



Examiners' Report

Principal Examiner Feedback

June 2019

Pearson Edexcel Advanced Subsidiary
in Economics (8EB0)

Paper 2: The wider economic
environment

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June 2019

Publications Code 8EB0_02_1906_ER

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Introduction

This was the penultimate sitting of the paper with a reduction in the number of candidates compared to 2018. The paper was split into 3 sections: Section A and B each had 5 questions and Section C had the 20 mark essay question.

Section A

Question 1a

This question involved candidates having to give a definition of the term 'brand'. Many candidates were able to get at least 1 mark by providing a partial definition of the term such as references to it being a name, logo, image or symbol. The second mark was awarded for references to the name or logo being used to differentiate or distinguish it from rivals. Examples of brands or the benefits of branding such as being able to charge a premium price were not credited.

1 (a) What is meant by the term 'brand'?

(2)

A company name or image that differentiates it
from other businesses, eg. apple.

Question 1b

Many candidates were able to score full marks by correctly calculating a YED of 3.48. With an incorrect answer, marks could still be awarded for showing workings, such as providing the correct formula for YED. Some candidates only scored 3 marks as they gave their answer as a percentage i.e. 3.48% which is the incorrect unit. The advice is always to show workings and to double check the correct units have been used otherwise marks will be lost on the calculation questions.

Estimates indicate that a 2.3% rise in incomes in the UK would result in an 8% increase in demand for premium chocolate.

(b) Calculate, to 2 decimal places, the income elasticity of demand (YED) for premium chocolate. You are advised to show your working.

(4)

$$YED = \frac{\% \text{ change in quantity demanded}}{\% \text{ change in price income}}$$

$$YED = \frac{8}{2.3} = 3.478$$
$$= \boxed{3.48}$$

Question 1c

This question was marked using points based AOs (Knowledge:1, Application: 2 and Analysis: 1). The Knowledge mark was awarded for giving one impact on chocolate manufacturers and Examiners accepted anything from lower variable costs, lower costs of production to cheaper imports. Application could be any use of relevant evidence and the use of numbers from the chart was rewarded. Most candidates only gave 1 piece of Application rather than 2 separate pieces. Analysis could be how the stated impact could affect profitability, sales, market share or any relevant consequence. Many candidates were able to gain at least 2 marks on this question and often it was Application which was lacking.

Hotel Chocolat imports all its cocoa from Saint Lucia.

(c) Using the trend shown in Extract A for the period 2016–2017, explain **one** possible impact on chocolate manufacturers, such as *Hotel Chocolat*.

(4)

As prices for cocoa beans has depreciated from about ~~\$20000~~^{\$3400} per metric ton to \$2200 per metric ton, this may ~~reduce~~ reduce costs for chocolate manufacturers such as *Hotel Chocolat* as the main raw material for production has decreased almost \$1200 per metric ton.

A reduction in cost for chocolate manufacturers may mean that with decreased cost, this will consequently lead to less products to be sold to breakeven and also potentially increase profits. This may also be used to decrease prices to increase competitive advantage.

Question 1d

This proved a popular question with many candidates being able to score at least Level 1 for some understanding and application of the economic cycle. The 'Discuss' question does require evaluation and many candidates did provide an evaluation of how the economic cycle might affect *Hotel Chocolat*. Candidates have been able to use some of the information in the Extract to write about the how *Hotel Chocolat* may positively benefit from rising incomes and low unemployment in a boom. The counter argument focused on how *Hotel Chocolat* might be negatively affected in times of an economic downturn or recession. Some candidates used their answer of 3.48 from the YED question to support their reasoning which was very pleasing to see. Although a conclusion was not required, some candidates brought in other external factors such as the exchange rate or price of commodities as other factors which may make more of an impact on *Hotel Chocolat*.

(d) Discuss how the economic cycle might affect manufacturers of premium chocolate, such as Hotel Chocolat.

(8)

The economic cycle is the fluctuations in an economy's performance between a boom and a recession. 'Hotel Chocolat' provides a 'luxury' item. In a boom or peak, where unemployment is likely to be low and incomes likely to be higher with increased confidence, workers' greater disposable incomes could increase demand for this luxury product as it is price & income elastic with a value of 3.48%. Increased demand could mean increased sales and thereby increased profit. This could allow them to go invest and grow the business giving a competitive advantage. In a recession, or after 2 consecutive quarters of negative growth GDP, incomes may be lower and meaning less disposable income. Unemployment is likely to be higher too so less consumerism in the economy. Inflation may also be low and stable so prices may suffer. Demand for an income elastic good is likely to drop, forcing hotel chocolate to reduce their prices or profit margin, in this case make it harder for them to reach their break even and survive.

However the chocolate bar states the 'revenue was £105.7m with 12% year on year growth' suggesting that the economic cycle may not have an impact on manufacturers of premium chocolate. It is stated that their product is affordable or 'affordable luxury' along with this, consumers may see it as a need, reducing its price elasticity of demand.

Other economic factors may play a more important role in firm performance like the exchange rates.

Question 1e

This proved to be a popular question and many candidates were able to give some benefits of organic growth in terms of risk and avoidance of culture clashes. Many candidates have evaluated, as this was an 'Assess' question and the counter argument focused on the problems of organic growth, typically speed of expansion and lack of new ideas into the business. Relevant evidence was somewhat lacking again and many responses were generic in nature. Responses with simplistic evaluations and with limited use of evidence typically achieved Level 2 only. Unfortunately, some candidates discussed the success of Hotel Chocolat without focusing on organic growth so did not answer the question. Better responses provided a conclusion as to whether this was a good way to grow and brought in other considerations as well.

(e) Assess the benefits of organic growth for a firm such as *Hotel Chocolat*.

(12)

Organic growth is the way of increasing a firm's productivity output by diversifying their range, or branching out to a different target audience of consumers. One way this can be done is by developing a new product, to increase aggregate demand for a firm. Through developing a new product, advertising must be done to create awareness & promote this product to consumers. As Hotel Chocolat doubled their profits from 2016 to 2017, paying for advertising should not be a problem for the firm. As wider recognition is gained, sales will increase as customers try a new product & hopefully become brand loyal. This will lead to increased revenue, which can be ~~reinvesting~~ reinvested into Hotel Chocolat to further increase productivity output. This can be done by raising an employees

wage to motivate them, hoping to increase their productivity or by training workers to be more efficient & productive. This would be a huge benefit of organic growth to Hotel Chocolat.

As Hotel Chocolat is a rapidly growing firm, shareholders may become dissatisfied by organic growth, as it provides a slow, sustainable level of growth. An objective for shareholders is that they want rapidly increasing profits, to ~~divid~~ provide large dividends to them, however organic growth is a slow & steady way of increasing productivity. Similarly, this could be a disadvantage to the firm as

shareholders become unhappy with a firm's ^{business} objectives.

As organic growth happens, the firm must rely on the market to grow as otherwise the money put into organic growth will be wasted. As Hotel Chocolat are in a niche market, the premium chocolate industry could be easily damaged if economic activity reaches a slump, similar to that of 2008. This would mean that revenue would heavily decrease as premium chocolate is an inelastic product that can be replaced with a cheaper alternative.

Another advantage of organic growth is that it is extremely cheap compared to inorganic growth. Inorganic growth occurs by firms merging & taking over other firms, which provides requires lots of investment for a risky business decision. Organic growth leaves Hotel Chocolat with extra money to spend in branching out & advertising the business in other countries, which is one of their current aims.
(Extract B)

In conclusion, the benefits of organic growth outweigh the disadvantages as it is a sustainable way of slowly increasing output & productivity. Great in the long run.

Section B

Question 2a

This question required candidates to provide a definition of exports and again 2 marks were available for a two-part definition. Credit was given for references to goods or services from one country **AND** goods being bought or transferred or received by another country. Marks were awarded for some indication that goods were being sent across a national border. Credit was also given for exports are an injection/money inflow into the economy as an alternative way of gaining a second mark. Examples and references to exchange rates were not rewarded.

2 (a) What is meant by the term 'exports'?

(2)

Exports are goods sold to another country, they're an injection of money into the economy, circular flow of income.

Question 2b

Some candidates were able to calculate the correct answer of -12.69% and awarded all 4 marks. Marks could be awarded for showing workings in situations where an incorrect answer was given. If the % sign was missing, then 1 mark was deducted. Some candidates calculated the answer as a positive change and unless there were some workings shown, 0 marks were awarded. It is essential that workings are shown as these can still be awarded marks for correct use of formula or for some correct use of data. Always check the decimal places and the correct units have been used.

(b) Using Extract C, calculate, to 2 decimal places, the percentage change in the amount of foreign direct investment (FDI) for Brazil from 2014 to 2017. You are advised to show your working.

(4)

$$\begin{aligned} \% \text{ Change} &= \frac{\text{change}}{\text{original}} \times 100 \\ &= \frac{84.6 - 96.9}{96.9} \times 100 \\ &= -12.69 \% \end{aligned}$$

Question 2c

This question was marked using a point based question with 1 Knowledge mark, 2 Application marks and 1 Analysis mark. Some candidates were able to gain the 1 Knowledge mark for stating a suitable impact such as less tax receipts, increase in welfare payments and credit was given for any reasonable impact on the government. Application could be references to the data in the extract e.g. unemployment had risen from 6.8% to 13% (1 mark) and for using the data in some way e.g. references to it almost doubling (1 mark), increased by almost 100% (1 mark) or any sensible use of the data. Marks were not awarded for a simple reference to unemployment has risen – candidates had to use numbers/data to gain the Application marks. The 1 mark for Analysis was awarded for candidates who showed the negative impact of the increase in unemployment in terms of a government budget deficit and/or less revenue to spend on public goods.

(c) Using Extract C, explain **one** impact these unemployment rates may have on the Brazilian government.

(4)

The unemployment rate in Brazil has almost doubled from '6.8% in 2014' to '13.2% in 2017'. An impact of this for the government means that there will be an increase in government spending for ~~their~~ benefits of those unemployed. At the same time, tax receipts will decrease, lessening the amount to be spent by the government.

Question 2d

This question was poorly answered with many candidates misreading the Extracts and thought that Brazil was becoming part of the EU trade bloc so there were many responses with flawed reasoning. This was a 'Discuss' question so required candidates to evaluate the benefits and drawbacks of being a member of a trading bloc. Some candidates were unable to do either and there was a clear gap in knowledge about trading blocs.

(d) Discuss the possible advantages for Brazil of being a member of a trading bloc.

(8)

A trade bloc is an agreement between participating countries to trade freely.

Being part of the trade bloc has huge benefits for the Brazilian economy, such as the ease of exporting to other countries within the agreement, such as ~~and~~ Argentina. The results of ~~the~~ implicating a trade bloc has shown benefits such as increase in GDP for example when India joined the RCEP, which could happen too for Brazil. Furthermore, the trade bloc will enable to purchase foreign goods at a cheaper price than would otherwise be possible from Paraguay or Uruguay, and Brazilian consumers who enjoy buying ~~import~~ ^{imported} goods will benefit.

On the other hand, Brazil charges a high tariff rate of 8.8%, which brings revenue to the economy and the government. Without the 8.8% charged, the Brazilian economy will have less money to spend on the public. Furthermore, a trade bloc will have a negative impact for domestic producers who will now have less of a competitive advantage than they did before, due to the lowered prices of competing imports from foreign countries coming into Brazil.

Question 2e

This was another 12 mark 'Assess' question and required an understanding of FDI. Credit was given for candidates who discussed the benefits in terms of jobs, skill/technology transfer and greater choice of goods for the Brazilian population. Again, despite plenty of examples in the Extracts, relevant evidence was again lacking and better responses made reference to some of the MNCs mentioned in Extract D and used some of the data in Extract C. The counter argument could be anything from exploitation of the environment and workers in terms of low pay or that many MNCs do in fact bring their own management rather than employ local workers for senior positions. For a high Level 4 response, we were looking for arguments which were fully developed and evaluated, supported throughout with relevant evidence as well as a full and balanced awareness of the validity and significance of competing arguments. On the whole, this question was better answered than the 12 mark question in Section A.

(e) Assess the benefits of inward foreign direct investment (FDI) flows to a country such as Brazil.

(12)

Foreign direct investment is where where where countries receive investment from abroad, to stimulate economic growth.

Despite FDI decreasing for Brazil from \$96.9bn in 2014 to \$84.6bn in 2017, the amount is still significant. The main advantage of FDI for Brazil is that it will create new jobs. More jobs means that individuals will have more disposable income and as a result will spend more. This increases output in the country, which could be good for Brazil as in 2015 and 2016 real GDP growth was negative. This should ultimately lead to higher standards of living.

Moreover, in Brazil, there is infrastructure support and a large pool of workers at all education levels. With more investment from FDI, firms in Brazil could be able to access more external economies of scale, which could reduce costs for manufacturers in Brazil. This could lead to lower prices for consumers in Brazil, giving them more spending power and the ability to afford a wider range of goods. This ^{extra spending} could lead to the

positive multiplier effects, increasing economic growth and ~~however~~ it could be possible standards of living

However, it could be possible that an FDI Brazil receives is not used effectively. Brazil has many favelas and high levels of crime, potentially meaning that FDI doesn't always go where it should (officials may be corrupt). This could result in wastage of the money, meaning that the FDI would be ineffective, and therefore not impact Brazil's economy significantly.

Additionally, FDI may not take into account negatively externalities: whilst Brazil has lots of raw materials these may run out quickly and the process of mining them could harm the environment. This could increase costs for healthcare for the Brazilian government, therefore ~~not~~ reducing the positive impact on the economy.

Overall, in the long-term, FDI could lead to more economic growth and better standards of living, providing it is sustainable.

Section C

Question 3

This was the highest mark question on the paper and this year it was pleasing to see that there had been an improvement in the quality of responses with many candidates being able to access the higher levels. Many candidates were able to show how lowering taxation (either income or corporation) could help economic growth in terms of jobs, investment and spending. Better responses used economic terminology throughout and were able to link to AD and AS (although rarely both). Again, there was plenty of relevant evidence provided in the Extracts about the rates of income and corporation tax which some candidates used but many candidates did write generic responses again. For the counter argument, credit was given for candidates who showed the consequences in terms of the budget deficit and the implications in terms of government revenue. Marks were also given for candidates who considered the impact on inequality and whether tax savings did translate into higher economic growth with some linking to leakages such as spending on imports, saving and the trade-off with inflation. The question did ask about the 'extent to which' and better responses structured their evaluation from this perspective and brought in other factors which might also affect economic growth.

3 Evaluate the extent to which a reduction in taxation will increase a country's rate of economic growth.

(20)

A reduction in taxes is part of expansionary fiscal policy. A decrease in tax means that consumers have more disposable income to spend. This increases aggregate demand in the economy. This increase in AD can greatly help a country's rate of economic growth as and national output will increase. Consumers are willing to spend more in the economy. In America, the new tax changes will include a reduction in top rates of income tax. This means that America's 'high-earners' will have to pay less tax income tax annually. This will cause an increase in demand from this demographic, often for more luxury and 'big-ticket' items. (For example, the demand for cars may dramatically increase). Here, the use of expansionary fiscal policy on consumers will help to increase demand across the economy, leading to economic growth.

However, the changes in taxation are not likely to affect the lower or middle income tax households as they are not in the affected tax bracket. This means that they won't experience an increase in disposable income and therefore, won't affect the shift in AD. The economic growth will be unequal across the economy. Trump's new tax laws won't help the millions of families struggling to make ends meet.

~~A reduction in taxes~~ A reduction in corporation tax from 35% to 20% will help boost economic growth. This significant and 'historic' tax cut means that America will become an attractive investment for MNCs. America has a huge population and work force meaning that with an increase in FDI from MNCs, the economy could grow rapidly.

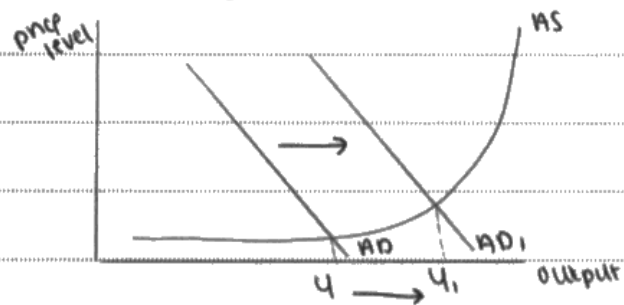
America's national output will increase causing AD to increase in the economy. This will increase the size of the economy. This use of expansionary fiscal policy by the US government will attract more MNCs to the US as its corporation tax will only be 1% higher than the UK's rate (before it is dropped in 2020). This means that for firms looking to invest in the West, America may become the preferred choice due to its high population and booming economy.

However, MNCs may choose not to invest in the US due to its unpredictable future economic growth. With such a huge drop (15%), change will happen quickly causing the future to look uncertain. Also, for established MNCs in the UK, this drop in corporation tax is unlikely to make them move business to America. Especially so as the corporation tax in the UK will lower to 17% in April 2020.

Furthermore, this huge decrease in tax will cause a large budget deficit due to lost tax revenue. Even though US estimates predict the economic growth will outweigh the deficit, it is predicted that \$1 billion will be added to the US budget deficit even with extra growth. This means that the US will suffer greatly from the lost tax revenue even with the huge investment it can attract.

Overall, in the short term, a cut in taxation can cause rapid growth in a country's economy due to an increase in FDI and AD. However, this rapid rate of growth is unsustainable and the huge budget deficit will cause issues for Trump's government. Expansionary

fiscal policy alone cannot provide sustainable economic growth. The US could use expansionary monetary policy also to increase economic growth. Interest rates ~~and~~ could be lowered to encourage spending (as ~~borrowing~~ borrowing is cheaper). This will help to shift AD to the right.



This overall, an ~~increase~~ ^{increase} in AD (which can be caused by cutting taxes) can help to achieve the government's objectives, like economic

growth and employment. However, a balance of payments equilibrium is not reached and inflation can start to rise when AD increases.

In conclusion, taxation alone cannot provide sustainable economic growth. Expansionary monetary and supply side policies (e.g. increasing education and training) should be used also. This huge decrease in tax in the US is unsustainable. Tax should be reduced slowly and gradually to avoid rapid changes.

Based on their performance on this paper, candidates should:

- Ensure the command words are followed and evaluate when necessary.
- There is more use of relevant evidence in the levels based questions.
- There are 2 separate pieces of Application in the 4 mark Explain questions.
- Calculations are given to 2 decimal places and the correct units are used.
- Use economic concepts rather than 'common sense' answers.