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## FOREWORD

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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

**Paper 9708/01**  
**Multiple Choice (Core)**

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

### General comments

The exam was taken by 4 358 candidates, of whom 20 scored full marks while 37 scored below the guessing level. The mean score was 17.89 with a standard deviation of 5.36.

Four questions (**6**, **11**, **12** and **14**) proved to be very easy. Three of these related to demand and supply, which when combined with the performance on the other questions on the topic indicated effective understanding. The fourth question concerned private and external costs, which candidates now handle competently. No question proved too difficult.

There were two questions on which a larger number of candidates opted for a distractor than selected the correct answer. In **Question 7** option **A** was correct because, with unit elasticity, total expenditure (revenue) remains constant as price rises. The more popular option **B** showed rising total expenditure, which results when price elasticity is inelastic. Some candidates may have mistaken option **B** for a unitary supply curve although the axes were wrong for this. **Question 23** dealt with unemployment rates. The largest proportion of candidates opted for **B**, which was incorrect as the statistics are for the rate of unemployment not the number of unemployed. Further information would be needed for this judgement to be possible on **B**. The correct response was **C**, which indicated a converging trend in the unemployment rates of the countries. In **Question 19** almost as many opted for **C** as the correct answer **D**. This indicated a confusion between absolute and comparative advantage. In the diagram the parallel production possibility curves indicate identical opportunity costs, which make benefits from trade impossible.

The easy nature of **Questions 12 and 14** meant that they did not discriminate as well as intended. In the case of **Question 25** some of the better candidates opted for **B** rather than **D**. While it is true that inflation continued in 2000 it was at a declining rate, 0.8% (2/204) against 2% (4/200), not a higher rate. Some better candidates preferred option **A** to **D** in **Question 18**. The price mechanism can still allocate goods between consumers even if supply is fixed, since a free interaction between buyers and sellers is still possible.

Candidates were able to deal with different presentations (verbal, numerical and diagrammatic) competently, although the two lowest levels of correct response were on **Questions 7 and 19**, where diagrams were involved. No section of the syllabus emerged as presenting candidates with particular difficulty.

**Paper 9708/02**

**Data Response and Essay (Core)**

**General comments**

Over the years it has been common for candidates to find the data response question more difficult than the essay question. This has been reflected in the generally lower marks for that question. At this sitting the discrepancy in performance was more marked than usual, with very few candidates indeed able to achieve higher marks on the data response question.

A number of factors contributed to this outcome. There was excessive copying of the text without drawing any conclusion as to its significance. It is unlikely that the direction to 'explain' could be satisfied by simply repeating the data. Lines of reasoning were usually ended at the first stage of statement and were not developed. Candidates were unwilling to venture beyond the limits set by the data. Points were left in very general terms without showing precise economic understanding.

In the essays candidates were better able to apply their understanding, although some cannot resist the temptation to write all they know about a particular topic. The standard achieved in the first part of the essays was frequently impressive although the second part often needed a clearer focus.

**Comments on specific questions**

**Section A**

*Data Response*

**Question 1**

- (a) The candidates who indicated the removal of obstacles to trade, such as tariffs and quotas, gained both marks. It was not sufficient to make a general statement such as removing trade protection. Those who interpreted it as measures to be more effective in trade missed the point of the question. The 'freer' trade element needed to be stressed.
- (b)(i) Most gained two marks for recognising Japan's advantage in technology and China's in labour-intensive goods. While some explained China's position in terms of population resources, very few attempted to explain Japan's advantage in technology. The instruction to explain required more than repetition of the text.
- (ii) Two different approaches were adopted and both were accepted. The expected approach was based on a comparison of the data to bring out the contrasting positions of the two countries. This was usually done well. The alternative was to apply general principles to this case. While general benefits were usually established, some candidates lacked sufficient current knowledge of the two countries to score the highest marks. Specific knowledge of the two economies was not expected in order to gain maximum marks. This could have been done by a combination of principle and data.

- (c) The deflation in Japan was usually identified, as were the higher rates of inflation in China. Some interesting comments were made on the significance of these levels of inflation. There was some confusion between the rate of inflation and the price level and the understanding of the terms hyperinflation and creeping inflation was not always accurate.
- (d) The standard of answer in this part was disappointing. There was much copying of the text without any attempt to clarify how this illustrated a potential threat or opportunity. It was often left to the Examiner to decide if a particular observation constituted a threat or an opportunity. Some candidates confused subsidiaries with subsidies. Better responses contrasted short-run and long-run outcomes. There was little evidence of the ability to introduce ideas not explicitly mentioned in the text. Given that the emergence of China and the difficulties of Japan have been well-documented it was hoped that a wider view might have been taken.

## **Section B**

### *Essays*

#### **Question 2**

This was the most popular question. Candidates, however, often wrote at length about the causes of inflation, which were not required in either part.

- (a) The more successful answers adopted a structure of defining inflation, clarifying the functions of money and then explaining the consequences of inflation for the functions. A well-made point was that the impact depended upon the rate of inflation. Weaknesses included confusion of the functions, properties and characteristics of money. Some also wrote about the demand for money rather than the functions and confused the internal and external value of a currency. There was a tendency to describe the effects of inflation rather than apply them to the effective operation of the functions of money.
- (b) There were some excellent answers to this part, with effective treatment of both the benign and harmful effects of inflation. Weaker responses tended to concentrate on the problems inflation caused and to assert rather than explain ideas. There continues to be much misunderstanding of the meaning of the Phillips curve, with candidates prescribing inflation as a cure for unemployment.

#### **Question 3**

This was the least popular question. Answers were relatively stronger on the first part of the essay.

- (a) Full marks were not uncommon. Accurate definitions and diagrams appeared frequently. Marks were lost for not specifying proportionate changes. Carelessness meant that some answers referred to demand rather than supply. It was not necessary to deal with unit and totally elastic measurements. Some candidates confused fixed and unit elasticity of supply.
- (b) Structured, analytical answers were quite rare. Only a minority of candidates were able to identify influences on elasticity of supply such as the nature of production, the ability to store and the time period involved and then apply them to the two industries. Answers often concentrated on shifts in supply rather than the elasticity of supply and some wrote generally about the problems of agricultural production. Having dealt successfully with elasticity of supply in part (a) some candidates then switched to applying the influences on demand elasticity in this part so gaining little credit.

#### **Question 4**

Many candidates chose this question. After a competent first part a significant number found it difficult to structure the second part. The result was a very descriptive account of market failure.

- (a) Candidates scored well on this part. They were knowledgeable about the nature of the two types of goods. Some confused non-rival and non-excludable in their explanations. It was not necessary to deal with issues of free and economic goods and merit and demerit goods at this point. Public goods were usually dealt with more thoroughly than private goods, although not all of the examples cited were cases of pure public goods.

- (b) Externalities were known by most candidates, who dealt with the positive and negative effects of both consumption and production. Negative externalities were dealt with in greater depth than positive ones. Fuller answers also clarified the relevance of demerit and merit goods. Diagrams were introduced in a relevant way in the stronger answers. Weaker answers tended to repeat the same point by the use of a range of examples and used the terms external and social interchangeably. Discussion of the use of cost-benefit analysis was not required. Descriptive responses usually failed to establish a foundation from which to approach the question. One successful method was to start from the difference between private motives, the position of third parties, the notion of social welfare and the role of government.

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

### General comments

Once again, candidates found this paper more difficult than had been anticipated. The overall percentage mean score of 46% was very similar to the 46.3% score recorded in November 2003, but considerably below the scores achieved in earlier years.

Two items, **Questions 9** and **22**, had facility scores just below the 0.25 'guessing level' for 4-option items. **Question 22** also had a rather low discrimination score, as did **Questions 23** and **27**. **Question 8** had a discrimination score close to zero.

### Comments on specific questions

#### **Question 1**

As a general rule, an effort is made to try to ensure that the first item on any multiple-choice paper is reasonably straightforward. Unfortunately, this was not achieved on this occasion. Only 30% of candidates answered the item correctly, with 49% opting for **C**. With hindsight, some improvement in the wording of the question might have helped some candidates. A firm is not usually spoken of as 'allocatively efficient'. It should also have been made clear that 'long-run equilibrium' in **A** refers to the industry rather than an individual firm. However, the discrimination statistics were very good, with the best candidates tending to get this item right.

**Question 7**

**C** turned out to be a positive distractor. The fact that a worker prefers leisure to work goes part of the way towards explaining why he might respond to an increase in his hourly wage by reducing the number of hours worked, but it is clearly not a sufficient explanation.

**Question 8**

The very low discrimination score suggests that most candidates resorted to guesswork. The key to answering this question is that the area below an individual worker's labour supply curve measures the minimum amount he would be willing to accept for any given number of hours of work (just as the area below an individual demand curve measures the maximum amount a consumer would be willing to pay for a given quantity of a good).

**Question 9**

In last year's report it was pointed out that most candidates appeared to be wholly unaware that a production function describes a technical relationship between inputs and outputs. The 24% facility score indicates that this is still very much the case.

**Questions 12 and 13**

The candidates who opted for **D** (48% of the total) failed to recognise that a monopoly can control price or output, but not both. A similar error arose in **Question 13**, where 36% of the candidates appeared to forget that a firm in perfect competition cannot affect market price.

**Question 22**

In any diagram, a change in the value of a variable measured along one of the axes will cause a movement along a curve (or a function) rather than a shift in the curve. The 42% of candidates who opted for **D** failed to realise this. The low facility score on this item (22%) also reinforces what has been apparent in previous papers that candidates have little understanding of the distinction between wealth and income.

**Question 23**

Some of the better candidates seem to have opted for **C**. In point of fact, a fall in the price level will lead to a reduction in the demand for money, causing a fall in the rate of interest, which, in turn, produces the increase in output depicted by the AD curve.

**Question 27**

One of the basic tenets of monetarist economics is that changes in inflationary expectations will cause shifts in the short-run Phillips curve. This has been a standard topic on multiple-choice papers, and the relatively low facility and discrimination scores was, therefore, something of a surprise.

**Question 28**

Finally, 41% of candidates were unaware that capital flows do not form part of a country's current balance, and so wrongly chose **D**.

<p style="text-align: center;"><b>Paper 9708/04</b></p>
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<p style="text-align: center;"><b>Data Response and Essay (Extension)</b></p>
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**Comments on specific questions****Question 1**

- (a) Most candidates were able to identify that BA used expensive airports, provided special lounges and free food and had restrictive work rules.
- (b) Many candidates were able to describe the conditions for price discrimination, mentioning the need for identical products, separate markets and the desirability of different elasticities. Quite a number of candidates then stated, strangely, that the example given was one of price discrimination having explained that the product (service) was *not* identical.
- (c) Candidates were able to describe the conditions for perfect competition. As with part (b) it was then strange to read that many candidates considered this example to be one of perfect competition despite the fact that they recognised that the companies were large, that entry to the industry was difficult and expensive and that the companies could determine their own prices. In both (b) and (c) these candidates demonstrated that they could not apply their theoretical knowledge to an applied situation.
- (d) Many candidates were not able to answer this question with any clarity. The better ones were able to explain that consumer demand had forced producers of the services to alter the price structure. Supply had followed changes in demand. Demand for some air services had altered because it had switched to competitors who were offering cheaper services.
- (e) Candidates were told that BA had reduced fixed costs, and had reduced labour costs. They were also told that demand had responded to lower prices charged by competitors but that some passengers preferred the comfort and facilities offered by BA. Better candidates used this information and then stated that there was no evidence of elasticity, nor any precise evidence of how much costs had fallen, nor any comment on the changes in revenue. They then correctly concluded that the outcome for BA profits was uncertain. Weaker candidates simply said that costs had fallen and therefore profits had risen. They ignored the changes in demand.

**Question 2**

This question required a clear explanation of productive and allocative efficiency. Better candidates were able to state the criteria for these efficient conditions and then explained that efficiency was difficult to measure in practice. They then debated whether the market system was likely to achieve these efficiencies or whether there might be areas of market failure. When they mentioned market failure better candidates then suggested ways in which this failure might be overcome by government intervention in the form of regulation, taxation or direction. Whether government intervention was able to redress any market failure to the extent that the situation was able to revert to one of economic efficiency was then discussed. Average candidates were able to describe the conditions of efficiency but did not debate whether they might be achieved in practice. Weaker candidates managed to describe productive efficiency but struggled with allocative efficiency.

**Question 3**

- (a) There were many good answers to this question, which was intended to allow candidates to demonstrate their knowledge of the determinants of investment. Better answers clearly explained the role of the rate of interest, expectations, the cost of capital, the marginal efficiency of capital and changes in consumer demand. Weaker candidates did not develop the argument and theory but merely stated that investment was determined by the desire to make more profits.
- (b) This part was designed to allow candidates to explain how the change in an injection would have consequences in other areas of the circular flow model. A change in investment might have consequential effects on employment, income, demand and possibly price levels. These could be explained by the use of the multiplier analysis. While the better candidates were able to use this analysis to good effect and were able to demonstrate how investment changes affected other economic variables, many did not mention the multiplier at all. Consequently the analytical foundation of their answer was weak.

**Question 4**

- (a) The purpose of the first part of the question was to get candidates to explain the economic considerations that might have led a company to move its production from the UK to Eastern Europe. The answers were generally of a good standard and candidates made useful and relevant comments on the possible differences in costs of production, such as cheaper labour and location sites, while contrasting these with the increased transport costs. Ultimately, the success or failure of the decision would be measured by whether profits increased or decreased. A number of candidates focused on the reference to mass production techniques and linked the potential lower unit costs of production to economies of scale and greater efficiency, and used an appropriate diagram to illustrate this. Some of the candidates also linked the comparison between the UK and Eastern Europe to the concept of comparative advantage.
- (b) The second part of the question was designed to allow candidates to consider how far the decision taken by the electrical goods company, despite meetings with the trade union, indicated that trade unions in general might have very little influence over wages and employment. There were a variety of responses, with some candidates suggesting that in many cases trade unions did not have very much influence while other candidates believed that this case was an exception and that, in many situations, trade unions did have a lot of influence. The better candidates were able to offer a more balanced view, perhaps by stating that the potential influence of trade unions would depend on the conditions of particular situations. A number of these conditions, such as the relative costs of labour compared to the other factors of production, the elasticity of demand for the product (stressing the idea of a derived demand) and the demand for and supply of labour in particular occupations, were mentioned.

**Question 5**

- (a) The purpose of the first part of the question was to ask candidates to describe the other major objectives of a government's macro-economic policy, apart from the promotion of economic growth. The vast majority of candidates were able to identify and describe the other objectives, which included a low rate of inflation, a reduction in the rate of unemployment, equilibrium in the balance of payments, a more equitable distribution of income and wealth and possibly a commitment to the conservation of scarce resources with an emphasis on the importance of sustainability. A few candidates, however, decided to focus not on the actual objectives but on the means of achieving those objectives and wrote at length on different aspects of monetary and fiscal policy. Candidates clearly need to answer the precise question asked and not offer an answer to a different question.
- (b) The second part of the question allowed candidates to discuss whether an emphasis on economic growth was always beneficial. A few candidates considered only the potential advantages of economic growth, but the majority of candidates offered a more balanced answer, looking at both the advantages and disadvantages of economic growth before drawing a reasoned conclusion. A most frequently cited advantage was the improvement in standards of living, which many candidates illustrated and explained through the shift of a production possibility frontier. Possible disadvantages which were mentioned included the potential exploitation of scarce resources and the existence of negative externalities such as pollution. The better answers placed the discussion within the context of time periods, contrasting the present with the future.

**Question 6**

- (a) The purpose of the first part of the question was to allow candidates to describe and explain the characteristics of a developing economy. The majority of the answers were very good and candidates had a clear and thorough understanding of this part of the syllabus. Characteristics mentioned included a high birth rate, the rate of population growth, low literacy levels, high proportion of employment in the primary sector, low levels of technology, balance of payments difficulties, debt problems, relatively high rates of inflation and unemployment, poor levels of health provision and generally low standards of living. These were often illustrated with appropriate examples from different countries. The better answers also showed an awareness of the fact that the term 'developing economy' was a wide concept, comprising many countries at different stages of economic development; and they included a discussion of how countries were seeking to develop and trying to improve their economic situation.

- (b) The second part of the question allowed candidates to consider the usefulness of GDP as a measure of the standard of living in a country. Answers were, as in the first part of the question, generally of a good standard. Candidates explained that GDP was of some use, especially when it was expressed in terms of real GDP per capita, but that it did have a number of limitations, such as a failure to take account of the hidden economy or an emphasis on quantitative rather than qualitative factors. A number of candidates then went further, developing the point that there are a number of alternative ways of measuring a country's living standards, such as the Human Development Index, which they then briefly explained.

#### Question 7

- (a) The purpose of the first part of the question was to ask candidates to consider who might benefit when a market consists of only a few large companies. Most were able to demonstrate a sound knowledge and understanding of the idea of oligopoly or monopolistic competition, often with appropriate diagrams, but they did not always focus on the question. The question was designed to see if the candidates could recognise who were likely to be the main beneficiaries of such a market organisation. Clearly, in most cases, it was likely to be the companies themselves and many candidates referred to the existence of abnormal profits in oligopoly in both the short run and the long run but it would also be possible, in certain situations, for the consumers to benefit. This could be, for example, through the existence of price rigidity which would help to keep prices relatively stable, or the development of new products through extended research. Candidates need to show not only that they have learnt the characteristics of market systems but that they can apply them to different questions.
- (b) The second part of the question encouraged candidates to discuss why in some markets firms remain small while in others the market is dominated by large companies. There were some very good answers to this part of the question. Candidates showed that they were aware of the fact that there might be good reasons for the continued existence of small firms, such as the difficulties of raising capital to finance expansion, the need to offer a personal service or the size of the potential market. They then demonstrated an understanding of why some firms might be large, such as the possibility of benefiting from economies of scale and the existence of barriers to entry and the control this would give in terms of market power. Better candidates were able to offer examples to illustrate the types of markets which would be characterised by small and by large firms.