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Question 1 (a)

Many candidates scored well on this question (mean 3.8/5), with the analysis mark being the main discriminator. For the fifth mark, candidates needed to go beyond listing characteristics of the market structure identified and instead develop the explanation, for example, by explaining interdependence or identifying price rigidity. If the candidate chose monopoly they could earn the 5 marks but they tended to be less able to talk about the process linking the market structure to the behaviour or the firms, or any other analytical process.

Over 67% of answers scored 4 or 5 out of 5, meaning that most candidates were confident in the area of market structures.

A significant number of candidates took the approach of describing a legally-recognised monopoly, either the 25% CMA figure or the more relaxed EU definition (40% of the market is unlikely to be a dominant position, Article 102 of TFEU – both definitions were equally acceptable), although the legal monopoly had to be clearly linked to the concept of market power or dominance rather than pure monopoly power to gain full marks. Candidates using the oligopoly approach found accessing full marks very straightforward when accompanied by a calculation of concentration ratios and a brief development of the explanation of the market structure.

Oligopoly was the most common answer – and the evidence fitted well with this approach.

(a) With reference to Figure 1, briefly explain the market structure that best describes the UK branded coffee shop market.

The UK branded coffee shop market is best described as an oligopoly market structure, as there is a collection of firms, who have some market power, and some vary within the market.

The G & S concentration ratio is 71%, which suggests there is a limited number of firms who have some market power. Firms are likely to engage in non-price competition, for example loyalty schemes, in order to retain customers. An oligopoly market structure will also mean that firms are producing a similar range of goods and services, however their may be some product differentiation, for example, the use of branding.
This is a clear 5/5.

Calculate the concentration ratio and if five or fewer firms have 50% of the market then you know it is oligopoly.
Question 1 (b)

Although there are several faults in this answer, it still gains full marks.

(b) With reference to Figure 3 and other information provided, discuss the price and non-price strategies that Starbucks may use to increase profitability.

Starbucks has 13% market share, it may try to increase its profitability by reducing the cross elasticity of demand of its products by engaging in non-price competition. Starbucks may use a loyalty scheme which encourages repeat customers or advertise its unique qualities of its coffee beans. This should help to differentiate it from the other firms in the market. This differentiation should reduce the cross elasticity of demand between Starbucks coffee and its competitors, enabling it to increase its price without causing a contraction in demand. This move in demand from D1 to D2 is likely to lead to an increase in the supernormal profit of Starbucks from abroad, e.g., China. This increased supernormal profit may be invested by Starbucks to achieve dynamic efficiency & organic growth, moving closer to productive & allocative efficiency & thereby future profitability.

However, the non-price strategy may not be successful at increasing profitability as any move...
is unable to compete with coffee cups away from McDonalds when offers espresso at £2.99, less than half the price of the Starbucks alternative. Moreover, other firms also use similar non-price competition strategies which will reduce the impact of the Starbucks strategy.

In the short term Starbucks may try to compete on price to increase profitably. Starbucks may use predatory pricing, to this is very unlikely fails, as one of its economies of scale & low cost structures sets price at below the average costs of scale firms such as Pret a Manger which only 5% market share. This may lead to them making their long run shut down point if average total cost per unit. Our average revenue (4) also competes in the market & allows it to raise its price in the short due to less competitive being to increase profitability.

Now, as the coffee market is an oligopoly with a

\[
\text{Price} = \begin{cases} 
\text{P1} & \text{if } 0 \\ 
\text{P2} & \text{if } 1 \\ 
\text{P3} & \text{if } 2 \\
\end{cases}
\]

Substituting market C(5) of 66% so Starbucks may try to use up price strategies to increase profitably. If Starbucks can no longer passively increase price firm for £2.90 a large retailer then does

set part so that would fail drastically losing to a comes in points. Similarly, if Starbucks can to reduce its price
This fulfils all the assessment objectives and demonstrates many of the points above.

Evaluation was often effective on this question, with better answers giving context to their answers and using the case study to help them e.g. referring to brand issues of Starbucks, and the damage to its reputation caused by the transfer pricing issues; and in evaluation, the observation in the data that the headquarters were moving from Amsterdam to London. There were good examples of kinked demand analysis, used to explain somewhat ‘sticky’ prices in the cases where Starbucks and Costa are charging the same price for an Espresso Double (Figure 3), which made a very effective evaluation point.

The main problem with the question was the opportunity cost, with candidates spending more than the 12-15 minutes they should allow, which was reflected in a higher than normal frequency of unfinished answers at the end of the paper.

Check the MC=MR points are extended to the horizontal axis, and if using the kinked demand curve (not required but can be used) then the angle of the MR will change after the kink to become steeper.
Many candidates tried to use externalities diagrams but faced issues with the fact that negative externalities in consumption is not required for this specification in diagrammatic form. Such an approach tended to lead to confusion and was rarely fruitful, and it is advised that candidates try not to learn diagrams that are specifically not required for this exam.

Question 1 (c)

Examine the advantages of using an indirect tax as a means of reducing the use of disposable coffee cups.

An indirect tax is on the expenditure of a good. It is a regressive tax usually so affects the poor more as is a higher percent of their income. One advantage of a indirect tax as means of reducing use of disposable coffee cups is that it internalises the externality. When we initially, the UK was consuming at $O_1$, the cost has been internalised so we may consume closer to social optimum $O_2$. MSC represents the marginal social costs, the effects the use of disposable coffee cups on the third party eg $C_0^2$. The indirect tax increases the cost of coffee within that cup, hopefully reducing the demand. It allows the negative welfare triangle $Y, Z, Z$, to be addressed and hopefully reduced.

However, as suggested in the extract of the increase in price changes coffee from £2.60 to £2.65 it is such a small proportion of disposable income and a small percentage
There are many points to raise in this answer:

- definitions are not required (indirect tax) but they can help the candidate focus on the question.

- reducing the use of cups is in the question and is not therefore a benefit, but the answer is awarded for ‘internalising the externality’ – a clear benefit in this context.

- the diagram does not show the effect of the tax, and a shift would be an effective way to pick up a second diagram mark. However it does illustrate the social optimum issue and is therefore awarded (deadweight welfare loss area).

- The diagram shows production externalities but the discussion is not explicitly about production. However there is an oblique reference to contraction of demand so credit is given here.

There is enough here to score full marks.
There were several other diagrammatic approaches that were valid, such as negative externalities in production as shown here, and indeed a diagram was not needed at all to gain full marks although it can be an efficient way to score two marks.
Question 1 (d)

This answer tries a range of micro and macro approaches and reaches Level 4 on two occasions. Evaluation does link to the points being made.

Write your answer here:

One microeconomic factor that might influence whether Starbucks chooses to expand could be the supply of labour. If there is a low supply of labour, it is likely to increase the wage rate of workers in that country. This could partially explain why wages for Starbucks workers might rise from w to w'. As a result, the company could increase new locations, as shown.
they have to pay more for wages within a

away. This would mean an AC, and result in a

lower area of supernumerary profit from pabe to

area pdef. This could also cause prices from

p to p, which could be

be harmful to demand as prices are

already above those of Costa and Greggs. The reduced area

development could make Starbucks less efficient, and could leave them with less profit to invest

into reusable or biodegradable coffee cups, which

could cause them to lose out to rivals who may be doing

so. The wage increase could also be caused by a national

minimum wage, which would passivity decrease cost, which

Starbucks due to its high amount of low skilled workers.

However, the impact of the depression

how large the wages are. As any small increase
in wages abroad could be outpaced by our factors
such as less competition. As a result, Starbucks may
continue to price expansion into their previous country.

Additionally, the Starbuck could work a way around higher

wage costs, such as by moving to a lower capital

intensive means of production, which does not require the

The need for high total wage costs can lead to by

developing key sector coffee machines. Wage rates can also

increase in farms in the country, and so the need to compete can

reduce the competitiveness of workers.

One macroeconomic factor that may be

influential could be the interest rate in a particular

country. If interest rates are low, like the 0.5% in the

UK, then there may be a rise in consumption

spending in that country, as more is less needed for

saving in banks. As a result, this would lead to higher

sales for supermarkets in that country.

As the economy will see a greater aggregate demand

in the country, meaning more GNP from Y to Y*

This could suggest that

growth which could suggest that incomes are

increasing and so demand may also increase. The low

interest rates also make it more or cheaper for

shoppers to invest money into new share or money

^ 3 High growth means more investment in the

country could also be beneficial for shoppers, as it

would leave more in a better position to transport goods,

and could make labour in the country more
Now consumer spending may not increase due to the law which reduces if there is high unemployment and weeks.

Employers' contracts may not be high in uncertainty.

Consumers, which would reduce consumer confidence and hence the level of spending. Additionally, there could be an unstable financial system in the country which could reduce the income for firms to spend.

The world also means lower output, fewer jobs, which would reduce prices of services in that country, making costs of production and wages may have been more prices.

One possible way that one could ensure more macroeconomic factors to analyse before entering a particular country, as consumer spending, exchange rates, economic growth and inflation will all have an impact on producers. However, the macroeconomic factors may be more directly concerning if a

faster cars.

One thing they can do to reduce

the impacts of MBD, such as moving to a capital-intensive means of production. Macroeconomic forces may be:

firms are likely to function in the long run, especially in a developing country, and so shareholders may be put off by sight.

Macroeconomic changes in the stock market.
Level 4 15/16 KAA.

Level 3 evaluation – just makes Level 3, therefore 7/9 Eval.

= 22/25.

Use diagrams and data to support your response. Evaluation must try to link to your points made.
Question 1 (e)

This is a wide ranging and carefully reasoned answer. It is fully applied and the diagrams are relevant.

Write your answer here:

One likely impact of increased UK demand is increased profitability, since it is an increase in demand for coffee. As a whole, this may lead to external economies of scale. There may be an improvement in ancillary/supporting industries such as re-disposable multi-use cup market, this may lower long run costs of production as many coffee shops can benefit due to lower cup prices and better transportation infrastructure. For example, the number of coffee shops has increased from 7225.

This coupled with increased consumer demand also leads to an increase in average and marginal revenue for coffee shops, for example, Starbucks in the UK has increased from 1 outlet in 1998 to 849 UK outlets currently. These impacts can be shown below:
This increase in average revenue and fall in long run costs of production means that quantity may increase from \( q_1 \) to \( q_2 \) and the fall in costs may lead to a fall from \( AC_1 \) to \( AC_2 \), this in turn may lead to an increase in supernormal profits from \((P_1, A_1, B_1, AC_1)\) to \((P_2, C_2, D_2, AC_2)\). This extra profit may be invested in dynamic efficiency in the coffee industry. However, firms such as Costa coffee may not see a large increase in average revenue. The UK coffee market is quite contestable so large increases in consumer demand may result in new entrants entering the market due to low barriers to entry, this could lead to increases in consumer choice and competition for large % of market holders such as Costa and lead to a possibly more monopolistically competitive supernormal market especially on a local level, thus profit may increase.
more for the smaller firms than the larger ones.

A likely macroeconomic effect could be an increase in aggregate demand and economic growth. This increase in demand for coffee may increase consumption in the UK economy as more people will buy and consume coffee, thus may increase SNP for firms as previously mentioned. This could lead to a macroeconomic effect of these coffee firms hence increasing investment, and the government may gain more tax revenues from the corporation tax of coffee firms hence allowing the government to spend more without incurring a larger fiscal deficit. This leads to a multiplied effect on AD as the initial consumption increase could lead to greater G and I, this multiplied increase on AD is shown below:

![Graph showing AD1, AD2, LRAS]

This increase in AD may lead to an increase in real GDP from Y1 to Y2, hence representing economic growth and an increase in inflation by price level rise from P1 to P2. Hence benefiting the UK economy, however, the UK has been thought to be
There are clear Level 4 passages, with carefully argued chains of reasoning, fully in context. There is a sound judgement after each piece of KAA, and a judgement at the end to consider the overall impact.
25/25 is clearly deserved, even though the answer is not over-long or complex. Simple is good.
Question 2 (a)

This example shows how to earn full marks.

(a) Using the data in Figure 4 and other information provided, explain the likely change to Indonesia’s terms of trade since 2011.

Terms of trade is how much needs to be exported in order to pay for all the imports. The fall in coal price from $125 to $80 would improve Indonesia’s terms of trade as more coal now needs to be exported to generate the same revenue to purchase the imports.

\[
\text{Terms of trade} = \frac{\text{Index of exports}}{\text{Index of imports}} \times 100.
\]

The formula is not perfect (no reference to prices) but prices are discussed in the answer so the outlining of the meaning of the terms of trade is valid.

Terms of trade worsening might mean the balance of trade actually improves. Don't be caught out by these apparent contradictions. It is this kind of reasoning that makes economics a logical challenge, and therefore very enjoyable.
Question 2 (b)

This is a short, clear and effective answer.

(b) Examine the likely effects on the profitability of Indonesian rice farmers of the government’s increased investment in dams (Extract E, lines 43-48). Use a cost and revenue diagram to support your answer.

The increased govt investment in dams will most likely lead to a fall in variable costs for Indonesian rice farmers. This leads to lower MC and AC shifting downwards for this. Assuming farmers profit maximise, they will go from making normal profit at P1 to a super profit at P2, to a super profit of P3. This clearly indicate an increase in profitability as farmers now have the ability to make economic profit, meaning they can be dynamically efficient and so can fund investment in new tech, allowing the profitability to stay sustainable with a permanent reduction in costs.

However, the market for rice could be considered perfectly competitive. In the long run, low barriers to entry allow new entrants, increasing quantity supplied, lowering the price. Firms being price takers means that only normal profit can be made.
The diagram is clearly labelled. The text describes the diagram. There is a clear paragraph set apart for evaluation. This is a joy for an examiner to read.

Note that you can also score all the marks using a shift in just the FC or AC, although you must be careful not to describe a change in VC and draw just a change in fixed costs, and vice versa.
Question 2 (c)
This answers well in terms of KAA, seeing a variety of types of aid and applying them well in the context of the data on Indonesia.

(c) Discuss the benefits of aid to Indonesia.

One Benefit of Aid to Indonesia is the improved Education and Healthcare. Extract D states that Aid will allow for free health care at the point of access for the poorest 88 million people. This will improve the health of the nation allowing people to seek medical help for accidents and injuries and reduce disease. This would result in a more fit and able work force increasing the amount of people able to work. As a consequence of the increased productivity of businesses could increase as less workers would be negatively affected by illness or injury. Increased productivity would lead to higher profits being made by firms as more is efficiently produced. As a result of higher profit wages of workers could be increased resulting in a higher disposable income which could be spent within the economy. This increase in consumption could shift AD to the right resulting in an increase in output and the GDP of Indonesia.

The GDP of Indonesia.

Improved Education could also have large benefits for

That Aid allows for free schooling up to the age of 12 and tertiary education for students accepted into universities. An increased education in the Indonesian society would allow...

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The diagram was useful, if not fully labelled, and there was Level 3 analysis throughout.

Unfortunately there is no evaluation at all – the candidate has possibly run out of time. Two good points are often better than three unjudged ones.

Evaluate each point as you go along, if you can, and shape your answers around the data provided.
Question 2 (d)

This response is full of data, theory and clear development of economic analysis.

One likely microeconomics effect is a lack of investment in volatile commodity industries. For example, coal has both price inelastic demand and supply. As a result, these commodity industries can have huge fluctuations in total revenue, as shown below:

![Market for Coal Diagram]

For example, if there was an increase in demand for coal, due to a country demanding more to fill a temporary energy shortage, then price rises from \( p_1 \) to \( p_2 \) and quantity increases from \( q_1 \) to \( q_2 \). This leads to an increase in total revenue.
in the Indonesian coal market from \((P_1X_1)\) to \((P_2X_2)\). This small change in demand has led to a proportionally greater increase in price than change in quantity. These volatile prices have lead to coal firms and commodity firms such as rice having very uncertain incomes as a small change in demand (increase or decrease) has a huge impact on the total revenue they earn.

As a result, firms will be uncertain about future as incomes change hence hold off on much needed investment. For example, coal now sells for $50 per tonne as opposed to $125 in 2011. As a result, this lack of investment could lead to lower, supernormal profits and worse quality for consumers. Due to a lack of investment in new industries, firms may not be able to have the best capital and most efficient production methods, hence may not be able to provide as high-quality a commodity as if they had stable prices and investment, thus limiting dynamic efficiency. These volatile commodity prices could also fall into a bubble or volatile poverty when the price falls. However, as the Indonesian economy grows and develops, the financial sector may improve and as a result, firms may be future markets developed for volatile commodity prices. The use of coal and put options can be used in commodity markets to set a price for future delivery, this could then lead to less uncertainty in incomes for these commodity farmers/firms hence resulting in more investment, more quality coal and lower cost of production.
The macroeconomic effect again is that it causes a lot of uncertainty. Due to volatile commodity prices, export revenues can vary significantly, e.g., through lower coal prices. Export revenue may fall as coal is relatively inelastic. This fall in export prices means that there is a lower demand for the rupiah, as seen by the 90% depreciation since 2010. Volatile commodity prices can lead to huge swings in current account position currently around 2% of GDP, and volatile exchange rates. This again leads to very volatile investment in Indonesia; investors may decide to buy the rupiah when the exchange rate is weak in the hope that it will rise in value to make a profit and sell when at its peak. This leads to a huge speculative buying and could create a market bubble for the rupiah which could lead to huge swings in aggregate demand due to currency value being a huge influence on CLED. Indonesia may consider short-term managed exchange rate in order to reduce this volatility. Furthermore, if government collects tax receipts from corporation tax on resource industries such as crude oil, rubber, coal, tin, this again leads to volatile fiscal positions and
Could lead to overly cautious "tint" fiscal policy from government as key need to save some tax receipts in order to boost economy through fiscal stimulus. All this volatility and uncertainty can lead to huge variations in growth and development in Indonesia as when prices are high all macroeconomic indicators will be positive but when it's low these indicators will worsen. However, despite this volatility the Indonesian real GDP has grown by an average of 6% since 2004-2014, despite its collapse in commodity prices. They still had a large and respectable 4.08% growth in 2015 which was the lowest since 2009. This may be a large change, but it is still large positive growth. Further more through sound governance, the volatility has been offset somewhat. They are fiscally tight during the boom stages of high commodity prices so they can provide huge government spending in slowdowns to offset the weak exports in low price times.

In judgement, the macroeconomic impacts are much more severe. This volatility can cause huge current account fluctuations and currency fluctuations which is really worrying for this economy, especially now is because too high a proportion of net exports are volatile. They should consider diversification into services of the Lewis model of industrialisation to reduce the effect of external shocks. The microeconomic impact is still important but it is
Although it seems that the answer is going to focus on causes not effects of volatility, it is soon clear that the correct focus is there, and the diagram clearly illustrates the impact of low PED on revenues. This is then clearly explained in the text (‘uncertain incomes’) and the data on coal prices is central to the answer. The Lewis model is used effectively and there are clear micro and macro points.

**Question 2 (e)**

The case study gave several supply side policies to evaluate the economic effects of, with discussion of education/healthcare, deregulation and opening up to FDI commonly used. Many candidates were then able to apply this knowledge to theoretical models, such as AD/AS, demand and supply and monopoly diagrams in order to provide in depth analysis in the context of Indonesia.

There were a surprising number of answers that shifted AD rather than LRAS. Whilst the effects of supply side policies can clearly have side effects on AD, the more coherent arguments focused on LRAS for the macroeconomic effects given. Rises in AD while of course valid (and on the mark scheme) were unlikely to be convincing when developed into a rise in inflation (given the increase in AS), and some candidates then went on to discuss the costs of inflation, including menu costs, which was highly ineffectual in the context given.

Candidates had clearly learned some downsides of supply side policies, but again the best answers would put these in the context of Indonesia (e.g. the fiscal constraint they face). Extract D clearly spelt out supply side policies (easing regulations, tax incentives and SEZs) and these formed the ideal basis for an essay. In evaluation, one of the most effective answers was to consider the social and fiscal implications of these specific measures.
This essay struggles at first to make it into Level 4 as the focus seems to be on the AD shift. However the chains of reasoning are logical, and clearly an AD shift is legitimate for interventionist supply side policies if government revenue remains constant.

Supply-side policies are aims to increase aggregate supply and can be either market-based or interventionist. The supply-side policies of increased levels of spending on infrastructure will help bring foreign investment as it’s easier for firms to set up businesses and is attractive. Foreign direct investment will improve the economy of Indonesia as it will create jobs for the locals who may have struggled before, thus reducing the level of unemployment in the economy. More jobs and income will generate a positive multiplier effect in the economy as it means more confidence and higher levels of spending, increasing aggregate supply.
demand for AD leads to AD3, as consumer expenditure and government spending are components. Subsequently, the level of real GDP real and actual economic growth will result and as Figure 5 shows, real GDP in Indonesia has risen from 4% in 2014 to 5.1% in 2016, meaning the supply-side policy of spending on infrastructure is beneficial to the economy. However, FDI may not increase if foreign firms don’t have confidence in the economy of Indonesia. They may not be willing to invest if they think it’s volatile and their investments won’t be safe, thus the effect of the policy will be limited. A microeconomic effect of supply-side policies may see business growth and as extract E says, are improving the business climate and improved infra...
Structure and education in Indonesia has meant a new enterprise is to flourish. Improved infrastructure may lower the costs of firms as it is easier to transport goods and services and make the firms more available to consumers. At the AC of output, curves shift to MC2 and AC2 as average variable costs will fall meaning a lower price of pb and the potential to make profit of area P2C2BA. The infrastructure may have allowed firms to exploit external economies of scale, aiding in the fall in costs and benefiting the firms in the future, allowing them to grow more, which may hopefully help the growth of the economy too if there is more economic activity.

However, business growth may be very slow in Indonesia for businesses.
that new power plants, it still takes 700 days for its approval. This may hinder business development, meaning although the supply-side policies are helpful, the time lags that accompany it may reduce their competitiveness and growth.

Overall, for a country like Indonesia, supply-side policies are very helpful despite the call to the government. They are a great way of encouraging growth and improvement in aggregate supply. The effects may have been even greater if they were accompanied with demand-side policies to like low interest rates which would have borrowing cheaper, encouraging investment and development of the country.

The AD point needs clearer links, as does the FDI discussion. However, the microeconomic argument is better and it is supported by a helpful diagram (Level 4). There is good context but the evaluation tails off on the micro section – time lags are underdeveloped and lose the connection with the thrust of the argument, and it feels as if they are a standard, rehearsed evaluation point that does not convince.

The final paragraph contains convincing judgement and is credited with a L3+. 