GCE A LEVEL

A520U20-1

S18-A520U20-1

ECONOMICS – A level component 2
Exploring Economic Behaviour

TUESDAY, 12 JUNE 2018 – AFTERNOON

2 hours 30 minutes

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ADDITIONAL MATERIALS

A calculator.
A WJEC pink 16-page answer booklet.

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.
Answer **all** questions.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question.
You are reminded of the necessity for good English and orderly presentation in your answers.

Answer **all** *the questions.*

1. Competition regulator backs scrapping of rail franchises.

According to the Competition and Markets Authority (CMA) Britain's rail system should be reformed to allow rival train firms to run services on the same routes. This would mean scrapping the current system of rail franchises (where rail companies bid to provide train services on a particular route over a fixed period of time) for major intercity routes.

In a recent report the CMA said that more direct competition on routes could lead to lower fares, greater efficiency and more effective use of capacity.

Figure 1 – The rail industry after privatisation:

- After privatisation the state-owned rail network was broken up. Network Rail, which is still state-owned is responsible for maintaining the track system.
- The network is used by both rail franchises and freight operators who pay Network Rail to use the rail network.
- Rail franchises also pay the government for the right to operate a particular route (a franchise).
- The industry as a whole is regulated by the Office of Rail and Road (ORR).

Franchising involves the Government setting out what it would like a franchise to do over a set period (level of service, upgrades, performance etc.). Companies then compete for the right to operate a franchise to that specification. The Government picks whichever company it thinks will deliver the best overall train service for the route and gives the best value for money. Franchise agreements include details of the performance standards that train operating companies must meet. The Government generally expects franchises to run for 7-10 years.

After a train operator wins a franchise, critics argue they essentially have a monopoly because they face little competition. In what the CMA described as a "significant departure from the current system", it has recommended that "multiple" train operators be allowed to offer passenger services "in a fully commercial environment" by competing on the same lines. In other words, more than one company would be able to run trains along a particular route.

The CMA's report says the potential for such competition exists on the three major intercity routes: the East and West Coast Main Lines, and the Great Western route between London Paddington and Cardiff. There are already a few regionally-based examples of this form of competition.

Figure 2 – Rail's share of total transport 1952-2016

The chief executive of the CMA, Alex Chisholm, said: "We've found that there is strong evidence, both here and abroad, of the benefits that the introduction of competition on mainline intercity routes can bring. The need to attract passengers who have a choice between train operators can mean lower fares, new routes and destinations and more innovations. In a more competitive environment train operators will become more efficient and there will be better use of existing capacity – so there are benefits for both rail users and taxpayers (who help subsidise the railways)."

The Rail Delivery Group, which represents train operators and Network Rail, gave a critical response to the proposal. Paul Plummer, its chief executive, said: "We must take a joined-up and consistent approach to competition, freight, franchising, regulation, capacity, the shape of Network Rail and how we fund much-needed investment. Considering these in isolation is unlikely to deliver the best results for rail users or taxpayers."

Mick Whelan, the general secretary of train drivers' trade union Aslef, said: "The idea that anything in this report would improve Britain's rail network is laughable to anyone who works in, and understands, our industry. Breaking up the railway further will only increase costs. Competition in the rail industry is a myth. There is only one set of tracks."

Many with a similar view want to renationalise the railways to re-create a single company like the old British Rail which was formed as a result of the nationalisation of the privately owned regional rail companies in 1948.

The government has committed billions of pounds to upgrading the railways. However, rather than focusing on more competition in the rail network, the best use of this investment might be to focus on linking the train network to other forms of public transport such as buses and trams. This would help to reduce reliance on the private car and reduce the market failures caused by pollution and congestion.

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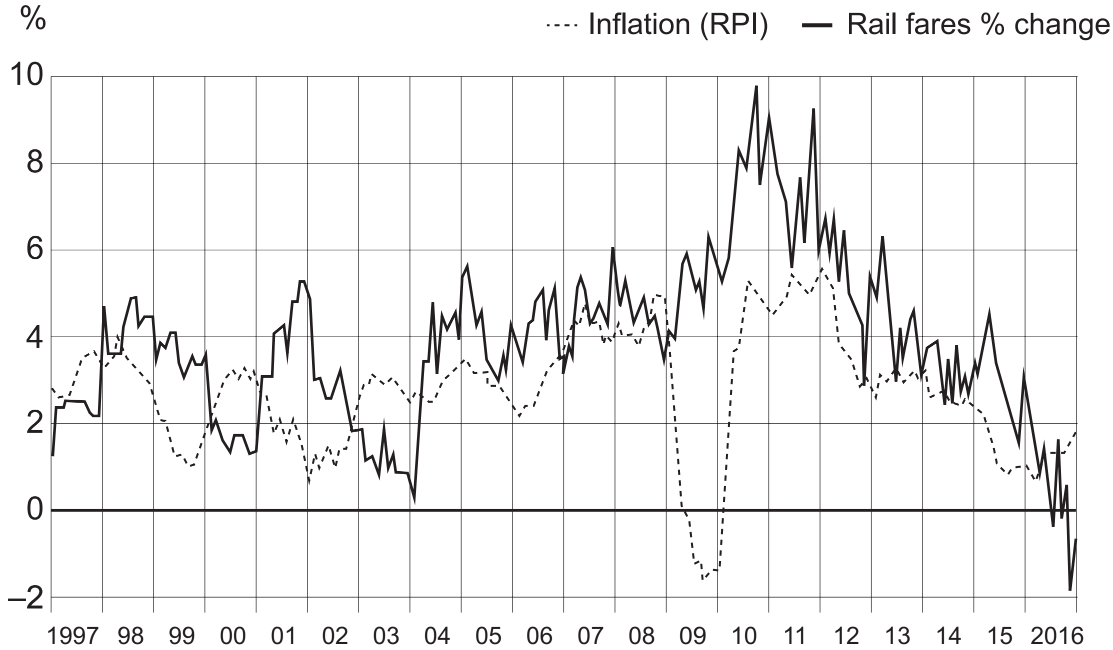
But the consumer group Which? urged the government to listen to the CMA proposals. Its executive director, Richard Lloyd, said: "Our annual rail survey shows that millions of passengers are not satisfied with the service they are receiving on Britain's railways. But on those lines where there is more competition between train operators, satisfaction is significantly higher. Passengers shouldn't have to wait until the end of a lengthy franchise for services to be improved."

Figure 3 – Rail fares versus inflation (% change year on year)



Source: BBC
Adapted Source: The Guardian, 8 March 2016

(a) What benefits do train operators such as Virgin and First Great Western get from winning a franchise for a certain route on the rail network? [4]

(b) Using Figure 3, outline what has happened to rail fares in both real and nominal terms over the period shown. [4]

(c) Using a costs and revenue diagram show how the trend shown in Figure 2 since privatisation would have increased the profits of train operators such as Virgin Trains. [4]

(d) "The most efficient price for a train operator to set would be price = marginal cost." How far do you agree with this view? [8]

(e) With the aid of the data and using economic analysis evaluate the view that the railways should be renationalised. [10]

(f) Using an appropriate diagram and with reference to the data, evaluate the view that the government should tax the use of private cars more heavily to provide more subsidies for the rail network. [10]

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2. IMF Survey: Weakening Growth in Sub-Saharan Africa Calls for Policy Change

- Growth lowest in 15 years, with significant variation across the region
- Severe shocks: weak commodity prices, limited external finance, drought
- Urgent need to change policies to promote growth

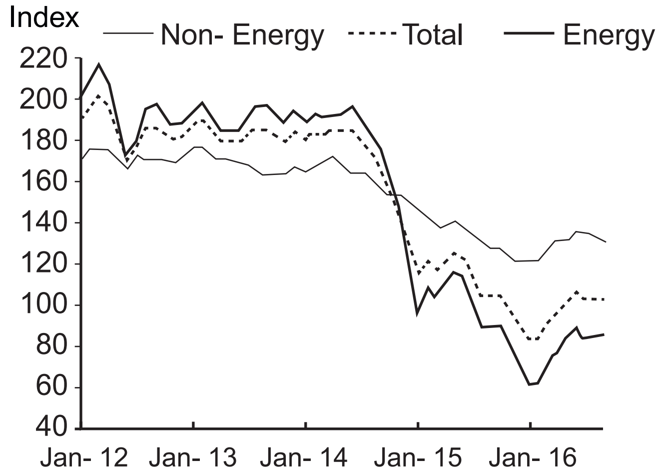
Hit by several shocks

The global commodity price slump (Figure 1) has hit many of the largest sub-Saharan African economies hard. While oil prices have recovered somewhat compared to the beginning of 2016, they are still more than 60% below 2013 levels—a huge drop.

As a result, oil exporters such as Nigeria and Angola continue to face particularly difficult economic conditions. The decline in other commodity prices has hurt non-energy commodity exporters, such as Ghana, South Africa and Zambia. Making everything worse is the fact that external financing is harder to get and many areas have been hit by drought.

Figure 1

IMF Commodity Price Indices
(2005 = 100)

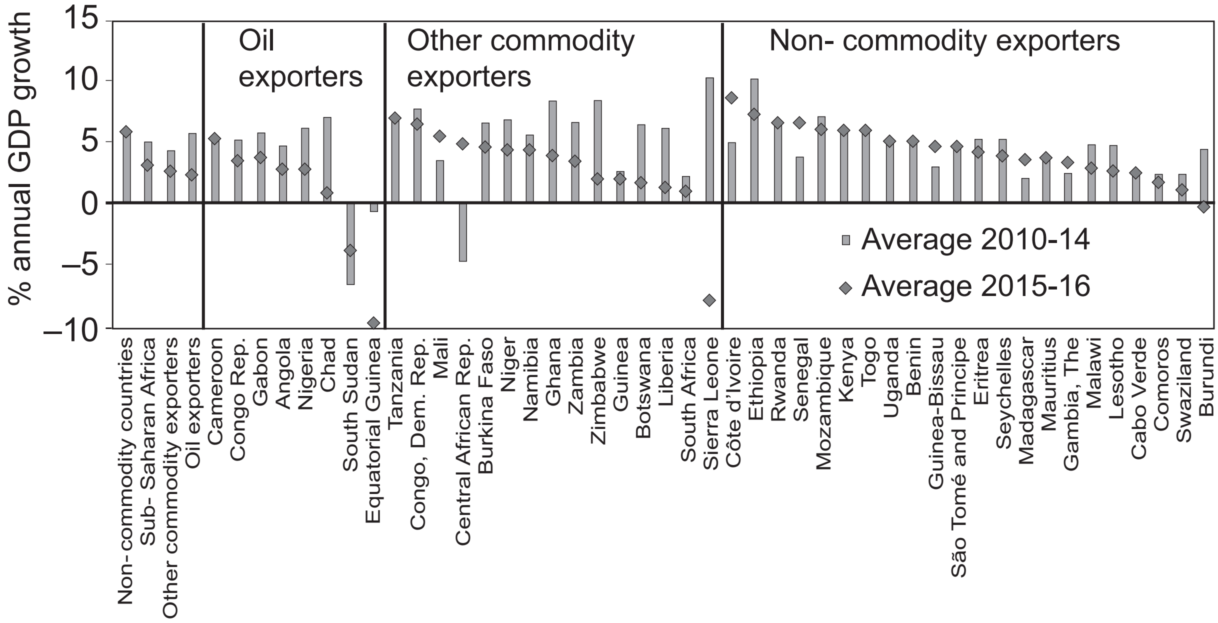


Medium-term prospects still favourable

However, the impact of these shocks varies significantly across the region and many countries continue to have strong growth (see Figure 2).

Figure 2

External shocks have hit many sub-Saharan African countries hard, but the impact on growth varies across countries.



While the immediate outlook for many sub-Saharan African countries remains difficult, the region's medium-term growth prospects are still favourable. The region's much improved business environment and favourable population trends (with a young and growing population) should help to support growth in the medium term.

Policy change urgently needed to promote growth

The IMF argues that to benefit from this strong potential, however, a substantial policy change is essential in many cases, as the policy response to date has generally been insufficient. Many countries are facing the prospect of both trade deficits and budget/fiscal deficits leading to falling foreign currency reserves and rising debt. In response to this, countries need to use exchange rate flexibility combined with policies to cut fiscal/budget deficits and to build a sustainable tax base outside of the commodities sector.

The required measures may come at the cost of lower growth in the short-term as well as damage to the countries' economic development. However, these measures will prevent what could otherwise be a much worse situation in the longer term if they are not implemented. These policies would lay the base needed for the region to benefit from the substantial economic potential which still lies ahead.

Malawi Economic Outlook (African Development Bank report)

In 2015, hit by weather and policy shocks, Malawi's real GDP growth was 2.9%, down from 5.7% in 2014. Floods and dry periods reduced maize production by 30%, resulting in a 2.3% slowdown in agriculture sector growth.

The services sector, particularly information and communication, proved stronger with 9% growth. This was partly driven by rapid expansion in mobile phone services. In 2016, economic growth was forecast to rise to 4%, possibly reaching 4.9% in 2017, with agriculture as the main driving force. The growth outlook was based on favourable weather conditions, macroeconomic stability, consistency in policy implementation and renewed private-sector confidence. Population growth of 2.8% a year will require consistent economic growth to reduce poverty.

Fiscal pressures will require stricter controls on government finances and greater transparency to reduce the mismanagement of government funds. The government has failed to control the budget leading to large budget/fiscal deficits and higher inflation and interest rates. Inflation rose to 24.9 % in December 2015 as food supplies ran low and the Malawi kwacha (MWK) (the domestic currency) depreciated more than expected.

Monetary policy was further tightened to contain inflation and to achieve exchange rate stability. Inflation was expected to fall to 18.1% in 2016, remaining above the government's initial 12% target. The sharp fall in the kwacha has been caused by capital outflows and persistent current account deficits. The current account deficit was estimated to be 6% of GDP in 2015 and was expected to remain at that level in 2016 and 2017, reflecting the narrow export base and strong dependence on imports and external aid.

Urbanisation in Malawi (whereby people move from rural areas to cities) creates both challenges and opportunities for growth. The country is one of the least urbanised in the region, but the 3.8% urban growth rate is higher than the overall population growth rate of 2.8%. The major challenge is to meet demand for housing and other basic services, despite limited resources. However, urbanisation presents an opportunity if its potential to transform the economy can be fully utilised.

Figure 3

Malawi Interest Rate

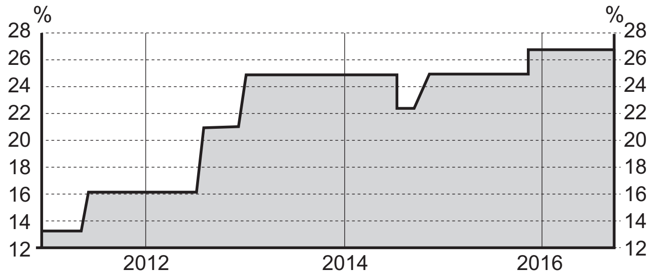


Figure 4

£ per Malawian Kwacha (MWK)

(a) With reference to Figures 1 and 2, consider how significant the impact of commodity prices has been on sub-Saharan African economic growth in 2015-16. [6]

(b) With reference to economic theory and using a diagram, explain why primary product prices tend to be very volatile. [6]

(c) Discuss the extent to which the relationship between Malawian interest rates and the Malawian exchange rate shown in Figures 3 and 4 can be explained by economic theory. [10]

(d) To what extent might the policies recommended by the IMF in lines 31-41 be beneficial for Malawi's economic development? [10]

(e) In line 28, the IMF speaks of 'favourable population trends'. To what extent is the Malawian economy likely to benefit from its rapid population growth? [8]

END OF PAPER