

# ECONOMICS

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

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

## General comments

The entry for the examination rose significantly against the previous year from 4676 to 5334 candidates. The mean mark fell from 17.45 to 16.37 and the standard deviation fell from 5.34 to 5.23. **Question 23** proved to be more difficult than intended. **Question 14** proved easier than intended, while three others (**2**, **15** and **18**) operated at the top limit of the test design. Disappointingly only 6 candidates scored full marks. Questions in verbal or diagram form were done more successfully than those presented numerically. The performance on questions which tested understanding of inflation was less impressive than usual.

## Comments on specific questions

Although the largest proportion of candidates opted for the correct response (D) in **Question 1**, it did not discriminate as well as was intended. The difficulty arose with option B; free goods are not by definition non-excludable (this property is usually attributed to public goods) but exclusion is unnecessary given the relationship between demand and supply at zero price.

In **Question 10** almost the same number opted for D as the correct response B. This was because they concentrated on influences on demand elasticity rather than the supply elasticity stipulated in the question.

Comparative advantage continues to prove difficult for candidates at this level. Some of the stronger candidates opted for D rather than B in **Question 19**. This is incorrect because country 2 has a comparative advantage (lower opportunity cost) in product Y rather than product X. Similar incorrect reasoning led a significant number to chose A.

In **Question 20** the largest proportion went for option A (a lower exchange rate). However, the resulting higher price of imports would usually be expected to act as a barrier to imports not to reduce protection. A higher quota (option B) would allow more imports to enter a country.

The calculation of the changing terms of trade in **Question 21** proved too much for most candidates. With an import price index of 125 the terms of trade index will only be 120 if the price of exports has risen to 150 (50%).

Candidates were unfamiliar with the methods used to measure the rate of unemployment and the participation rate. As a result only 16% answered **Question 23** correctly. While the largest proportion opted for A, some of the stronger candidates selected C, although the correct response was B. The unemployment rate links the number unemployed to the labour force, while the participation ratio concerns the proportion of population which is economically active. The latter includes the unemployed.

In **Question 24** more chose option D than the correct response A. This indicated a very basic error in the understanding of the distinction between rates of change and absolute levels. This is a problem which is evident in most years.

The belief that disequilibrium in the balance of payments must involve a deficit was seen in **Question 27** where option C was the most popular selection. A larger (positive) disequilibrium existed in option B.

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Paper 9708/02

Data Response and Essay (Core)

## General comments

The average standard was generally similar to the previous year but with rather fewer very strong and very weak scripts. Candidates find it difficult to produce consistency across the different sections of the paper. A key issue for candidates is the ability to structure essay answers. All too often the essays lack a coherent thread and repeat themselves or move between elements in an apparently random way. Time spent considering the point of the question and producing an outline summary is rarely wasted.

This year there was some evidence of candidates ignoring the mark allocation. This results in poor use of scarce time. In the data response there were some unnecessarily long answers to early sections where only two marks were available, while in two of the essays some part (a) answers were significantly longer than part (b) answers which carried 50% more marks. Diagrams were generally accurately drawn, although in the data response they were not always used to draw out the full amount of information required.

Finally some candidates tended to see questions purely in theoretical terms. The stronger responses saw the issues in an applied context and related them to recent and current events in their own economies.

## Comments on specific questions

### *Section A*

#### **Question 1**

The data response question was based upon the actions of the Bangladesh government to deal with a sharp, seasonal rise in the price of a basic foodstuff.

- (a) (i) The calculation of a previous price of the product proved to be a difficult starter question for many candidates. They did not understand that the price prior to a rise of 50% is not calculated by halving the final price. While the correct answer was \$18 or \$19 (only an approximate price was wanted) many gave \$14 as the answer.
- (ii) This was done well. Candidates usually referred to a rise in demand and a fall in supply. Some concentrated on the deliberate action of producers to raise price. A brief answer was all that was needed since only two marks were available and the directing command was 'identify'. Some candidates went into unnecessary detail with diagrams and lengthy explanations.
- (iii) There were some impressive answers on the concept of a 'just price'. The needs of both consumers and producers were recognised and expressed succinctly. Some candidates wrongly associated the idea with an equilibrium price.
- (b) (i) This part discriminated well between candidates. Full marks required recognition of price inelasticity of demand, its implication for revenue and a diagram with a leftward shift in the supply curve and a change in total revenue. A weakness was to draw in the two sets of co-ordinates without using them to denote the increase in total revenue. A significant number of candidates wrongly suggested that the reduction in supply would automatically be followed by an increase in demand and showed this on the diagram. Written descriptions of inelasticity were often imprecise. Very few moved the supply curve in the wrong direction, while a small number offered a diagram without any commentary.

- (ii) Full marks were often awarded on this part. Candidates generally identified the need for an effective maximum price to be below the market equilibrium and understood that this would create a shortage. Many went on to suggest the possibilities of the need for rationing, the emergence of black markets or the growth of queuing. A similar omission to that in the previous part was evident with candidates not making the amount of the shortage explicit in the diagram. The operation of a maximum price was well understood.
- (c) As has sometimes been the case in previous years, answers to the final part requiring a limited discussion were of variable quality. Attention was usually focused on the need to protect consumers from the sharp rise in the price of an essential foodstuff. This was often treated in an uncritical way which omitted consideration of the potential drawbacks of government intervention. Stronger responses recognised the costs and possible failure of action. Long descriptions of the policies which had been implemented in the Bangladesh case or alternatives which might be used gained little credit if they were not linked to the motives behind the action. There were some candidates who missed or ignored the reference to the market for onions. In this case they wrote about public and merit goods. This was not considered a relevant approach.

## **Section B**

### **Question 2**

The question concerned the use of production possibility curves to judge economic performance and the effectiveness of the mixed economy in tackling the basic economic problem. It was a popular question, which enabled candidates to score well.

- (a) Virtually all candidates used diagrams of production possibility curves to explain their thinking. The strongest answers gave a clear definition of a production possibility curve and dealt with static and dynamic interpretations to show how efficiency, growth and the level of employment of resources might be deduced from the diagrams. Average answers did not get beyond an analysis of the static position. Less relevant answers turned the emphasis to the causes rather than the results of the positions and changes in the production possibility curves. Some candidates appeared to have been expecting a different question and wrote at length about the use of the curves to illustrate opportunity cost. The overall standard was sound.
- (b) Much knowledge of the operation of different economic systems was evident. This was not always structured in a way which directly answered the question. Some started with long descriptions of the features and performance of the free market and planned economy and had written extensively before mentioning the mixed economy. A better approach was to start with clarification of the basic economic problem and the nature of the mixed economy, then going on to judge the outcomes of its operation. There was almost total praise for the mixed economy based on the advantages that might be drawn from the market and planned economy. Relatively few, only the strongest answers, acknowledged that the disadvantages of the two systems might still persist and undermine the mixed economy's performance, even if it remained the best option. The more interesting responses saw the issue in an applied rather than a theoretical context.

### **Question 3**

The question concerned absolute and comparative advantage and the explanation of trade patterns. It was by far the least popular question and the standard of response was very variable.

- (a) The question set the quite narrow task of distinguishing between absolute and comparative advantage. It did not require the demonstration of the production gains from specialisation and international trade. While the better answers gave accurate definitions and used numerical proofs of the distinction others were less impressive. Ideas were often expressed in a vague manner, the two concepts were confused and errors were made in the use of numbers. This is an area of the syllabus which candidates find difficult but it is of great concern that they often appear unaware that they lack a clear understanding.

- (b) The reference in the question to ‘an economy with which you are familiar’ was intended to indicate that the subject should be attempted from an applied rather than a purely theoretical angle. Those who understood this referred to the nature of an actual trade pattern of an economy and then considered if comparative advantage was at work. This was done by reference to the economy’s factor endowment as the basis for trade. A disappointing number made no reference to a pattern of trade. Other explanations of trade patterns, such as relative bargaining strength, international trade arrangements and historical links were used to suggest alternative explanations. Most candidates referred to the lack of realism of the assumptions of the comparative advantage as a criticism of its applicability. While there was a small number of impressive answers, the majority were disappointing and suggested a poor understanding of this area of the syllabus.

#### Question 4

The causes of inflation and inflation’s link to the balance of payments were the focus of the question. It was popular and answered in a competent manner.

- (a) Candidates understood the cost-push and demand-pull types of inflation and distinguished between them accurately. Some omitted to define inflation itself and listed, rather than explained, the different influences at work in the two cases. There was some carelessness in talking of demand and supply of a good rather than setting it in the context of the general price level. Candidates who had covered aggregate demand and aggregate supply often used this approach, but those who were following the Advanced Subsidiary syllabus were able to score equally well with a more descriptive approach. Full marks were not uncommon.
- (b) There were some really good answers to this section. These did however require a clear structure in organising some rather complicated elements. Central issues were the relative level of inflation, the price elasticity of the products and counterbalancing effects and policies. Better answers went beyond the trade in goods and services and considered investment flows and other aspects of the balance of payments. There was some inaccuracy in talking about surpluses and deficits in the balance of payments rather than in the component sections. Weaker candidates were confused on the relevant elasticities and the impact and relevance of exchange rate changes. The standard achieved was pleasing and indicated sound understanding of the issues involved. It was also encouraging that some candidates introduced real world examples which enlivened their answer.

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

## General comments

The overall percentage score on this paper was 43.14%. This is slightly below the scores recorded in recent years. 22 of the 30 items had facility and discrimination scores within the test design limits. However, 5 items, **Questions 4, 15, 19, 27 and 30** had facility scores below the 0.25 guessing level for 4-option items. Apart from the items that proved to be too difficult, there were a number of items with low discrimination scores where more candidates opted for one of the distractors than for the key.

## Comments on Individual Items

The 58% of candidates who opted for A in **Question 3** failed to recognise that in order to maximise its output a firm would have to expand its workforce until its MPL was zero.

**Question 4** created all kinds of problems. Those candidates who opted for D (39% of the total) failed to realise that to maximise its profits, a firm will need to increase the number it employs until its MRPL (**not** its ARPL) is equal to the market wage. However, the main problem with the question was almost certainly not so much the subject matter but the complexity of the numerical manipulation required of candidates.

In **Question 6**, 58% of the candidates wrongly supposed that an increase in a firm's fixed costs would increase its marginal cost.

Flexibility in meeting customer requirements is one of the strengths of small firms. Those candidates who opted for D in **Question 8** (39% of the total compared with just 32% who answered the item correctly) were clearly unaware of this.

If a government fixes the price of a good supplied by a monopoly supplier, the firm effectively becomes a price-taker, and to maximise its profits it should equate price and marginal cost. Only 22% managed to work this out in **Question 15**, compared with 42% who wrongly opted for B.

The statistics would suggest that most candidates in **Question 19** resorted to guesswork. The factors determining the shapes of AD and AS curves are imperfectly understood by most candidates and this is a topic that clearly deserves more attention.

Most banks now pay interest on current account balances, whereas in Keynes' day, 'idle money balances' were non-interest bearing assets. This might partly explain why 40% of the candidates wrongly opted for B in **Question 22**, compared with just 30% who answered the question correctly. In retrospect, the assumption that no interest is payable on idle balances should perhaps have been made explicit.

With a fixed money supply, fiscal expansion can be expected to result in higher interest rates, thereby diminishing its impact on output. The statistics recorded for **Question 25** would suggest that this is not well understood by most candidates.

As the proportion of the working-age population in employment increases, the new entrants into the labour force are likely to be less productive than those already in employment. Hence, labour productivity as measured by output per head can be expected to decrease. In **Question 27**, it was anticipated that candidates not familiar with this line of reasoning would nevertheless be able to work out from basic theory that an increase in employment, *ceteris paribus*, is likely to result in a fall in the MPL and, hence, in labour productivity. In the event, 54% of the candidates chose A, compared with just 19% who answered the question correctly.

Candidates were completely at a loss on **Question 30**. If tax and benefit rates are kept unchanged (B), thereby allowing automatic stabilisers to operate (A), tax revenue will automatically decline in a slump and government spending will increase. Hence, to maintain a balanced budget, tax rates would need to be raised or spending cut. It is clear that candidates had not covered this topic even though it is explicitly in the syllabus.

# ECONOMICS

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Paper 9708/04

Data Response and Essay (Extension)

## Question 1

- (a) Most candidates were able to identify the three factors as fierce competition in market, high production costs, weak demand.
- (b)(i) Candidates made a good attempt at this question. Some, however, omitted to state the relationship with output and others simply said that fixed costs are costs which do not change. Both these answers are not precise enough.
- (ii) This question caused some problems. It followed from part (i) and, therefore, the intention was that candidates should decide which category of cost mentioned there, either fixed or variable, was suitable. Unfortunately a significant number of candidates did not make this link and wrote about other categories, for example, bonus systems, piece rates. It is recognised that the link between parts (i) and (ii) is not as clear as it might have been and account was taken of this.
- (c) The statement about competing on price presumably means a lower price. This may be appropriate to meet competition or, depending on elasticity, to encourage demand. It would not seem appropriate to ensure higher costs are covered. Better candidates made a judgement about each of the factors they mentioned in part (a). Weaker candidates wrote general comments about whether it is wise to lower prices and ignored the factors mentioned in part (a).
- (d) Answers to this question could involve a discussion on relative costs between countries, a comment on different standards of living and different costs of living, or a suggestion about possible different costs for other inputs. These would make any comparison difficult to judge without more information and leave the conclusion in some doubt. However, it is known from the extract that costs are higher in Germany by 80%. This high figure, if true, would remove some of the doubt even allowing for different conditions. Candidates could have mentioned that more information on what is included to get to this 80% difference would be useful.

## Question 2

- (a) Better candidates gave a sound explanation of the analysis of productive and allocative efficiency and demonstrated a clear understanding of the principles involved. This was a popular question and many candidates answered it well, illustrating their answer with appropriate diagrams which were correctly labelled.
- (b) This question required a discussion on the idea of market failure, the deviation from allocative efficiency and a comparison of the possible allocation between perfect and imperfect markets. Better candidates discussed the idea of market failure, giving a good explanation of the analysis and a clear understanding of the principles involved. They illustrated their answer by writing about the lack of information, the influence of monopolies, the existence of externalities and the need for public goods. They gave reasoned evaluative comments and drew a relevant conclusion.



**Question 3**

- (a) This question required candidates to explain the Law of Diminishing Marginal Utility and discuss whether it can be applied to money. Candidates could have mentioned that money has a diminishing marginal utility as does any good according to some writers. There are, though, exceptional goods where marginal utility increases as the quantity used/owned increases; some would argue money is in this category. Perception of utility is for a given time period and so over time the second part of the statement could be true whichever of the two views is believed. However, higher incomes allow the purchase of more, or different, goods and each of those gives utility. Whether it is possible to add utilities of different goods is debatable. Extra consumption also sometimes gives utility when one's situation is compared to that of other people. However, the externality of consumption on consumption is not easily calculated and the comparison of one person with another in terms of utility is difficult. So, the final conclusion of the argument would not be certain. Most candidates were able to explain the theory of utility. Better candidates were able to make some judgement about whether money has a similar diminishing utility as that suggested by the general utility theory.
- (b) There were some good answers to this section which discussed the use of different policies including taxation, transfer payments, subsidies and industry support. Better candidates used the examples they gave to form a conclusion about the effectiveness of the policy.

**Question 4**

- (a) There were some good answers to this question which required a knowledge of the theory of different market structures. Better candidates distinguished between monopolistic competition and oligopoly in terms of output, price, profit, numbers of firms, differentiation and entry barriers. The answers were illustrated with appropriate diagrams which were correctly labelled.
- (b) This question required a discussion of the effect of investment on profits and required a comment on the possible changes to costs and revenues that an investment might cause. They could have argued that, in the short run, fixed costs increase and revenue does not necessarily increase to match it. In the long run the revenue may increase and, as China is a large market for cigarettes, average total costs may fall as production rises. The result might be that profits may rise in the long run. It is likely that the company would not invest unless it thought that profits would rise. Better candidates did develop the argument in this way and drew a relevant conclusion.

**Question 5**

- (a) Answers to the first part of the question were, generally, of a reasonably good standard. The purpose of the question was to get candidates to explain what indicators would suggest that a country was developed rather than developing. There were several characteristics of developed and developing countries which could have been used and these included output, employment, income, the demographic structure, the balance of payments and a variety of social factors, especially in relation to health and education. A number of candidates made reference to the Human Development Index and used this particular approach to good effect.

Some candidates, however, tended to offer a descriptive list of the possible indicators rather than explaining them, despite the question starting with the directive word 'explain'. It should be emphasised that candidates should always pay attention to the particular 'command' word at the beginning of each question. A number of candidates were inclined to offer very sweeping generalisations about the characteristics of different types of economies; for example, many of them wrote that every developed country persistently had a balance of payments surplus and that there was no unemployment in any of them. It was also often stated that every developed country has a large population and every developing country a small one, despite the evidence of countries such as Belgium, China and Namibia for example. Candidates need to ensure that if they are referring to rates of population **growth**, they should make that clear. It would have been useful if candidates had attempted to point out that it is far too simple to divide countries into two broad categories; it might have been more appropriate to have discussed them in terms of a continuum.

- (b) In the second part of the question, candidates were required to discuss whether the policies of governments in developed countries necessarily harmed developing countries. This proved to be a more difficult question than part (a). The better candidates recognised that developing countries were likely to concentrate on the production of agricultural commodities and that farm subsidies and forms of protectionism such as tariffs would, therefore, not be in their interest. They were also able to point out that some of the policies of the developed countries might be to the advantage of developing countries, such as various forms of aid. These candidates were able, therefore, to offer a balanced answer.

The weaker candidates, however, struggled to discuss why farm subsidies and different forms of protectionism might disadvantage developing countries and some became confused stating that such policies were being taken by the developing, rather than the developed, countries.

### Question 6

- (a) The purpose of the first part of the question was to get candidates to explain what determined the demand for money. The majority of candidates recognised that they needed to compare and contrast the transactions, precautionary and speculative forms of demand for money and there were some good answers, pointing out the distinction between demand that was interest inelastic and that which was interest elastic. Many of these answers included a diagram which was used to good effect. In many cases, the first two motives were explained clearly but there was sometimes a degree of confusion and uncertainty when explaining the speculative motive.

The weaker answers, however, failed to make any reference to the three motives for holding money and either offered only a very general and superficial treatment of the demand for money or described the functions of money.

- (b) In the second part of the question, candidates were required to consider the use of credit cards and to discuss what might be the consequences of a large increase in consumer spending. The majority of candidates demonstrated a knowledge and understanding of the growing use of credit cards and focused on the potentially inflationary effects of this where aggregate demand exceeded aggregate supply. A number of them used a diagram to explain the potentially inflationary consequences.

It was hoped that candidates would discuss the concept of the multiplier. This would have allowed them to consider not just the negative inflationary effects of the use of credit cards but also the positive effects in terms of a greater level of demand in the economy. Those that did this demonstrated a good level of understanding and were able to explain the concept clearly and fully. Some also considered the consequences of an increase in spending for the balance of payments relating expenditure on goods to the marginal propensity to import.

### Question 7

The purpose of this question was to ask candidates to discuss the aims of government economic policy, in particular those of employment, health, education and a good environment in contrast to those of the balance of payments or gross domestic product. There were some good answers to this question with candidates discussing the relative merits of the different possible government economic aims. Some answers, however, were rather poor with candidates struggling to discuss the arguments in favour of particular objectives. There was also, sometimes, a reluctance to see the links between the different aims, such as the link between increases in gross domestic product and the potential to spend on education or health; there was a tendency with some candidates to consider the different aims as being mutually exclusive.