. As a consequence, Walkers may not suffer from the +36% yearly change in the agricultural price index of potatoes from September 2017 but can pay current prices. This may mean that Walkers can produce a more accurate cash flow forecast as there is a set cost and may results in greater profits in the cost is lower than at the time of shipment.

However, Walkers may not benefit from forward markets as the price may actually fall. This is because the monthly change from August 2018 in API for potatoes was −8.6%. So the price would be lower. As a consequence, Walkers may have higher costs of inputs ~~than~~ than competing brands ~~a~~ such as Kettle chips and ~~so~~ may become less competitive if they have to raise their prices. This may mean that there is a fall in demand in Walkers, resulting in less revenue and thus less profit.

Question 2 (b)

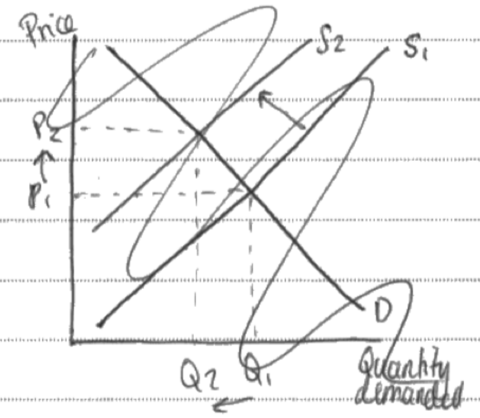
By contrast this question proved to be a bit of a disaster for the majority of candidates who completely misunderstood the point of the question and assumed that it was about Walker's as an individual firm rather than the whole market. As a result many candidates failed to score any marks. Some candidates even ignored the instruction to 'use a suitable diagram'.

The response below was a rare example of a good answer that clearly illustrates and explains the likely outcome within the market. It reached L4 and 9 marks.

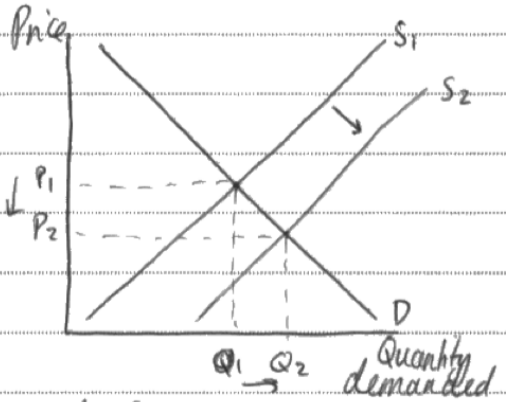
In 2017 the potato price index rose by 36%.

(b) Using an appropriate diagram, assess the possible impact of this on the potato market in 2018.

(10)



~~In this case, the one possible impact of an increase in~~



In this case, the impact of an increase in the price index is ~~an~~ an increase ~~in the amount of ...~~ in supply. This is because the increased price acts as an incentive for others to join the potato market as there is more profit to be made. As a consequence supply shifts right from S_1 to S_2 resulting in a drop in price from P_1 to P_2 but an increase in quantity demanded from Q_1 to Q_2. This may mean that there are more people willing to pay for potatoes at this price.

However, an increase in the price index may not increase supply as there may be many barriers to entry in the potatoa market such as land.

As a consequence, supply may not ~~increase~~ shift right as there are not the resources available. This may mean ~~that regulation~~ that potato suppliers become more profitable as supply remains the same.

In judgement, the increase in the price index may result in a higher supply ~~as~~ because, despite demand potentially falling from increased prices, firms may allocate their resources in this market over ~~market~~ animal and animal product markets as it only rose by +0.6% in September 2017. This judgement depends on how easily it is to change markets. ~~as~~ If it is quick and easy, the supply for potatoes may increase but if it is difficult firms may continue to supply other agricultural products.

Question 2 (c)

This proved to be more straightforward than the previous question for most candidates and was generally answered well with many candidates being able to explain the impact of rising input costs. Less well done was their ability to balance their argument beyond simplistic assertions.

One or two responses used the evidence well and brought in other considerations such as PED or whether these rising costs were also affecting overseas competitors as well.

The response below has some understanding but tends to repeat the evidence without making much use of it. As a result it reached L2 and 5 marks.

(c) Assess the extent to which rising input costs are a problem for food and drink firms.
(12)

~~Input~~ Rising input ~~firms~~ costs refer to an increase in the cost of production due to an increase in the cost of materials, ~~this can be a~~ in this case an increase in ingredient costs. 'More than three quarters of ~~m~~ manufacturers expect input prices to continue to rise throughout 2018' this means that it would be more risky to invest, despite this, 'many companies said they were still hoping to invest, ~~this~~ with investments in new machinery and product launches, this has the biggest impact on ~~food and drink firms~~ smaller food and drink firms as they ~~face higher risks~~ are unable to take higher risks as they do not have the capital to support ~~them in the case~~ if they are unsuccessful with the risk. Also large food and ~~drin~~ drink manufactures benefit from better ~~m~~ machinery and economies of scale which means that they will not be affected as negatively by the increase in ingredient costs, however smaller food and drink firms would be ~~less compe~~ significantly less price competitive as a result of this.

Although Extract 1 states that 'many companies were still hoping to invest' ~~and~~ an increase in the rise of input costs create uncertainty ~~for~~ within ~~the market~~ food and drink markets and therefore make the market less dynamic. Which has negative effects on consumers as there will be less product launches and less money invested into firms and also bad for the firm so it reduces revenue and profit.

Question 2 (d)

Exchange rates always seem to prove a difficult topic for many students and this question was no exception. Even those who did not get tangled up in appreciation/depreciation and the impact on trade seemed unable to add anything beyond repeating the evidence in extract J.

The development of competing arguments and balance, supported by evidence is important in this paper and particularly so with the longer questions. Many candidates limited their marks by failing to do so.

The response below is typical of many, in that it shows understanding but relies heavily on repeating the evidence without adding much by way of development. The 20 mark questions are designed to be open ended and to give candidates a chance to show what they know and to demonstrate their understanding of the interconnectedness of the subject matter. A narrow focus is potentially limiting in terms of achievement. This response reached L2 and 8 marks.

(d) Evaluate the implications of exchange rate volatility for firms.

(20)

Exchange rates refer to the value of one currency in terms of another currency. Exchange rate volatility is when there is uncertainty surrounding the fluctuation of ~~price~~ in the ~~cost~~ worth ~~price~~ of a currency.

Extract I states that 'Exchange rate volatility remain a concern for food and drink business'. ~~All businesses~~ nearly all businesses are effected by exchange rate volatility due to globalisation. Exchange rate volatility is usually a negative externality for firms as it discourages firms from investment and ~~sometimes~~ creates fluctuations in the ~~competitiveness~~ competitiveness of firms ~~an~~ that export or import.

Extract J states that 'weak sterling is a major concern ~~to~~ for Irish companies exporting there goods and services to the UK', this is applicable to all countries as ~~the~~ a fall in the value of the currency that a country is exporting to would make the goods being exported seem more expensive in comparison this shows ~~th~~ how exchange rate volatility ~~has a negative~~ can have a negative effect on in exporting companies ~~in the~~ pia

However, in other cases, ~~some~~ exporting companies benefit from exchange rate volatility, for example if the value of

the domestic currency decreases ~~the~~ it will make the exporting company more competetive as ~~they will be able~~ there products will seem cheap in comparison.
~~However~~ Although exchange rate volatility can benefit markets, it is a negative externality as a rapid change in the value of a currency would create uncertainty and make the ~~fir~~ market for firms less dynamic as it discourages investment.

Extract J also shows how exchange rates could benefit importing companies 'Irish importers have been enjoying a "Brexit Boom" as spending ~~from~~ on bargain imports from Britain has soared' this makes Britain more competetive as our goods seem cheaper in comparison is the value of sterling drops, however if this is volitile companies will be ~~so~~ ~~wary~~ uncertain to make investments in Britain.

Extract J also talks about how a decrease in the value of sterling has lead to an increase in Foreign Direct investment, 'expand production into the UK and take advantage of lower production costs, this shows how a decrease in the value of a currency can have a positive effect on the economy, if it however proven to be volitile, ~~Foreign direct investment will dec~~ firms will be discouraged from investing in the UK, however

This can be seen as positive overall as 'the operational moves offset sterling costs and revenues thus mitigating currency exposure'.

Based on their performance on this paper, candidates are offered the following advice:

- The case study should be thoroughly prepared for, and real-life examples researched to reinforce argument and discussion
- Always support your arguments with evidence and examples
- Take note of command words and specific instructions
- QS skills account for 20% of available marks, more details in the specification. Practice and preparation of key diagrams is crucial
- It is well worth looking carefully at the level descriptors and taking time to understand what they mean
- There is a lot of data in this paper, take the time to read through it all carefully before starting your answers
- Watch your timing and do not spend too long on the shorter questions

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