



GCE A LEVEL

A520U20-1



021-A520U20-1



FRIDAY, 8 OCTOBER 2021 – AFTERNOON

ECONOMICS – A level component 2

Exploring Economic Behaviour

2 hours 30 minutes

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.

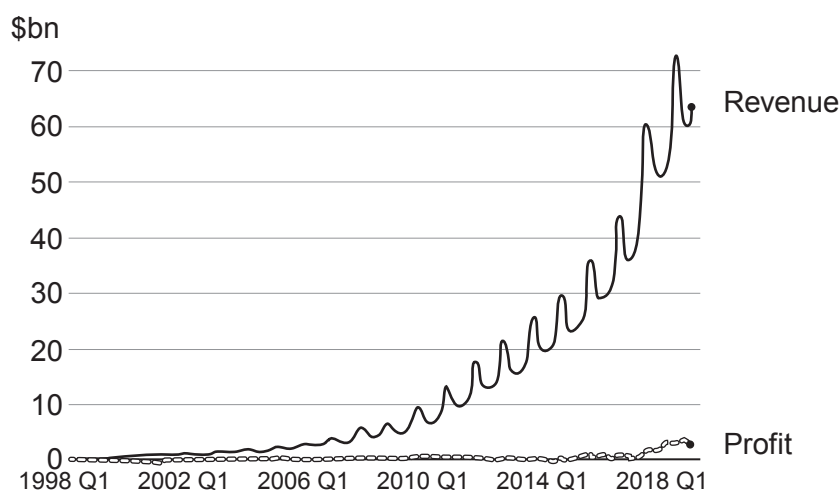
You are reminded of the necessity for good English and orderly presentation in your answers.

Answer all the questions.

1. Prime suspect

After almost 20 years of focusing on sales revenue growth, Amazon has started to turn its attention to profits. In the first quarter of 2019, Amazon made record profits of \$3.6 bn.

Figure 1: Amazon's revenue and profit (by quarter)



Amazon is continuing to invest in a wide range of different sectors. There are big projects in artificial intelligence, smart home devices and even retail outlets, although these are not expected to generate significant revenue for some time.

Amazon began life as an online bookseller and quickly developed a model which was based on the idea that low prices and a wide selection would draw customers to Amazon. This would allow Amazon to have more power over suppliers, which would lead to yet lower prices and an even wider selection. At the same time, Amazon has invested continually in giant scale, highly automated 'fulfilment centres' where customer orders are processed, again driving down costs. This power extends to non-physical items, such as e-books, where Amazon's near-monopoly power allows it to reduce the royalties that it pays to publishing firms and their authors, infamously leading to a dispute with Harry Potter author JK Rowling, in which her new detective novel was unavailable through Amazon's website during the dispute. Today, its sales revenue is larger than the GDP of many European countries.

Amazon's power over its suppliers also extends to its employees, who, according to some critics, are tracked around the warehouses and avoid taking toilet breaks to hit productivity targets. According to these critics, those who persistently miss productivity targets are dismissed. This led to a series of strikes in July 2019, with workers protesting about poor pay and conditions. According to the BBC, workers in some American warehouses have to pick 330 items an hour for 10 hours a day to avoid being dismissed. Amazon itself says that it offers great employment opportunities, employing 29500 people in the UK alone and paying £9.50 an hour, well over the National Minimum Wage (although this might be linked to the current situation in the UK labour market, where unemployment (**in 2019**) is at historic lows).

Over time, Amazon has expanded into a range of different areas, both to diversify and to increase its power. By the late 1990s it was selling music and DVDs, it then branched into electronics and toys. In 2000, Amazon Marketplace was launched, which allowed small sellers to access Amazon's website, enabling them to sell to a global marketplace that they would never otherwise have been able to reach – for a fee.

Since then Amazon has innovated in both products and processes – some successfully and some less so. Amazon’s failed attempt to break into the mobile phone market with the Fire Phone cost over \$170m, but Jeff Bezos, Amazon’s founder and former chief executive argues that:

35 “you need to be making big, noticeable failures... when you take this approach, a small number of winners pay for dozens, hundreds of failures”.

He argues that it is this continual drive for innovation that has allowed Amazon to succeed. Some critics, however, argue that there is an inefficient waste of resources by Amazon, for example, the purchase of a \$40 000 skeleton of an Ice Age cave bear for its headquarters.
 40 Amazon has become so powerful that there may be no need for it to keep costs down. Other criticisms have centred around the huge amount of packaging that the firm uses, including the introduction, in 2019, of non-recyclable plastic packaging, going against the more environmentally friendly stance of other big retailers.

Amazon’s reach is impressive, accounting for 7.7% of all retail sales in the US. It sells 89% of e-books in the US and 47% of all physical books. Its cloud computing service is its fastest growing area, where it competes with other giants such as Google and Microsoft.
 45 In subscription services for TV and music, it is up against Netflix and Spotify. Recently Amazon bought the rights to show 20 Premier League football matches, competing against Sky and BT which have dominated this area in the past. Nevertheless, it is perhaps only in its online stores that Amazon really does rule supreme as the biggest online sales platform in the world (Figures 2-4).
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Figure 2: 2018 Amazon’s global sales revenue by category

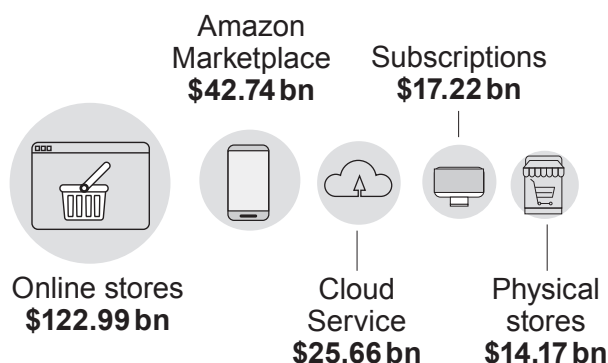
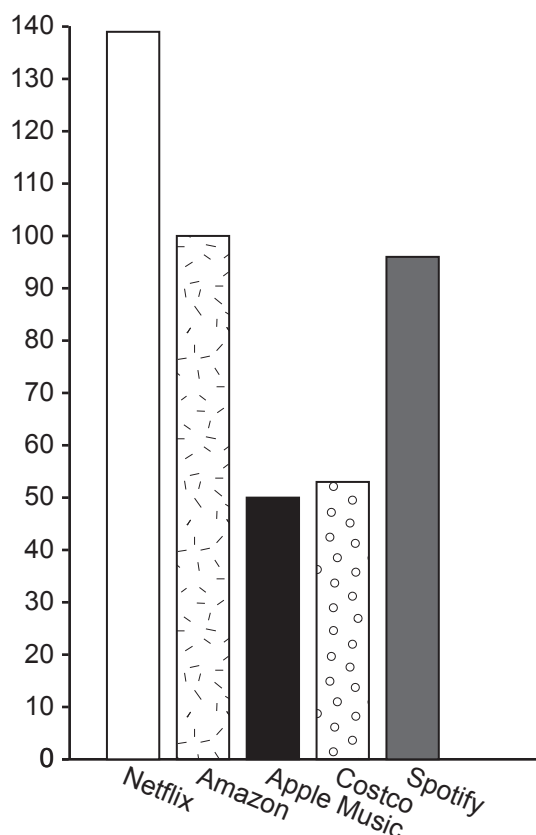


Figure 3: 2018 Amazon is the biggest online sales platform in the world



Figure 4: Largest global streaming subscribers (millions of subscribers 2019)



Nevertheless, not everyone is happy with Amazon's continual growth. In the UK, the Competition and Markets Authority (CMA) has begun an investigation into Amazon's investment into Deliveroo (a fast-food delivery firm). Deliveroo lost £232m in 2018, even though its sales rose by 72%. However, there is a logic to the deal because of Amazon's huge delivery network, but the CMA is concerned that Amazon's entry could reduce, rather than increase the level of competition in the sector in the long run. Deliveroo claims that Amazon's investment is quite small scale, not giving Amazon overall control, but the CMA is concerned about the deal and (at the time of writing) ordered the two firms to pause any attempts to combine their operations.

In spite of temporary setbacks such as these, Amazon's power and reach continue to grow. The question for regulators around the world is, when does big become too big?

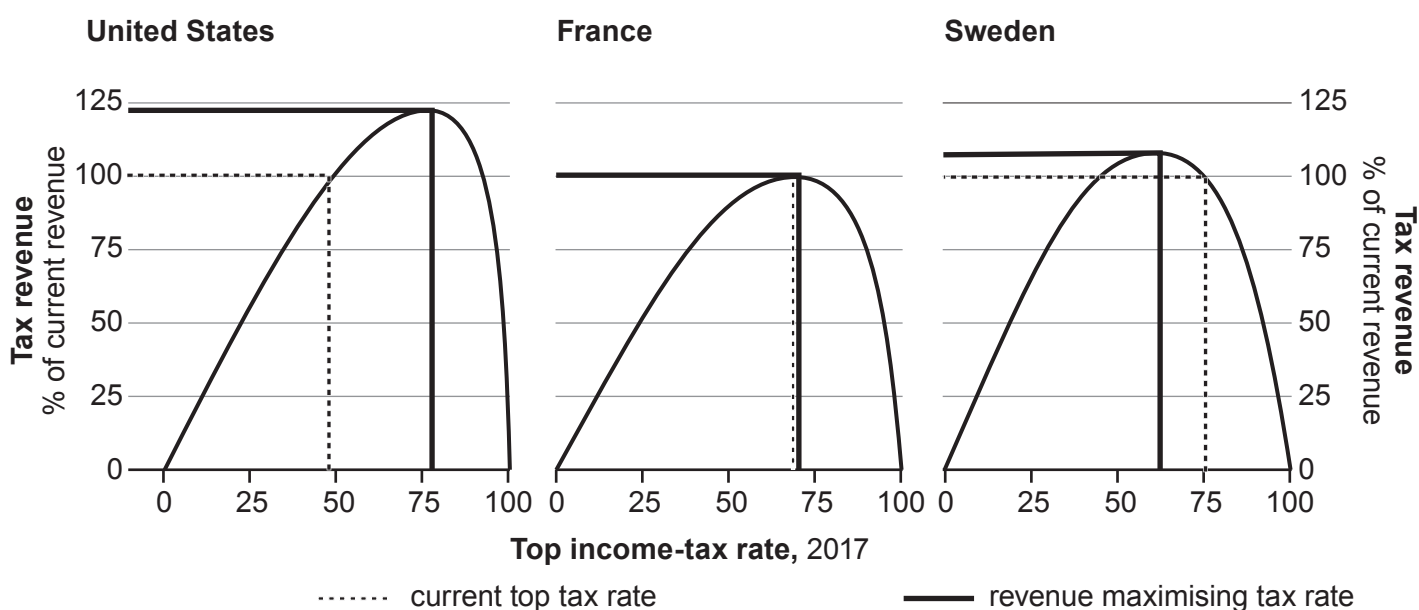
- (a) Using a cost and revenue diagram, explain how Amazon has been able to continually drive down prices. [6]
- (b) Using a diagram, explain why Amazon might pay workers more than the minimum wage. [6]
- (c) Using cost and revenue diagrams, consider whether Amazon is efficient. [8]
- (d) Discuss whether at its current stage of development, Amazon's main objective should be profit or growth. [10]
- (e) Discuss whether Amazon should be more heavily regulated. [10]

2. Last laugh for Laffer

The award of the US Presidential Medal of Freedom is usually an uncontroversial affair. Yet, Donald Trump's honouring of the 'godfather of supply-side economics', Art Laffer, made some economists very angry. Nobel Prize winner, Paul Krugman, branded Laffer a 'crank'.

Laffer and his famous curve were introduced to the world when Laffer drew it on a napkin in a restaurant, for US politicians Donald Rumsfeld and Dick Cheney in 1974. Recent research has shown that different countries have very different Laffer curves (**Figure 1**).

Figure 1: Finding the sweet spot
Estimated Laffer curve for the top income-tax rate, 2017



The effect on global tax policy of Laffer's supply-side school is indisputable. Economies across the globe followed the US in slashing top rate taxes, on direct taxes such as income and profits. The US top income tax rate was 70% when Ronald Reagan was elected in 1980, but is now much lower. In the UK, the top rate fell from 83% in 1979 to 45% today. Across developed economies, since the late 1970s, top income tax rates fell from an average of just under 70% to 40%, while the average corporate tax rate fell from 48% to 23%.

According to Laffer, cuts in marginal tax rates raise GDP by increasing the potential size of the economy. The impact of a tax cut on government revenue depends on how easily those affected can change their behaviour. Incentives matter and taxes can change behaviour (as can be seen by the enthusiasm shown by many governments to place indirect taxes on carbon, sugar and tobacco).

There is little doubt that in the 1970s income tax rates in many developed countries were on the downward slope of the Laffer curve. However, some argue that right wing politicians and populists have now cut taxes so far that they have now reduced government revenue rather than increased it. There is evidence that President Trump's recent tax cutting reforms have contributed to larger structural budget/fiscal deficits in the US. Some commentators have argued that this over-enthusiasm for low taxes is simply an excuse for tax cuts that favour the rich and that the Laffer curve is a faulty theory.

25 However, even if tax cuts aren't self-financing, the economic impact of cutting them might still be desirable. A government with very low marginal tax rates might be targeting strong economic growth. Alternatively, a government with very high marginal tax rates on top earners (part of a more progressive income tax system) might be targeting a reduction in income inequality as part of its social policy.

30 Similarly, in the UK, the Prime Minister, Boris Johnson has said: "There are plenty of taxes that you can cut which will actually increase your tax revenues and there are ways of ensuring that these tax cuts stimulate economic growth."

35 In 2010, the Labour Government introduced a top income tax rate of 50% (previously the top rate had been 40%). But in 2012, the then Chancellor, George Osborne told Parliament that the 50% tax rate raised only £1 bn or so extra – rather less than the £2.5 bn that Labour had predicted. In April 2013, the Chancellor cut the top rate of income tax from 50% to 45% and in the following year, tax receipts rose by £6 bn. High marginal tax rates often lead to increased avoidance and evasion – made easier in the UK because of complex tax regulations that are easily manipulated by clever tax accountants.

Figure 2: UK income tax rates and thresholds

Tax Rate (Band)	Tax Rate	Taxable Income 2018/19	Taxable Income 2019/20
Tax-free Personal Allowance	0%	Up to £11 850	Up to £12 500
Basic rate	20%	£11 851 to £46 350	£12 501 to £50 000
Higher rate	40%	£46 351 to £150 000	£50 001 to £150 000
Additional rate	45%	over £150 000	over £150 000

40 Independent research on expansionary fiscal policy suggests that each £1 in income tax cuts creates a 30p boost to GDP. On the other hand, capital spending by the government has a higher multiplier effect, as for every £1 spent on projects such as full fibre broadband, there is a £1 boost to GDP. The UK Government takes around 40% of GDP in taxes, so some of any tax cut or capital spending will return to the government in the form of increased tax revenue, effectively reducing the true cost.

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In 2020, Boris Johnson was planning to implement about £20bn of income and business tax cuts and a similar increase in government investment in infrastructure. In addition, there were pay rises planned for workers in education and health, sectors where there are significant shortages of workers.

- (a) Explain the shape of the Laffer curve. [4]
- (b) With reference to **Figure 1** and the data, discuss whether cuts in the top rate of income tax will be beneficial to an economy. [8]
- (c) (i) A worker on the National Minimum Wage in the UK would earn around £15 000 per year. Calculate how much income tax this person would pay in the 2019-20 tax year. [2]
- (ii) UK MPs earn around £80 000 per year. Calculate how much income tax an MP would pay in the 2019-20 tax year. [2]
- (iii) Using the data, discuss the relative merits and demerits of direct taxes and indirect taxes. [10]
- (d) Outline the difference between a structural and a cyclical budget/fiscal deficit (line 22). [4]
- (e) With the use of AD/AS diagrams and the data, discuss the extent to which government capital spending is preferable to government current spending. [10]

END OF PAPER