

Surname	Centre Number	Candidate Number
Other Names		2



GCE A LEVEL – NEW

1520U30-1



ECONOMICS – A2 unit 3
Exploring Economic Behaviour

TUESDAY, 6 JUNE 2017 – AFTERNOON

2 hours

For Examiner's use only		
Question	Maximum Mark	Mark Awarded
Section A	1	8
	2	8
	3	6
	4	6
	5	6
	6	6
Section B	7	4
	8	12
	9	8
	10	8
	11	8
Total	80	

ADDITIONAL MATERIALS

A calculator.

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Write your name, centre number and candidate number in the spaces at the top of this page.

Answer **all** the questions in the spaces provided.

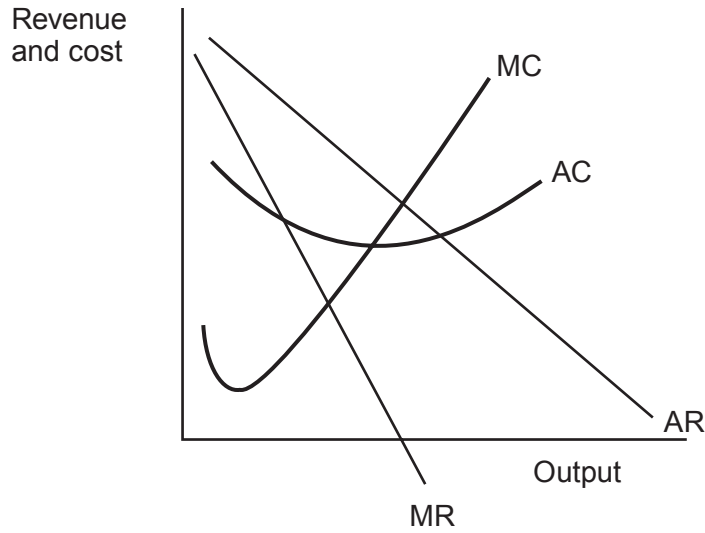
INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question.

SECTION A

Answer all questions in the spaces provided.

1. The diagram below illustrates a firm operating as a profit-maximising monopoly.



- (a) Describe the difference between normal and abnormal profit. [2]

.....

.....

.....

.....

- (b) Adapt the diagram above to show the area representing the level of abnormal profit being made by the monopoly firm. [2]

(c) Using the diagram, explain why this firm is not productively efficient.

[4]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

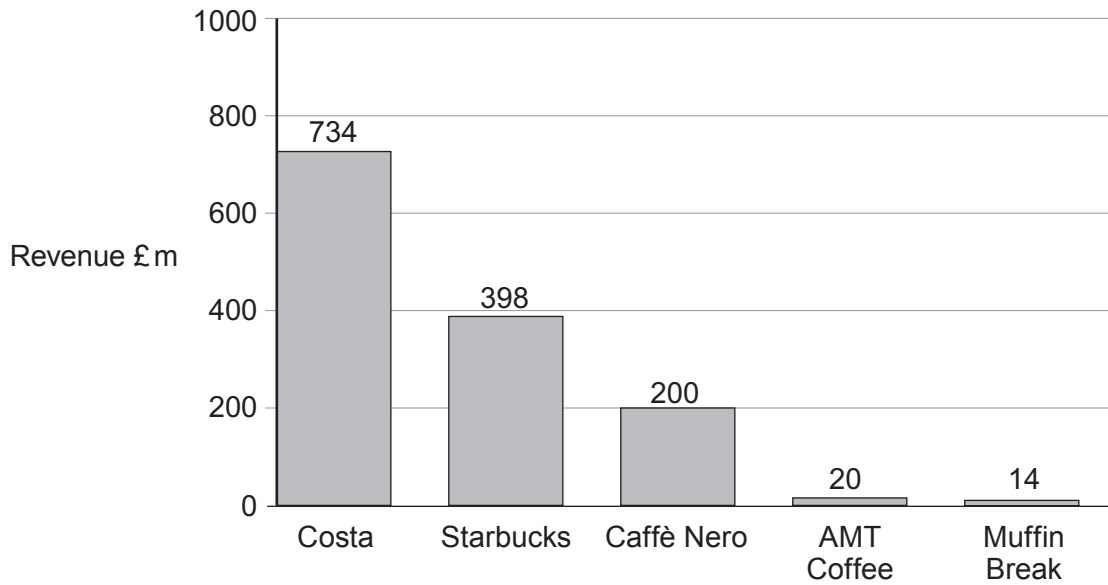
.....

.....

1520U301
03

8

2. The following bar-chart shows the amount of revenue for selected coffee shop companies in the UK in 2013.



- (a) Calculate the 2-firm concentration ratio for the selected UK coffee shop companies. [2]

.....

.....

.....

.....

- (b) Using an example, describe how coffee shop companies could compete using non-price competition. [2]

.....

.....

.....

.....

.....

- (c) The following payoff matrix illustrates possible profit (in £ m) if Costa and Starbucks decide to compete in terms of price.

		<i>Starbucks</i>	
		<i>High Price</i>	<i>Low Price</i>
Costa	High Price	95, 45	65, 50
	Low Price	120, 30	75, 40

Indicate the Nash equilibrium in this scenario, and justify your answer.

[4]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

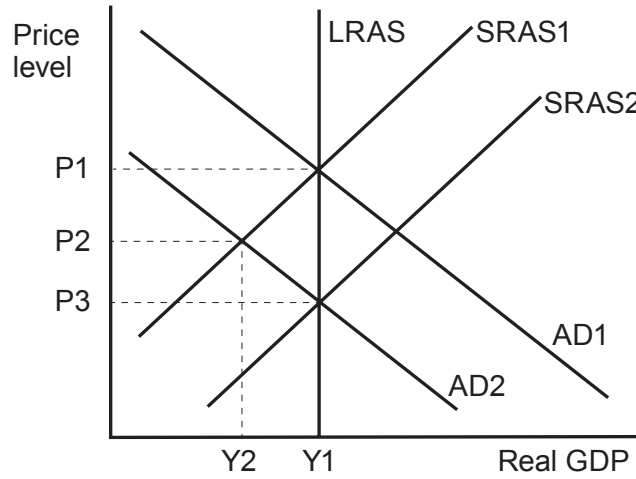
.....

.....

1520U301
05

8

3. The following aggregate demand and aggregate supply diagram shows an economy that is initially in equilibrium at P1Y1. AD then falls from AD1 to AD2, resulting in a short-run equilibrium at P2Y2. The economy eventually returns to a long-run equilibrium at P3Y1.



- (a) State and outline **one** possible factor that could cause the downwards shift in the short run aggregate supply curve from SRAS1 to SRAS2. [2]

.....

.....

.....

.....

- (b) Explain possible reasons why a Keynesian economist might disagree that a new equilibrium at P3Y1 would be reached. [4]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

4. The following table provides information regarding the unemployment rate (%) in Wales from 2005 to 2015.

Region	2005	2010	2015
Wales (overall)	4.9	8.1	6.3
North Wales	3.3	6.3	5.3
Mid Wales	3.2	4.9	3.5
South Wales	5.4	8.5	7.4

Source: Stats Wales

With reference to the data, discuss the likely reasons for the patterns shown. [6]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

1520U301
07

5. Every month, Nationwide (a building society) publishes data on house prices for all regions of the UK. The table below provides selected time-series data for house prices in Wales from 2005 to 2015.

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Average House Price (£)	137,256	141,401	150,017	151,499	123,990	137,148	133,569	129,682	132,971	139,911	139,171
Index (1993 = 100)	283.5	292.0	309.8	312.9	256.1	283.2	275.8	267.8	274.6	288.9	

(a) Calculate the index number for house prices in Wales in 2015. Show your workings. [2]

.....

.....

.....

.....

.....

(b) With reference to the data, discuss the consequences of house-price bubbles for the Welsh economy. [4]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

6. The majority of countries in the European Union use the euro as their main legal currency; these countries are known as the eurozone or euro area countries. The European Central Bank (ECB) sets monetary policy for these countries; its main task is to keep inflation under control.

The following table provides data on 2016 macroeconomic indicators for some eurozone countries.

Country	GDP annual growth rate (%)	Annual inflation rate (%)	Unemployment rate (%)	Government Debt (% of GDP)
Estonia	3.0	1.9	5.5	10.4
France	1.7	1.5	10.1	103.5
Germany	2.0	1.5	4.8	68.9
Greece	-2.9	-0.4	27.1	193.7
Ireland	4.9	1.9	7.1	97.9
Spain	2.7	1.0	20.7	103.2
Eurozone Average	1.8	1.2	11.0	92.8

Source: Ernst and Young

To what extent is the eurozone an example of an Optimal Currency Area? Refer to the data provided in your answer. [6]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

Section B

Answer all the questions in the spaces provided.

- 1 Japan's economy has suffered for nearly two decades from dangerously low rates of inflation and interest rates, coupled with very high levels of national debt. Japan has been further battered by a constant appreciation of its currency, the yen, and a rapidly ageing population.

5 **Figure 1 – annual GDP growth rates (%) in Japan, High-Income Countries and Low-Income Countries**

	2008	2009	2010	2011	2012	2013	2014	2015	2016*	2017*
Japan	-1.1	-5.5	-3.5	-0.4	1.7	1.6	0.0	1.1	1.7	1.2
High Income Countries	0.4	-3.5	-0.2	1.9	1.4	1.4	1.8	2.0	2.4	2.2
Low Income Countries	5.4	5.8	5.7	6.1	6.5	6.2	6.2	6.4	6.6	6.6

Source: World Bank - Global Economic Prospects Report

* = estimate

Back in 2012, Japan elected a new Prime Minister, Shinzo Abe, who promised to tackle Japan's poor economic performance. He decided to use three 'arrows' of policy: expansionary fiscal policy, expansionary monetary policy, and supply-side structural reforms, in order to shock the economy back to life. This combination of policies is known as 'Abenomics'.

- 10 The size of the fiscal stimulus in 2012 was huge, with \$116bn of additional direct government spending. The government hoped that the total impact of its spending, once the multiplier effect had worked, would reach \$212bn. Much of the spending was on large-scale capital projects such as building tunnels, roads and buildings that would be able to cope with the frequent large earthquakes that shake Japan.
- 15 Prime Minister Abe followed this initial 2012 injection with a further top up injection of \$29.1 bn in late December 2014, which was targeted specifically at helping small businesses and poor households to cope with the effects of the strengthening yen and falling real incomes. The government gave free shopping vouchers to consumers which they could use instead of cash at the shops, and there were further subsidies on fuel for heating.
- 20 Whilst there was an initial increase in GDP as a result, by September 2015 GDP growth rates had fallen again, causing many Japanese to believe that the target of 2% annual GDP growth would be missed. As a result of the rapid increase in government spending, the size of Japan's national debt has soared to around 240% of GDP, the highest level in the world. In an attempt to plug the gap, Japan had to raise the rate of VAT from 5% to 8%, but this move has been highly unpopular with the poor and with businesses. Well-known economists such as Joseph Stiglitz, Larry Summers, and Paul Krugman argued that there was no need for the increase in VAT. They said that economic growth was more important for Japan than fiscal tightening, because strong economic growth would automatically reduce the size of the government's fiscal deficit. Japanese business leaders also tried to persuade the government to lower the rate of corporation tax from 35% to 24%.
- 25

- 30 To complement the fiscal stimulus measures, the Bank of Japan (Japan's central bank) carried out large amounts of quantitative easing, and was given an inflation target of 2% in order to raise inflationary expectations in the economy. With inflation still barely above zero, some economists have argued that the Bank of Japan should raise its inflation target to 4%, and carry out even more quantitative easing. They say that rising inflation would help to automatically reduce the value of the national debt. If Japan's inflation rate had been around 2% since 1992, economists have calculated that its ratio of national debt to GDP would be closer to 80% than 240%. In an attempt to raise inflationary expectations, the Bank of Japan changed how it measures inflation in mid-2015; it now uses a new core CPI measure, which excludes both energy costs and food costs (the two main factors that have led to low inflation).
- 40 If neither the fiscal nor monetary reforms have worked well, what about the supply-side structural reforms promised by Prime Minister Abe? He has introduced policies to try and prevent Japan's population (currently 127m) falling below 100m, by providing better care for the elderly (therefore creating jobs) and making life more affordable for families. If current birth rates and death rates continue, Japan's population will decline to just 87m by 2060. So far, Prime Minister Abe has steered clear of increasing Japan's tiny immigration rates. Japan has also legislated on company reform. For example, businesses must now have external advisors on their board of directors, providing stronger oversight of their operations and strategies. However, some sectors such as car manufacturing and rice farming remain heavily protected from foreign competition. In an attempt to diversify the economy, the government has also started advertising abroad to attract more tourism and more foreign direct investment. Furthermore, in October 2015, the Japanese Government signed the Trans-Pacific Partnership, a large and extensive free-trade deal, along with the US and 10 other countries that border the Pacific Ocean. Prime Minister Abe described the deal as a "major outcome...for Japan".

Figure 2: Key macro-economic indicator forecasts for the Japanese economy

	2016	2020
Unemployment rate (%)	3.4	2.9
Inflation rate (%)	0.2	1.8
National debt to GDP (%)	240	258
Budget balance (% of GDP)	-7.64	-7.65
Productivity (index, 2010 = 100)	99.63	95.12
Trade balance (% of GDP)	0.7	0.92

Source: Trading Economics

7. Outline, using an AD/AS diagram, how a stronger yen could have contributed to falling economic growth rates in Japan. [4]

.....

.....

.....

.....

.....

.....

8. With reference to Figure 1, and lines 6 to 14.

- (a) Explain **two** likely reasons why there are differences in the GDP growth rates of low-income and high-income countries. [4]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

4

(b) Assess how powerful the multiplier effect of the 2012 fiscal stimulus appears to be. [4]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

(c) Explain how the fiscal expansion in Japan in 2012 led to an increase in the GDP growth rate in 2012 and 2013. [4]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

12

9. Discuss the extent to which Japan's high government debt is a problem for the Japanese economy. [8]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

8

11. With reference to the data, discuss the extent to which Japan’s economy is likely to benefit from increased free-trade and reduced protectionism. [8]

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

8

END OF PAPER