



AQA qualification training

A-level Economics: Getting Started with Year 2

Student responses and examiner commentaries

BOOKLET 3

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Question 31

*To what extent, if at all, do the data suggest that the level at which the NMW is set in the UK is damaging to the international competitiveness of the UK economy? You must use the data in **Extract C** to support your answer.*

Student 1

The national minimum wage is the lowest amount a company can employ a worker for. In the first table from extract C it is shown that the minimum wage in the UK is average, this suggests that whilst the rate of pay is not so high that the costs are damaging it is also not as competitive as it could be.

The bar graph showing adult minimum wages relative to full time median earnings shows that the UK NMW is set at 47% of the average earner's income. The UK places in the middle of the group again, though the gap in % is greater between the UK and the countries whose NMW is a greater percent of the median earnings than the countries whose NMW is a smaller percent of median earnings, these being France at 62% and the US at 38%. This suggests that the impact the NMW has on pushing up wages is slightly less in the UK than the mean average because there is a greater amount of higher earners in the UK than the average of the other countries.

On the other hand, the productivity index of the UK is significantly lower than a large portion of other first world countries as well as being lower than the G7 average. This shows that, whilst the average pay in the UK is slightly lower than the average of the sampled groups, the amount paid for each unit of goods produced is higher making the UK less competitive.

Even though there seems to be a slight competitive edge when it comes to costs of labour in the UK economy compared to other first world economies this is negligible when compared to the greater level of production most other countries are achieving, if the NMW was lower then it's possible this could increase competitiveness.

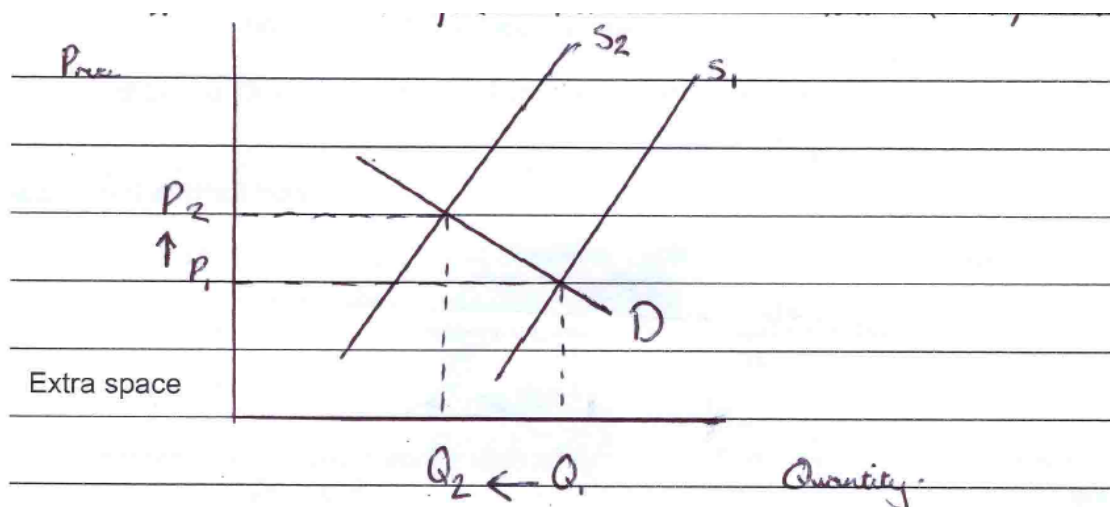
Examiner Commentary

This answer is well organised and includes several well-developed issues. It makes effective use of some of the numerical/statistical data and shows some appreciation of the limitations of the data. A final conclusion is attempted which is supported, to some extent, by evidence presented in the response. The phrase 'greater level of production', in the final paragraph, isn't quite right. There is only a very limited recognition of the wider aspects of competitiveness.

The provisional judgement is that this is a **high Level 2 response** and is worth **7 marks**. It satisfies the Level 2 criteria and contains some features that would be found in a Level 3 response.

Student 2

International competitiveness refers to the degree to which a country can, under free & fair market conditions, meet the test of international markets. The NMW is the lowest wage that can legally be paid to a worker. One factor that affects competitiveness is the cost of production. As extract B states a National Minimum Wage will 'significantly add to business costs'. Rising costs of production will shift the supply curve leftwards from S_1 to S_2 as firms decide to reallocate their resources to more profitable ventures. In order to protect profit margins, firms are likely to pass this increased cost onto customers in the form of higher prices. Increasing prices from P_1 to P_2 could therefore reduce international competitiveness.



However, it is important to note that competitiveness is measured in relation to other countries unit costs. Looking at extract C, the UK minimum wage would still be less than countries like Australia & France, even if the minimum wage was increased to £6.50. Therefore the level of the national minimum wage will have little effect on competitiveness in relation to these countries. However, it is higher than some of our main trading partners, including the US (£5.31), Canada (5.89) and Japan (£4.80).

Extract C shows that in 2012 the UK had the worst productivity after Japan for the countries shown. Productivity measures output per worker per hour. If productivity increases faster than the increase in wages then the unit labour costs will fall & international competitiveness will probably improve. For example, France's productivity has an index of 132 whilst the minimum wage is £7.77. Higher productivity therefore offsets the higher minimum wage. Furthermore, 'competitiveness is not just about wages'. Non-price competitiveness looks at factors such as quality, reliability and innovation. Changes in the exchange rate will also result in changes in competitiveness and exchange rates can be volatile.

Examiner Commentary

This is a **Level 3 response** and is provisionally judged to be worth **9 marks**. It has a clear, logical structure and considers several relevant issues. Effective use is made of the numerical and statistical data and most of the analysis is sound. An appreciation of the limitations of the data is demonstrated but the final judgement is not presented as clearly as it could have been.

Question 32

It has been suggested that the NMW should be increased so that it is the same as the Living Wage.

Explain the possible effects on individuals and the economy if the government were to adopt this suggestion.
[15 marks]

Student 1

If the government were to raise the NMW to the same as the living wage this could raise the average living standards in the UK particularly for the younger generations who are more likely to be effected directly by the rise in NMW. Though the rise in the NMW may also cause more people to become unemployed because companies decide it is no longer worth hiring as much labour.

For workers with a higher income this won't make any direct difference to their salary.

For the economy this may make it less competitive due to higher production costs for businesses and cause overseas companies to be discouraged from expanding to the UK.

On the flip side it may do the reverse for the economy by giving lower paid workers a greater incentive to work so that productivity actually increases in comparison to labour costs which would make the economy more competitive and solve the UK's problem of low productivity rises. This could also reduce the rise in unemployment from increasing wages because firms may decide that the rise in productivity makes the extra labour costs worthwhile.

If the rise in the minimum wage does not increase productivity then the increase will result in an increase in unemployment. If the rise in wages does increase productivity of labour then presuming there is a greater demand for more productive labour the increase in unemployment would be smaller or may not occur.

Other effects this may have on the economy is improving areas in poverty seeing as there is a direct correlation between the average level of income gained in an area and the amount of crime and mental health issues. This will help increase the standard of living for the area by more than what the total increase from a rise in income would do. It's also worth noting that this will help reduce the strain on the emergency services allowing for a reduction in the budget deficit, everything else being equal.

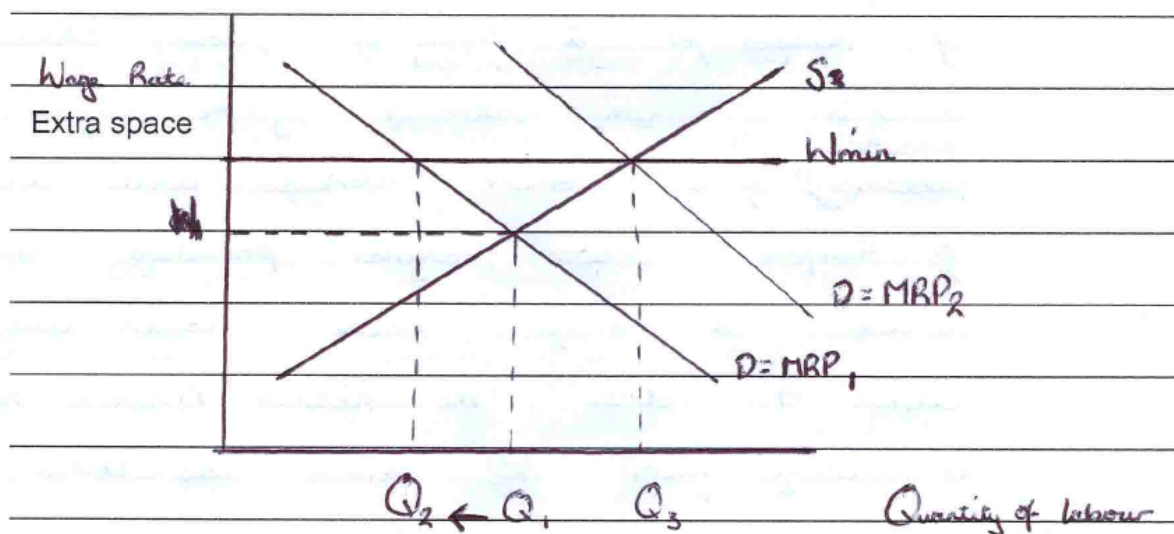
Examiner Commentary

This is a Level 2 response and subject to standardisation is worth around 9 marks. It has a logical structure and focuses on issues that are relevant to the question. Sound knowledge and understanding of a limited range of economic terms and concepts is shown. The student's ability to apply economic concepts and principles to the context is reasonable. There is some use of the data and application to the UK economy. There are examples of reasonable analysis but it is partial and not fully developed.

Student 2

Wages are largely determined by the interaction of demand and supply of labour. Demand for labour is in turn determined by the marginal revenue productivity of a worker. Workers with lower skills & therefore lower marginal productivity are in less demand and therefore receive lower wages. As extract A states: 'the National Minimum Wage provides a wage floor'. This prevents less skilled workers from being exploited. Increasing the National Minimum Wage to the Living Wage will help to lift some workers out of relative poverty (in which the individual is poor relative to the rest of society) as it ensures the wage is sufficient to meet the 'basic needs to maintain a safe, decent standard of living'. This benefits the economy as a whole as it will reduce government welfare spending on unemployment related benefits whilst revenue from income tax will rise. This will help to reduce the budget deficit, one of the key objectives of this government.

However, for businesses, setting the National Minimum Wage at £8.80 an hour in London and £7.65 elsewhere will significantly increase firms' costs of production. Higher costs may mean that firms are less competitive than rivals overseas; this could damage UK industry and harm the balance of payments. Rising incomes may also increase spending on imports which is not welcome at a time when the UK is running a large current account deficit.



Firms are only willing to employ up to the level where marginal revenue product is equal to marginal costs. Increasing the National Minimum Wage to the Living Wage will increase the marginal cost above the free market equilibrium of W and therefore the quantity of labour demanded will fall from Q_1 to Q_2 .

Others argue that a higher minimum wage encourages firms to invest in their workers by improving their skills which in turn improves productivity. Moreover, workers may feel more valued and motivated – one study suggests that paying the Living Wage reduced absenteeism by 25%. These factors increase the MRP of labour shifting the demand curve rightwards to $D = MRP_2$ thus actually increasing employment from Q_1 to Q_3 . Also, if the labour market is dominated by a monopsonistic employer, the increase to the higher living wage could increase employment as firms can no longer reduce wages by restricting employment. Hence the lowest paid individuals could benefit from a higher standard of living without others losing their jobs.

Examiner Commentary

This is a Level 3 response and, subject to standardisation, is probably good enough for full marks. The answer is well organised and deals with both parts of the question, i.e. the impact on individuals and the economy as a whole. Sound knowledge and understanding is shown throughout, there is good application of economic principles and use of the data. There is some application to the UK economy but this is an area that might have been developed. There are examples of well-developed analysis. Not much more could be expected in the time available.

Question 33

The authors of a report published by the Institute of Economic Affairs have recommended that the NMW for apprentices and under 18 year olds should be abolished and that each region of the UK should have its own minimum wage.

*Taking into account the information in **Extract E** and the original evidence, do you support these recommendations? Justify your answer.*

[25 marks]

Student 1

I believe that each region in the UK should have its own minimum wage but not that the NMW for apprentices and under 18 year olds should be abolished.

This is because each region varies in productivity, living costs and average pay making a national minimum wage less effective and perhaps hindering in many regions. As stated by extract E, the NMW in Wales is 70% of the median hourly earnings whilst it's only 42% of median hourly earnings in London, this means that the NMW could be damaging to businesses in Wales by forcing them to pay workers more than is needed to be considered equitable. This could lead to unemployment from firms being unwilling or unable to hire more staff and a lack of competitiveness from Welsh firms due to high costs of supply. As stated by extract A "the purpose of the NMW is to provide a wage floor, in order to protect low paid workers against exploitation, without causing job losses", in this case it is likely that many workers are losing their jobs because the NMW is too high whilst the lower prices in Wales means a lower wage will still allow a fair living standard.

Another bonus of regionally adjusted minimum wages is effectively an increase in the mobility of labour as workers unable to find jobs due to lack of demand can move to other areas of the country where they are able to work for a more competitive rate.

The regional minimum wage would be likely to decrease unemployment by a large amount across the country. Several benefits to this are an increase in living standards as people in poorer parts of the country become able to get a job, this will help many households out of the poverty trap and into the labour market where they can learn skills and become more attractive to employ. This will help reduce the budget deficit as less benefits are needed to be paid and more people are paying into the tax revenue which is particularly important for the economy right now as the government attempt to reduce deficit. This will allow for less budget cuts in public services many of which are under threat and underperforming.

Another reason for the regional minimum wage is that it can be unequitable to workers in London and other areas with high costs of living who are being paid less than the living wage, the living wage being the minimum amount a worker needs to earn so that they can live a standard of living deemed equitable. The living wage in London is estimated at £8.80 and £7.65 elsewhere, though other large UK cities like Birmingham are likely to be between the two and less developed areas of the country are possibly lower than £7.65.

By creating a regional minimum wage output, standard of living and employment can be optimised, this will likely help to reduce the balance of payments deficit by making UK goods more competitive due to lowered costs so that UK goods are bought in favour of foreign goods resulting in less imports and more exports, though the increase in growth of the economy may result in more imports and balance out this effect.

I believe that the national minimum wage for apprentices and under 18 year olds should be kept, though that it should be adjusted for each region rather than on a national level. This is because it allows younger people to have a fair level of competitiveness so that they may take up unskilled labour but also so that there isn't too much supply of labour from under 18 year olds. A lower minimum wage would make working less attractive and help encourage more of a focus on education. The reason I believe this is important is because a better educated economy will have a better trained workforce. This will improve the productivity of workers and

increase the growth of an economy which is particularly significant to the UK because it has been having a low or no increase in the productivity of workers over recent years. This will improve the long run growth of the economy and help make UK goods more competitive from decreased costs thus improving standard of living at the same time by making goods more affordable.

To conclude, I support the regional minimum wage because it makes the economy more efficient and whilst it may reduce competitiveness of city firms and the standard of living for some workers the net benefit is far greater. However, I am against abolishing the minimum wage for under 18s because, likewise with regional minimum wages, age related minimum wages allocate unskilled labour more efficiently whilst maintaining a balance on ability to compete, demand for labour and equity.

Examiner Commentary

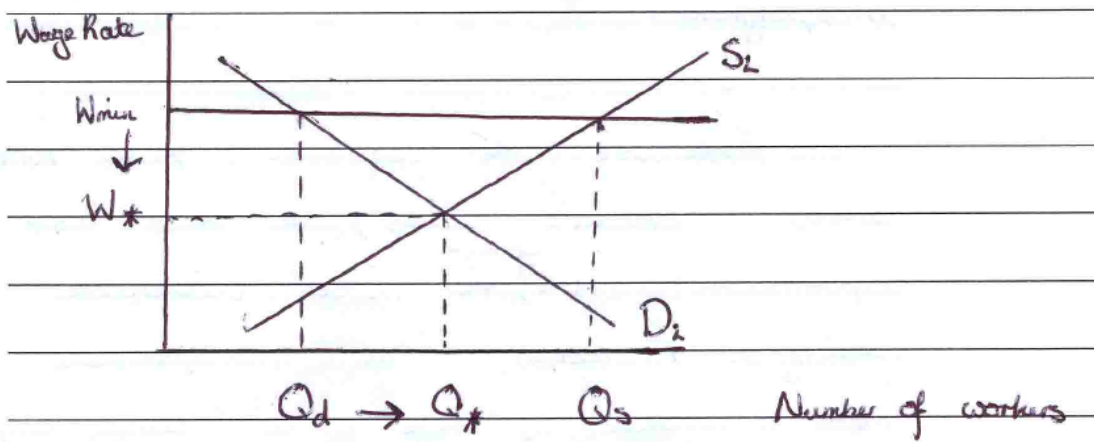
The answer is well organised. Knowledge and understanding is generally sound but there are some weaknesses. It contains some focused, fairly well-developed analysis but the sections devoted to analysing the effect of regionally determined minimum wages are stronger than the section on the merits of abolishing the NMW for apprentices and under 18 year olds. There is some reasonable, supported evaluation of the consequences of introducing regionally determined minimum wages but the attempted evaluation of the consequences of abolishing the minimum wage for apprentices is fairly weak and unconvincing. There is some appropriate use of the extracts, including use of the quantitative evidence to support the judgements made. This is a low Level 4 response which, subject to standardisation, is worth around 17 marks.

NB The Level of Response mark scheme that is used to mark this question is identical to the mark scheme used to award marks for the last part of the DRQs and last part of the essay questions on Papers 1 and 2.

Student 2

The aim of a NMW is to create a wage floor to prevent exploitation of workers. However, some economists have called for a review of the NMW arguing that it doesn't take into account the regional & occupational differences in demand and supply of labour and prevents the allocative function of wages from working properly.

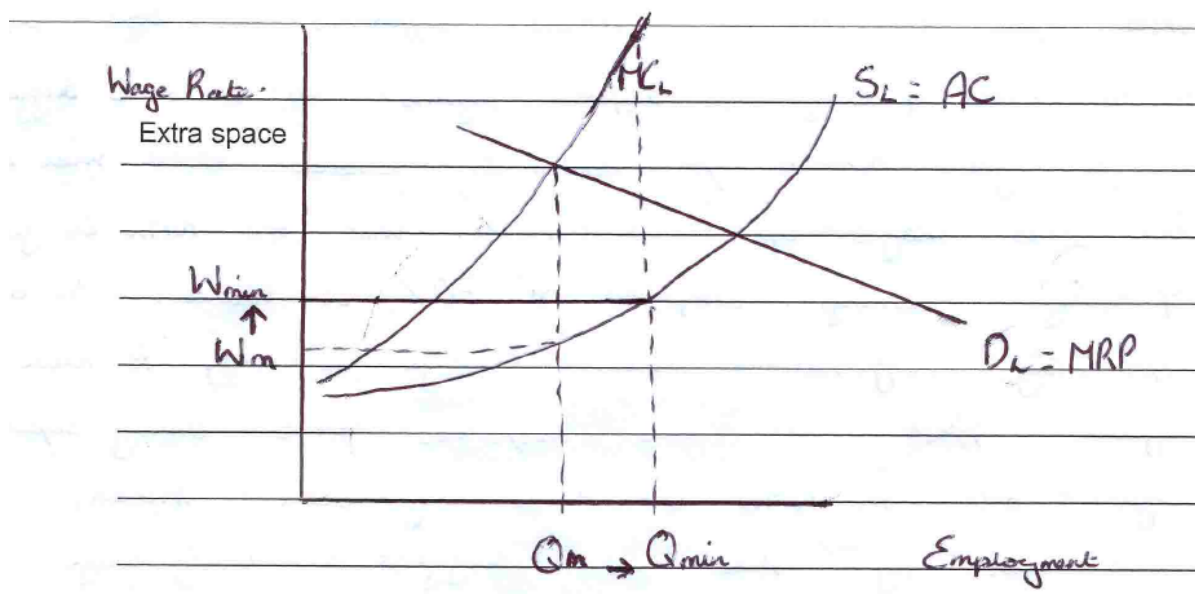
One argument for the abolition of the NMW for apprentices and under 18s is that it will 'help to tackle persistently high youth unemployment'.



A NMW increases firms' costs of production therefore they will demand less labour. This creates unemployment of $(Q_s - Q_d)$. Some critics argue that lower wages are better than no income at all, thus by removing the NMW the signalling and incentive functions of the price mechanism would be able to work properly. Excess supply of labour 'signals to workers to accept a lower wage of W^* . This in turn creates incentives for firms to employ more workers hence employment will increase from Q_d to Q^* .

However, the extent to which a NMW creates unemployment depends upon the elasticity of supply and demand for certain types of workers. In highly specialised apprenticeships where there are few alternatives, the supply of workers is likely to be fairly inelastic. In this case, abolishing the minimum wage will have little effect on the number of young people seeking apprenticeships. After completing the apprenticeship, the worker can usually expect a significant increase in their wage. Training a young person can be costly and eliminating the minimum wage should encourage firms to take on more apprentices, increasing the demand for young workers. However, some young workers may be put off by the low wage and this could affect productivity in the UK. It could be those from poorer families that are most affected, condemning them to a life of poverty. The abolition of the NMW raises serious ethical issues, it could lead to the exploitation of the young and the most vulnerable in society.

Moreover, in monopsonistic markets in which there is a single employer a NMW may actually be required to increase both wages and employment. Firms are only willing to employ up to the point where marginal cost of labour is equal to marginal revenue product. In a monopsonistic market it is pointless to employ beyond Q_m as the marginal cost will exceed MRP and profits will begin to fall. By keeping the NMW for apprenticeships and under 18s it keeps the firm's marginal cost constant up until Q_{min} . Beyond this point to attract more workers the marginal cost would jump above the MRP therefore the firm will employ up until Q_{min} .



As shown, in monopsonistic markets, removing the NMW may actually result in both lower wage and lower employment.

One argument for a regional minimum wage is that a single NMW fails to take into account differences in both supply and demand, and the cost of living in different regions. As extract C suggests there is far greater demand for labour in London than in Wales. This bids wages up and means that the NMW is just 42% of average earnings compared to 70% in Wales. As a result, implementing a single national minimum wage is likely to have a greater negative effect in the less prosperous areas lending support to the argument that the NMW should be regionalised. Indeed, this approach was taken by those who suggest a Living Wage which is determined by the cost of living relative to each region.

A significant problem with this is that it would be extremely expensive and complex to gather information about 'productivity and economic conditions' in each region of the country. What's more, firms may be put off from setting up in certain areas in which the minimum wage is higher which could result in certain areas of the country declining. Consequently a regional minimum wage could result in government failure in which intervention in the market leads to a less desirable outcome.

In conclusion, I consider that the risks of abolishing the NMW for apprenticeships and under 18s in terms of exploitation outweigh the benefits from any potential increases in employment. This is particularly true for monopsonistic employers who could use their market power to lower wages & reduce employment. A regional minimum wage is a good idea in theory as it takes into account the regional variations of supply and demand for labour, productivity and the cost of living. In practise however, the cost involved in collecting the relevant data and the potential reduction of greater mobility between regions could mean that such measures are ineffective. Overall, although the NMW is not perfect, it performs a vital function of preventing extremes in income within a capitalist society.

Examiner Commentary

This is a well organised answer that devotes sufficient attention to each element of the IEA's proposals. The understanding and application of relevant economic principles to the scenario is good. Appropriate use is made of the extracts, including the quantitative data. The analysis is well developed and there is supported evaluation throughout the response. The final paragraph includes a clear recommendation that is justified by drawing on arguments that were presented earlier. This is a Level 5 response and, subject to standardisation, would be worth close to full marks.

