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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

GCE Advanced Level and GCE Advanced Subsidiary Level

Paper 9708/01
Multiple Choice

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

General comments

There was again a significant rise from 6524 to 7468 in the candidature. This was accompanied by an improvement in performance, with a rise in the mean from 17.7 to 18.2 with a standard deviation of 5.6. There were 51 candidates who scored full marks and 72% of candidates gained half marks or more. Three questions (**Questions 1, 9 and 20**) proved to be easy for candidates, while none was too difficult. Candidates found numerically-based questions slightly more difficult than those based on text or diagrams.

Comments on specific questions

Question 1, a high scoring question, did prove that candidates were able to differentiate between the main or basic economic problem and other economic targets. The high scoring on **Question 9** was pleasing, given that it required some mental dexterity on complements and substitutes. The high facility on **Question 20** might have been anticipated as it required only a straightforward knowledge of trade barriers, and candidates showed this.

Some better candidates answered **Question 2** incorrectly. This was the result of selecting not the opportunity cost to the individual but the opportunity cost to society of the employment of an unemployed worker.

In **Question 7**, more candidates (including some of the stronger ones) opted for **D** rather than the correct option **C**. The question was slightly more complicated than usual and they missed the fact that the increase in output was 15% ($1/2 \times 10 + 1/2 \times 20$) and not 30% ($10 + 20$). Similarly more candidates opted for the incorrect response (**C** rather than **D**) in **Question 27**. It is not right to assume that a strong current account surplus can cause a surplus in the trade in goods and services since the resulting prices of exports and imports can undermine competitiveness. Although **Question 19** discriminated well, half of the candidates opted for **D** rather than **A**. There was insufficient information to make a decision about absolute advantage for good Y, but the factor endowment on good X for Fantasia made comparative advantage likely.

Question 25 had an even spread of responses, with only 36% selecting the correct option **C**. Candidates do find the interpretation of inflation diagrams difficult and need to realise that a falling but positive rate of inflation means that the general price level is still rising. Thus the cost of living would rise and the value of money would fall.

Paper 9708/02

Data Response and Essay (Core)

General comments

After a number of years in which examination technique had improved it was disappointing to see the re-emergence of some common errors. As a result candidates were not always able to make the best use of the economic knowledge they possessed. The performance on the essay question was usually stronger than on the data response, although this was not necessarily the case when **Question 3** was selected. Despite these comments there were some papers which were most impressive and gained very high marks based on thorough understanding and the ability to apply this understanding relevantly. Regrettably, at the other extreme, a small number of candidates showed insufficient understanding to make their entry for the exam worthwhile. Candidates need to address these issues:

- data needs to be interpreted or manipulated, not copied
- data response answers need to be set within the context of the data
- ideas need to be explained rather than asserted
- the whole of a question with sub-sections needs to be read before answering
- questions need to be read carefully to pinpoint the exact task being set
- relevance must be maintained
- the length and detail of answers should reflect the mark tariff.

The application of these practices should enable candidates to do themselves more justice.

Comments on specific questions

Question 1

- (a) A significant error was to copy out data rather than to manipulate it. A 25% rise or a 50% fall within a year indicated a dramatic change. Smaller changes within a month were also accepted. However, long descriptions of the data did not establish the point. It was not necessary to explain why the changes had occurred. Candidates seemed unfamiliar with index numbers. The changes were denominated in points, not currency values.
- (b) Most candidates recognised that worsening economic conditions were the influence which increased the demand for gold. Fewer completed the analysis for the second mark by pointing out that it was the greater safety or return on gold which made it the choice.
- (c) The majority of candidates drew a demand and supply diagram with a decrease in supply, an increase in demand and a rise in price. This gained full marks. Marks were lost for omitting one of the curves or the price change. Some diagrams were poorly drawn and some moved the supply curve incorrectly. Others answered with bar charts or line graphs of commodity values; these were not given credit.

- (d)(i) The definition of price elasticity of supply was, for the most part, well known and earned high marks. Carelessness resulted in definitions of supply or elasticity of demand or the relationship between them and causation.
- (ii) The relevant data referred to the level of stocks as an influence on elasticity of supply. Those who recognised this scored well. When this was missed candidates either asserted the degree of elasticity or tried to use statistics on price to prove a case. Virtually none of these succeeded.
- (e) Candidates recognised the link between palladium and platinum through substitution, but the ability to clarify the relationship from the data was less common. It was expected that the contrast in price behaviour would be related back either to the change in demand for substitute final products or to the price difference in December 2000. Frequently candidates offered a theoretical statement that made no use of the data, but such answers did not gain credit.
- (f) This was a disappointing part. Candidates were able to highlight potential effects but too often left them as no more than a list. The benefits of the price rises were given more prominence than the drawbacks. Good marks required that both sides were considered. Few answers gave details, for example clarifying the relevance of elasticity, when making assertions about balance of trade effects. The exchange rate appreciation effect was often mentioned but then became the single focus of the answer, so ignoring all other macro and micro impacts. The mistaken belief that a trade surplus is the equivalent to government income continues to be expressed.

Question 2

The question examined the features of economic systems and the role of government in providing goods and services. It was the most popular question and gained the best marks.

- (a) This part was very well done, with a significant number of candidates scoring full marks. The weakness of some was to write at excessive length and anticipate the content of the following part. This resulted in some wasting of time and repetition in the subsequent answer. Knowledge of the market system was particularly detailed, although some suggested that it supplied only luxuries but not necessities.
- (b) Some answers changed the question from one of government provision to one of government regulation. This meant concentration was on market failure in all of its forms rather than those best dealt with by government supply. Those candidates who analysed the cases of public and merit goods started well. Although many mentioned these terms they were not always clarified accurately and the failure of the market system to provide them was left unexplained. There was good awareness of other motives for state provision, such as price levels, availability and production costs. Some attempt to criticise the appropriateness of government supply was usually offered with comments on choice and efficiency leading the way.

Question 3

The question examined the role of money and the importance of its retaining a stable value. It was the least popular and least well-understood question, which resulted in relatively low scores.

- (a) This part produced the least competent of the part (a) answers by a considerable way. The better answers not only identified the functions of money but also made clear the benefits they provide, but these answers were relatively scarce. This was sometimes done through an examination of the barter system, which proved an effective approach. However, many answers dealt not with the functions of money but with its characteristics. Others dealt with the demand for money while others used a very descriptive approach which illustrated the uses to which money can be put. These approaches did not score well.
- (b) Those candidates who made the link between the (in)stability of the value of money and the rate of inflation were able to make a reasonable attempt at the question. This involved a straightforward analysis of the impact of various rates of inflation and gave the candidates the scope to consider domestic and international consequences. Those who missed the link tended not to go far beyond the issue of confidence for planning and investment. There was a large amount of unsubstantiated assertion of effects on the standard of living, the exchange rate and balance of payments. A major error was to turn the question into one with a focus on the exchange rate. The reference to 'domestic value' was intended to steer candidates away from the international value of a currency. There was much carelessness in confusing changes in the price level with changes in the value of money.

Question 4

The question examined the organisation of a country's international transactions and the significant deficit balance on current trade. It was a popular choice and competently done.

- (a) There were some excellent answers on the structure of the balance of payments. The best answers not only identified and explained the individual items in the different sections but also made clear the logic behind the organisation. The area which caused most difficulty was the treatment of the capital items and the flows which result from them. In some cases capital was interpreted as spending on capital goods, which belong in the current not the capital section. Most candidates were familiar with the more recent terms and organisation based on the IMF standard presentation.
- (b) Candidates were able to show that a deficit can be both harmful and beneficial, depending upon the particular circumstances. The level, length and composition of the deficit were often considered. A large number of identifications of a deficit balance were inaccurate, referring to more imports than exports without stressing the values involved. There was evidence of answers which had been prepared in the anticipation of a question on policy to correct deficits. These gained very limited credit and diverted time from a more productive use. Some thoughtful answers were produced.

<p>Paper 9708/03 Multiple Choice</p>
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<i>Question Number</i>	<i>Key</i>	<i>Question Number</i>	<i>Key</i>
1	C	16	C
2	C	17	C
3	B	18	A
4	D	19	B
5	A	20	D
6	B	21	B
7	D	22	A
8	B	23	A
9	B	24	D
10	C	25	D
11	C	26	B
12	B	27	C
13	B	28	D
14	C	29	A
15	B	30	B

General comments

The mean percentage score on this paper was 51.75%. This was significantly higher than the 47.7% score recorded in the corresponding paper in 2004.

24 of the 30 items had facility and discrimination scores that were within the test design limits. Three items, **Questions 2, 13 and 21** had facility scores below the .25 guessing level, i.e. they were answered correctly by fewer than 25% of the candidates, and there were a further three items, **Questions 3, 25 and 26** which had relatively low discrimination scores, i.e. the candidates who answered them correctly were not necessarily those who did well on the paper as a whole. In **Question 10**, more candidates opted for one of the distractors than for the key.

The two easiest items on the paper were **Questions 1** and **4**, both of which had facility scores of 100%. Somewhat ironically, productive efficiency is usually one of the least well understood topics on the paper and one suspects that many of the candidates who answered **Question 1** correctly may well have done so incorrectly that **C** implies that all firms are producing at their cost-minimising level of output!

It is not entirely clear what caused candidates so many problems in **Question 2**. It is, of course, possible that most candidates are just not familiar with the notion of the paradox of value. However, another possibility is that candidates tend to become confused when questions are “turned around”. If candidates had been asked what explains the paradox of value, and the statement in the stem had been included as one of the options, then the facility score might well have been much higher.

In **Question 10**, 50% of the candidates chose **B** compared with the 41% who chose the correct response, **C**. The discrimination statistics indicate that most of those who opted for **B** were among the weaker candidates. Nevertheless, to avoid any possible ambiguity, it should perhaps have been made clear in the stem that economies of scale were operative over the firm’s entire range of output.

The effect of imposing a specific tax on a monopoly producer will be to shift its MC curve upwards by the amount of the tax. By drawing a rough diagram one can work out the effect will be to reduce the quantity produced and to increase the price, but by less than the amount of the tax. In the event, only 17% of candidates answered **Question 13** correctly. The 48% who opted for **C** effectively failed to recognise that a monopoly cannot control both price and quantity.

Anyone reasonably familiar with the theory of loanable funds, should not have had too much difficulty with **Question 21**. In the event, only 18% answered the item correctly, while 50% opted incorrectly for **A**. The theory of loanable funds is arguably now somewhat dated, and possibly for that reason the topic is one that has tended to be disregarded.

The relatively low discrimination score in **Question 25** suggests that some of the better candidates failed to distinguish between those factors that affect potential output as opposed to those that affect actual output.

An increase in government spending financed by borrowing from the public will cause interest rates to rise. Given exchange rate flexibility, this will cause the currency to appreciate, which, in turn, will reduce the level of net exports. On the other hand, one could argue that the increase in interest rates will also reduce domestic spending, which would reduce the level of imports. Hence, the overall effect on net exports is not entirely clear-cut. This means that the correct answer in **Question 26**, unfortunately, is not wholly unambiguous, and this, in turn, may account in part for the item’s relatively low discrimination score.

Paper 9708/04

Data Response and Essay (Extension)

Comments on specific questions

Question 1

- (a) Nearly all candidates were able to select two advantages of Botswana from those mentioned in the text, which included an educated workforce, no exchange controls, low taxation, the possibility of sending profits back to the home country, an economic administration based on free market principles.
- (b) Candidates could have used the following as evidence: the extent that the economy relies on a primary industry (the mining of diamonds); the fact that this accounts for 77% of export earnings, 45% of GDP; the lack of water, the need for foreign developers, the low life-expectancy and the poor infrastructure leading to high transport costs.
- (c) There was some confusion with this question with candidates answering what type of economy existed (a mixed economy) rather than what type of market structure existed. It was expected that candidates would answer that the market structure was imperfect or that they would say it was a monopoly organisation. The evidence is that there is one major company, partly owned by the government, there are possible barriers to entry, the monopoly position enable high profits (75% to the private company form high total earnings) and possible exploitation of labour through low wages.

- (d) Candidates made an attempt to explain what 'free market principles' meant but, surprisingly, omitted to mention the influence of demand and supply in the allocation of resources. Some stated that the government had little or no influence but did not say what was used instead as a means of allocating resources. While all candidates answered the first part of the question in some way, all of them then continued to answer the second part, which asks whether the article supports the view that there is a free market in Botswana. The article says that the government was involved in Botswana in the industrial sector. This would contrast with the strict analysis of the pure free-market system.
- (e) Candidates were able to suggest some of the internal advantages which could, for example, include a wider choice of products, possible greater income and employment, increased standard of living from increased income and use of resources. Some mentioned international aspects as well, which could include less reliance on imports and less dependence on trading in primary products.

Question 2

- (a) Many candidates attempted this question. It was a common assertion that marginal revenue productivity determined wages in competitive markets. Conceptually, marginal revenue productivity is an element in the explanation of why demand curves for labour may be downward sloping with respect to real wages; wages are determined by the interaction of market demand and supply curves.

Unfortunately, a considerable number of candidates were confused between the analysis of the firm and the analysis of the industry, and some did not distinguish between the firm and the industry at all. Those who did distinguish between them often argued that the labour demand curve of an industry is the horizontal aggregation of the given MRP curves of individual firms. This, however, is not so. If, conceptually, the market wage falls, a firm hires more labour, but so will all the other firms in the perfectly competitive industry. The industry output will increase and the price of the product will fall, so the MRP curve of the individual firm will shift downward.

- (b) Most candidates were able to give examples of where the conditions needed for perfect competition would not be descriptively fulfilled in real labour markets. The usual conclusion drawn was that, because of unrealistic assumptions, perfect competition wage models were not very helpful in explaining how wages are determined in reality. However, there are sections of the labour market where trade unions, monopsony power and state-imposed minimum wages are not important influences, and certain observed wage differentials can be plausibly explained in a demand and supply framework. Many candidates, in fact, used demand and supply curves to illustrate how wage differentials could emerge, but then tended to argue that such differentials provided yet another example of the uselessness of perfect competition models. Overall, however, this part was dealt with very effectively and it was clear that there had been much careful preparation, with the better answers commenting on both demand and supply aspects of the theoretical analysis.

Question 3

- (a) In answering this part a majority of candidates were able to use the Keynesian model of income determination to predict that a rise in consumer spending would lead to an increase in China's national income.

However, although many argued that consumption spending was induced by an increase in income they interpreted this increase in consumption as resulting in an upward shift in the aggregate expenditure curve. The aggregate expenditure curve will shift upwards only if there is an increase in the autonomous element of consumption – i.e. a change in the intercept term in the consumption function which depicts the influence of factors other than income. Similarly others thought that if the marginal propensity changes there will be a parallel shift in the curve rather than a change in the slope of the curve. Others failed to indicate that the Keynesian model applies in a slump or recession or where there is unused capacity.

- (b) Most candidates could discuss why an increase in tourism might be desirable but there was a lack of rigour in many answers, which tended to be very general and descriptive and did not analyse how an increase in tourism might affect, for example, the balance of payments, employment or the exchange rate.

Question 4

- (a) Candidates showed a clear knowledge and understanding of the change in value of one currency against another, explaining that this represented an appreciation of the value of the US dollar and a depreciation of the euro. Although a diagram was not specifically asked for, a number of the best candidates did include a diagram and used it effectively in their explanation. Secondly, candidates needed to explain what was meant by a 'failure to grow' and, in particular, the state of recession in Germany. Again, many of the answers were of a good standard and candidates correctly defined recession as two consecutive quarters of negative growth. Candidates then linked the two elements of the statement, pointing out that low growth rates, and especially a recession, indicated a poorly performing economic situation and that this was likely to affect the value of the euro in terms of other currencies, including the US dollar. There was some good discussion of the various factors which could explain the movement of currencies in a floating exchange rate system.
- (b) In the second part of the question, candidates were required to discuss what policies the German government might use to try and combat the recession. Many of the answers to this part of the question were extremely thorough. Candidates considered both monetary policy, such as a lowering of interest rates, and fiscal policy, such as a reduction in taxation and/or an increase in government spending. As in part (a), diagrams were not specifically asked for but many candidates used them very well, showing clearly how monetary and fiscal policy could lead to an increase in the level of aggregate demand in the economy. A number of candidates went beyond monetary and fiscal policy and included a discussion of both supply-side and exchange rate policies. (In reality Germany now no longer has the power to change its own interest rates. As a member of the eurozone, this would be determined for all twelve countries in the zone by the European Central Bank in Frankfurt and the scope for independent action by Germany is limited, now that the Deutschmark has been replaced by the euro. However, answers which presumed that Germany could act independently were entirely accepted and the mark awarded was based on the strength of the economic analysis presented.) The very good answers then concluded by offering an evaluation of the strengths and weaknesses of the various policies before coming to a judgement as to which ones might be the most appropriate.

Question 5

There were two elements to this question. First, candidates were required to demonstrate a knowledge and understanding of the main features and characteristics of oligopolistic markets and, in particular, the behaviour of firms in such a market. Secondly, candidates needed to discuss how far such behaviour was supported by the statement given, which described the behaviour of two firms, Gillette and Energizer Holdings. Answers to the first part were generally of a good standard. Candidates recognised that there were a number of important features of an oligopolistic market, such as the existence of a kinked demand curve, barriers to entry, product differentiation and innovation, interdependence and a high level of price rigidity. Diagrams were not explicitly asked for but many candidates did draw them and used them well in their explanation, especially in terms of the kinked demand curve.

The second part of the question, however, was answered less satisfactorily. Some candidates wrote very little about the two firms in the statement and what they did write was often an afterthought, with little or no attempt to relate the two firms to what had been written previously about the general nature of oligopolistic markets. Some candidates did, however, attempt to incorporate discussion of the two firms in the answer. Points which could have been raised include:

- *Branding and advertising:* These are key features of firms in oligopolistic markets and Gillette and Energizer Holdings both offered appropriate examples of this in terms of such brands as Sensor3, Mach3Turbo, Duracell and Schick.
- *Profits and prices:* Very few stated that the theory assumes profit maximisation and that Gillette is concerned with profits and has increased sales and revenue – however, nothing is said about whether prices were kept the same as revenue increased.
- *Market share and prices:* It is stated that when a competitor increased its advertising, Gillette reacted as it was concerned about market share and increased its advertising also. It is likely, but not stated, that prices would not remain the same – as stated in the theory – as the advertising costs increase unless sales can increase to meet the costs. The theory does not emphasise an increase in market share as a policy and in this respect the practice of the firm which was concerned with market share does not fit with the theory.
- *Potential competition:* The theory assumes potential competition. The article says that there is direct competition.

In questions such as this it is advisable for candidates to set out the assumptions of the theory and to consider whether they apply in the case stated. It is often better, to avoid the impression of an answer that conclusions about the case stated are made after the explanation of each part of the theory rather than as a short paragraph at the end of the answer. If candidates attempted to apply their knowledge after each part of the theory they would find that such questions might not appear as daunting as perhaps they think. State a part of the theory; look to see if there is evidence of that part in the information given; if it is found, state what the evidence is; draw a conclusion. If there is no apparent evidence, simply state that that part of the theory is not proved from the evidence given. Apart from a knowledge of the theory, no other knowledge of the industry than that supplied is required.

Question 6

This question required the candidates to explain what was meant by efficiency and then discuss whether, if resources are left to the market, there might be occasions when this efficiency would not be achieved. The familiar arguments about market failure should have been mentioned and included a discussion on market imperfections, lack of knowledge, the provision of public goods, the provision of merit goods and the existence of externalities. Candidates were often able to discuss market failure, although some lacked rigour in their analysis. What was unfortunate was that it was often not clear why this market failure would not have achieved an efficient allocation, as the candidates had not explained what was required, or what was meant, by efficiency. To say that there are externalities or to say there are monopolies is only half the story. Why their existence is problematic needs to be put in context; that context is the definition and achievement of an efficient allocation.

Question 7

- (a) This was a popular question which was well done. The different methods of calculating gross domestic product using either the income, output or expenditure method had been well learned. The better candidates knew what was included, and what was excluded, in each of the methods. Most of the answers were accurate even if some of them only gave a brief description of two methods with no elaboration.
- (b) This part was again answered well. Candidates gave a discussion of the use of the statistics when making comparisons within a country over time. The better candidates, in addition to discussing the standard difficulties of calculating GDP, suggested alternative indicators of living standards. The question did ask 'How useful are national income statistics?' and for the higher marks candidates needed not just to state a list of drawbacks but to make an explicit conclusion about the usefulness of the figures. Many, having listed the drawbacks, left the reader to conclude whether, in the light of the problems stated, the figures were of only a little use, some use in certain circumstances, or no use at all.