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# FOREWORD

This booklet contains reports written by Examiners on the work of candidates in certain papers. **Its contents are primarily for the information of the subject teachers concerned.**



# ECONOMICS

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## GCE Advanced Level and GCE Advanced Subsidiary Level

**Grade thresholds** taken for Syllabus 9708 (Economics) in the November 2005 examination.

	maximum mark available	minimum mark required for grade:		
		A	B	E
Component 1	30	24	21	14
Component 2	40	27	23	15
Component 3	30	21	19	13
Component 4	70	46	40	30

The thresholds (minimum marks) for Grades C and D are normally set by dividing the mark range between the B and the E thresholds into three. For example, if the difference between the B and the E threshold is 24 marks, the C threshold is set 8 marks below the B threshold and the D threshold is set another 8 marks down. If dividing the interval by three results in a fraction of a mark, then the threshold is normally rounded down.

Grade Thresholds are published for all GCE A/AS and IGCSE subjects where a corresponding mark scheme is available.

### Paper 9708/01

#### Multiple Choice (Core)

Question Number	Key	Question Number	Key
1	C	16	A
2	D	17	D
3	D	18	A
4	A	19	A
5	C	20	C
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6	C	21	B
7	C	22	B
8	B	23	A
9	A	24	A
10	A	25	B
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11	B	26	D
12	C	27	C
13	A	28	C
14	D	29	D
15	C	30	C

### **General comments**

The examination was taken by 4676 candidates. The mean score was 17.45 with a standard deviation of 5.34. The performance was similar to the previous year. Eight candidates scored full marks, while 44% scored more than half marks.

**Questions 5, 10, 14, 15 and 16** proved significantly easier than intended. **Questions 18 and 29** were more difficult. Questions based on numerical data were handled well while the performance on diagrams was rather mixed. Candidates are knowledgeable on examples of economic concepts, which usually provide few difficulties. This was borne out in **Question 16** (public goods), which proved easy but surprisingly not by **Question 3** (capital), where the options were quite evenly spread. As indicated in the following comments on specific questions, topics that candidates continue to find troublesome are unitary elasticity of demand and consumer surplus.

### **Comments on specific questions**

**Question 11** performed below the discrimination target, with some of the better candidates selecting option **D**. This was incorrect because only  $OS_1$  operations would have been carried out, so there would have been no consumer surplus relating to  $S_1-D_1$  operations. **B** was correct, as the number of operations was  $OS_1$ , which would have set the equilibrium.

Diagram questions on changes in consumer surplus often cause problems for candidates. In **Question 12**, where the correct option was **C**, the largest group opted for **A**, while some of the better candidates opted for **D**. The increase in consumer surplus relates to the extra surplus on the existing 1000 journeys and the new surplus on the additional 1000 journeys resulting from the toll reduction. This gives a value of \$3000.

The most difficult question turned out to be **Question 18**, with only 17% of candidates answering correctly. While option **A** was correct, some better candidates went for **B** and the largest number chose **D**. In last year's examination a question hinging on the idea of unitary price elastic demand also proved difficult. A steady income would result from market action as the change in supply would move to a new equilibrium on the unitary elastic demand curve giving constant revenue. A fixed price would give different levels of income in line with changes in supply.

**Question 20** proved surprisingly difficult. It is unclear why candidates opted for options **A** and **B**, since both would result in higher prices for domestically produced goods making them less competitive with foreign goods. Option **C**, however, would mean that smaller quantities of imports would be allowed, so increasing the level of protection.

Exchange rate questions in diagram form are usually done well by candidates. **Question 29**, however, was poorly done, possibly the result of some carelessness in reading the information. Candidates needed to recognise that the market was for the US\$ and that more holidays in Europe would require an increased supply of the US\$ to buy the €, hence **D**. A large number opted for **B**, which would have meant an increased demand for the US\$.

**Paper 9708/02**  
**Data Response and Essay (Core)**

### **General comments**

There were some excellent scripts, in which candidates demonstrated concise understanding in the data response and the ability to apply and evaluate economic concepts in the essay. Among the less successful candidates, there were tendencies to overlook the basic knowledge points, an unwillingness to summarise numerical data and the misuse of technical economic terms. There were very few rubric infringements. However, insufficient attention was sometimes paid to the data response mark allocation. This resulted in an imbalance between both the parts of the data response and the division of time spent on the data response and the essay. The performance on the essay was generally stronger than that on the data response.

### **Comments on specific questions**

#### **Question 1**

- (a) Candidates were either well informed on the comparison of a free trade area with a customs area or appeared to be guessing or trying to find the answer from the data. When only one aspect was known it was usually the similarity. An error was to believe that customs unions had a common currency.
- (b)(i) Candidates found little difficulty with this part. There were some unnecessarily long descriptions of the data and some failure to recognise that an index number (not currency units) was being employed.
- (ii) Careless reading of the question meant that some candidates missed the reference to 1999, when there was an upward trend in the exchange rate as opposed to the overall downward trend for the whole period. This error meant no credit was awarded. The strongest answers linked the underlying influence to the demand and supply for the currency.
- (iii) There was a wide range of achievement in this part. Some answers missed the reference to a fixed exchange rate and ignored the role of the government, others stopped at recognising that government intervention was the determining factor, while the best analysed the government action needed to maintain a fixed value.
- (c)(i) The interpretation of the index numbers proved a significant problem. While many saw that Argentina moved towards deflation, the majority asserted that Mexico faced a continually rising rate of inflation. The distinction between the rate of inflation and the price level was not understood. There was some overstatement about hyperinflation.
- (ii) Those who tried to explain the right direction of cause and effect were quite successful. They identified the change in an influence, linked it to the demand for currency and argued it through to the effect on the exchange rate. A surprising number reversed the cause and effect or confused the internal and external value of the currency.
- (d) Most candidates were familiar with devaluation and were able to describe the process by which it can improve the balance of trade. The 'discuss' element of the question required that the circumstances needed to ensure success were analysed. There were plentiful references to the Marshall-Lerner condition and J curve effects. These needed to be clarified rather than asserted. Aspects of elasticity of supply and retaliation were also brought into the answers. A weakness was to be drawn into the effects of devaluation on inflation and employment without relating the point back to the position on the balance of trade. Some candidates wrote about capital and financial sections rather than trade.

**Question 2**

This question on externalities was popular and done well. There was a tendency to repeat information between the two parts.

- (a) There were some first-rate responses, which gave clear definitions, used appropriate diagrams and drew conclusions about the allocation of resources. Less impressive answers confused external and social costs and benefits and drew inaccurate diagrams. Some candidates turned the question into one about merit, demerit and public goods. Discussion of cost-benefit analysis was not required. Diagrams were not essential, but those who used them found it easier to convey their ideas.
- (b) Too many candidates repeated information that had already gained credit in part (a). While there were some thorough evaluations of the two methods, common errors emerged. The most frequent was to overlook the problems and weaknesses of the measures. Better answers referred to the difficulty of measuring the external costs and benefits and to the possible harmful side-effects of the actions. Again the drawing of diagrams was not always accurate. Consideration of alternative approaches to the problem of externalities tended to be descriptive and added nothing to the value of the answer.

**Question 3**

This question was also popular and was generally done competently. Candidates were well aware of current issues in international trade and wrote enthusiastically about them.

- (a) Candidates were aware of the idea of equilibrium in demand and supply analysis. Rather a lot of unnecessary background description was offered. A small number confused demand and supply in the drawing of diagrams. Changes in the conditions of demand and supply were used effectively, although not universally, to show the process of price determination. Issues of elasticity were not looked for as part of the answer.
- (b) Good marks were scored on this, as candidates were able to offer arguments both for and against free international trade. Few answers considered only one side of the argument. The perspective of developing countries was examined thoughtfully and the general consensus was against free international trade. There was some imprecision with the concepts of dumping and the terms of trade. Comparative advantage was relevant as the underpinning of the case in favour. As so often in previous examinations some candidates confused the cases of absolute and comparative advantage and lost their way in a numerical approach.

**Question 4**

This question on unemployment and labour was by far the least attempted question and the weaknesses in the first part meant that overall it was the least well done.

- (a) The basics of the question were often overlooked. Unemployment was not defined nor were the methods of measurement identified. The explanations of the problems of measurement were rarely convincing and suggested limited understanding of the issues. It seemed that mention of unemployment drew candidates into a prepared answer on the types of unemployment and their effects. These do not fall in the compass of the AS Level syllabus.
- (b) There were a minority of thorough answers, which considered both the relative importance of the different factors and the division of labour. The majority, however, concentrated on the division of labour. This allowed a competent answer but was not comprehensive. The treatment of relative importance was generally very simplistic and did no more than assert that labour was irreplaceable. It was hoped that candidates would consider the relationship between the factors in a variety of situations and recognise their inter-relationships.

**Paper 9708/03****Multiple Choice**

<i>Question Number</i>	<i>Key</i>	<i>Question Number</i>	<i>Key</i>
1	<b>A</b>	16	<b>D</b>
2	<b>C</b>	17	<b>D</b>
3	<b>D</b>	18	<b>C</b>
4	<b>C</b>	19	<b>C</b>
5	<b>D</b>	20	<b>A</b>
<hr/>			
6	<b>B</b>	21	<b>A</b>
7	<b>C</b>	22	<b>A</b>
8	<b>C</b>	23	<b>A</b>
9	<b>B</b>	24	<b>A</b>
10	<b>C</b>	25	<b>B</b>
<hr/>			
11	<b>C</b>	26	<b>D</b>
12	<b>B</b>	27	<b>C</b>
13	<b>D</b>	28	<b>B</b>
14	<b>C</b>	29	<b>B</b>
15	<b>C</b>	30	<b>B</b>

**General comments**

As in previous years, candidates found this paper more difficult than had been anticipated. The overall percentage score of 46% was almost identical with the scores recorded on the corresponding papers in 2003 and 2004.

One item, **Question 9**, turned out to be too easy, while on the other hand three of the items, **Questions 6, 24** and **29** had facility scores below the 25% guessing level for four-option items.

**Comments on specific questions**

In **Question 6** most candidates appreciated that the income effect and the substitution effect worked in opposite directions, but only 23% got them the right way round.

The statistics suggest that most candidates resorted to guesswork in **Question 11**. The diagram shows that the firm is minimising its losses by equating MC and MR, and so is in equilibrium, at least in the short run.

In **Question 12**, only 27% of the candidates recognised that in order to deter potential competitors a firm in a perfectly contestable market will aim to make only normal profits.

The poverty trap is a concept with which most candidates are clearly not familiar. This resulted in 46% of the candidates wrongly opting for **D** in **Question 14**, and for the item's low discrimination.

**Question 17** was also a poor discriminator, with more candidates opting for **C** than for the correct response, **D**. It is true that if the liquidity trap is operative an increase in the money supply will leave the level of output unchanged. However, the existence of a liquidity trap is a Keynesian rather than a monetarist hypothesis.

In **Question 24**, if actual output grows more rapidly than potential output one can expect employment to increase.

When drawing a SRPC (**Question 26**) one assumes a given natural rate of unemployment and a given expected rate of inflation.

In **Question 28**, those candidates (59% of the total) who opted for **A** or **C** failed to recognise that FDI results in out-payments of profit and dividends.

Finally, **Question 29** revealed that most candidates had no idea how automatic stabilisers work.

**Paper 9708/04**

**Data Response and Essay (Extension)**

**Comments on specific questions**

**Question 1**

- (a) Candidates could choose from the facts that there were only four companies, they could fix the price, they had product differentiation in the handsets, and there was not perfect knowledge in the market. Most were able to start the question well and used at least part of this information.
- (b) Candidates were expected to explain that one product or service was subsidised by the profits of another that itself might be overpriced. The removal of the subsidy will result in an increase in the price of the subsidised product if profit levels are to be maintained. Often the subsidised product makes a loss but is produced because it is supplementary to other, profit-making, products or services. Sadly, very few candidates were able to present a satisfactory answer to this question. Many confused the idea of cross-subsidy with the concept of a government subsidy. Allowance for candidates' difficulty with the term 'cross-subsidy' made when determining the grade boundaries for this paper.
- (c) A range of answers were produced with a variety of suggestions which included the possibilities that the companies could try to reduce labour costs, implement some redundancies, stop research and development, generally try to reduce costs or try to increase revenue by promoting products through advertising.
- (d) Termination charges are placed above the market level. The diagram that was expected should have shown a price above market clearing which would result in reduction in consumer surplus. Sadly not many candidates understood consumer surplus and a good proportion of those that did gave an answer to the question 'What would happen to consumer surplus if the termination charges were removed?' rather than what happens if they exist.
- (e) Candidates could have drawn on the information that consumers would save £700 but that this would be over the next three years, and that the price reduction would be on all calls. Both of these points were in the consumers' interest. Against the consumers' interest were the facts that the cost of telephone handsets would rise, the fear of increased calls for text messages and the possibility of the phone company finding some other way to keep profits high. It was expected that an overall conclusion would be drawn balancing these opposing views.

**Question 2**

- (a) Candidates were expected to explain the idea of a free market and the analysis of productive and allocative efficiency within that market. Many were able to deal with the free market and the idea of productive efficiency. Fewer were able to explain in a satisfactory way the analysis of allocative efficiency. Some explained productive efficiency but did not structure the answer well because they omitted to put the explanation into the context and description of a free market.
- (b) It was hoped that candidates would use the stimulus material to discuss the possible reasons for market failure. Monopolies, merit goods, public goods and lack of information were areas that could have been mentioned. This discussion could have been followed by a consideration of whether any of the market failures mentioned might apply in the case of the large engineering company. While a discussion of market failure was often given, not all the candidates were able to place that discussion in a well-structured answer that linked the material to the question asked. Very little extra knowledge was required for this, indeed nothing other than that which was in the stimulus, but when it was done the resulting answer had much more style, presence and relevance to the particular question asked. When it was not done the answer read as if a set of notes had been learned and repeated.

**Question 3**

- (a) Candidates were asked to comment on trade unions. The economic theory of wages that was relevant was, therefore, that of imperfect market. This theory should preferably have been explained using marginal revenue productivity analysis. Candidates could have explained that trade unions can have an effect on the supply curve which would, with the existence of unions, now no longer be solely determined by market forces. Where the actual wage will eventually lie would depend upon the relative strengths of the employer and the trade union. Most of the candidates who answered this question made a good attempt at the analysis, although some restricted themselves to perfect competition, which led to errors. Some answered rather baldly in terms of demand and supply. Answers on wages at this level that do not mention marginal revenue productivity analysis may not be incorrect but they lack the development that analysis can allow and, therefore, the marks that are awarded are inevitably lower. Candidates should be made aware that questions on wages at this level of examination usually require some more detailed analysis than demand and supply. Better candidates were also able to distinguish between the situation in the factor market and that in the product market.
- (b) Many candidates answered this question well. Trade unions could affect the supply of labour and working practices. They could cause production to decrease with consequent downward effects on income, spending and national income.

Better candidates saw that there might be another side to the argument. As well as creating overall downward pressure on incomes, unions could prevent disruption of production by conducting negotiations with employers. They could also monitor the implementation of safety procedures which might involve extra spending by the employer. This might well have an upward effect on national income.

**Question 4**

- (a) The purpose of the first part of the question was for candidates to distinguish between normal profit and abnormal profit. The majority of the candidates produced good answers, clearly distinguishing between the two types of profits and placing the answer within the context of both the short-term and long-term period and within differing market situations. One common mistake, however, was that a number of candidates thought that normal profit meant zero profit and confused it with the idea of 'breaking even'. There was some very good discussion of the differences between perfect and imperfect markets. The question explicitly required candidates to include diagrams. Sadly, this caused some candidates problems. The better answers contained very clearly drawn and labelled diagrams contrasting normal and abnormal profits in both perfect and imperfect markets. Some answers, however, contained diagrams that were inaccurate. The two major faults were the position where MC and MR met and the position where AC crossed MC. The consequence of the errors was that, in many cases, abnormal profit was shown incorrectly.

- (b) The purpose of the second part of the question was to get candidates to discuss whether firms were always able to maximise profits in the way suggested by economic theory and then to debate whether it was likely that firms always wanted to maximise profits. Unfortunately, this was not answered very well. Candidates did not appear to fully understand that the two elements were involved.

A good answer would first explain that the profit-maximising position was where MC was equal to MR but that it might not always be possible for firms to know precisely where this position was. Secondly, it would discuss some other possible alternative objectives of firms such as sales maximisation, behavioural, managerial, satisficing and market share aims. It was pleasing to see that where candidates had looked at these other possible aims, the answers were of a good standard. Too many assumed that firms had no other aim but profit maximisation and spent all of the time discussing the differences that would result when perfect competition was contrasted with monopoly.

#### **Question 5**

The purpose of this question was to invite candidates to consider the different aims of government policy and for them to discuss how far they agreed that low interest rates and low inflation were most important among those aims in maximising economic welfare.

There was some good discussion of the two aims mentioned in the question and candidates generally demonstrated a sound knowledge and understanding of how these might contribute to the maximising of economic welfare. A number of the better answers recognised that there might actually be a conflict, or trade-off, between the two aims, for example, high interest rates might be necessary to bring about low inflation while low interest rates might actually contribute to high inflation.

The main weakness of many of the answers was that the candidates did not always pay attention to the 'How far do you agree?' part of the question. These two aims are important but candidates were expected to consider other possible aims of government policy, such as economic growth, low levels of unemployment and a balance of payments equilibrium and then to come to a balanced judgement as to which might be regarded as the most crucial in terms of maximising economic welfare. Some candidates thought that the question was concerned with the means of achieving various aims and wrote extensively about monetary and fiscal policy without making any judgement on the aims themselves.

#### **Question 6**

- (a) The purpose of the first part of the question was to get the candidates to use the multiplier analysis to explain what effect the investment by IKEA might have on the Malaysian economy. The majority of the answers were of a good standard, displaying a good grasp of the multiplier analysis and explaining how such an investment might increase the Malaysian national income by more than the initial investment. A number of candidates explained the multiplier extremely fully in terms of two, three and four sectors and many candidates used diagrams to assist their discussion and explanation.
- (b) The purpose of the second part of the question was to invite candidates to consider the operations of multi-national companies and to discuss whether their activities were always beneficial. Most of the answers to this part of the question were of a good standard. Candidates demonstrated a clear knowledge and understanding of multi-national companies, recognising that there were both advantages and disadvantages to their activities. The main weakness was that a number of candidates did not offer a balanced discussion of their operations, emphasising either the advantages or disadvantages without saying very much about the other view, or discrediting the other view as a means of supporting their choice.

**Question 7**

The purpose of this question was to get candidates to think about living standards in different countries and, in particular, how they might be measured and then compared. The question referred to the difficulties in measuring living standards: candidates were invited to consider the assertion that, as a result of these difficulties, it would be impossible to assess whether people in one country were better off than those in another. The quality of many of the answers was good. Candidates recognised that real GNP per capita was the main yardstick to compare living standards but that there were numerous difficulties, such as the extent of the hidden economy and the types of products being produced. A number of candidates recognised that there were now a number of other ways of looking at living standards, such as the Human Development Index, and contrasted these with more traditional approaches. The main weakness in some answers was that candidates offered a long list of the various difficulties without linking this to the issue of trying to make a contrast between standards of living in different countries. Candidates need to understand that they are required to apply the knowledge that they have to the particular question being asked.

For this question, candidates needed to consider each part of the statement. They should have discussed whether there are many difficulties in measuring living standards and given reasons for their conclusion on that part of the question. They should then have considered whether it is possible to compare one country with another and discussed what use national income statistics might be in this comparison. They should then have formed an overall conclusion. No extra knowledge is required to do this. It is a question of structure and use of existing knowledge. The difference between the marks of an answer which is well-structured and follows the question asked in the manner just described and one which, essentially, is a repeat of learned notes with little reference to the argument in the question is, however, significant.