

Mark Scheme with Examiners' Report

GCE O Level Economics (7120)

June 2005

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ECONOMICS 7120, MARK SCHEME

Section A

1. (a) Price is determined by demand (1 mark) and supply (1 mark). Also acceptable diagram which shows demand and supply curve (1 mark) and equilibrium price (1 mark), (quantity is not required). Also acceptable price mechanism for 1 mark. 2
- (b) 1 mark for each way identified, eg indirect taxation, subsidies, maximum prices, minimum prices, controlling wage rates, regulation, public goods, ie producing the goods the free market doesn't. Don't accept government demand, as this demand would be reflected in the free market price. 2
2. (a) Capital goods: goods which are used to produce other goods (1 mark). Example 1 mark, eg machinery or a particular type of machine. Consumer goods: those which are bought/used by individuals (1 mark). Accept consumer goods are "goods for final consumption" and "satisfy consumer wants directly". Example 1 mark, eg carpets, cookers. 4
- (b) Each effect identified 1 mark, eg fewer consumer goods, increased economic growth, increased competitiveness, increased exports. Reward use of production possibility curve. Question asks for "possible effects" so most answers are acceptable (even if improbable, with no explanation required! However, not acceptable: "increase in employment and decrease in employment" for two effects without some reasoning for 2 marks. An "increase in the production of consumer goods in the future" together with decrease in production in consumer goods in present" is OK for 2 marks. Acceptable = "demand pull inflation" together with "less production of consumer goods" (2 marks) but do not accept inflation of any kind on its own. 2
3. (a) The responsiveness of demand (1 mark) due to a change in income (1 mark). Price elasticity of demand definition is not acceptable. 2
- (b) (i) Product A: % change in demand = 25%
 % change in income = 50%
Answer = +0.5. Do not need +ve sign for both marks. Calculations are not required for full marks. 2

- (ii) Product B: % change in demand = 50%
 % change in income = 50%
 Answer = -1 Must have - sign in answer or indicate -ve change in demand for full marks. Calculations are not required for full marks.
 If final answer in calculation incorrect due to trivial mathematical mistake then 1 mark may be awarded, eg in (ii) $2/4 = 1$ or if numbers in formula are correct but trivial mistake made in maths award 1 mark. 2
- (c) Product A is a normal good (1 mark), eg cars (1 mark)
 Product B is an inferior good (1 mark), eg public transport (1 mark).
 Also acceptable is a good explanation, eg “cars (A), as incomes increase, demand for cars increases, unlike public transport (B), where an increase in incomes leads to a decrease in demand”. 4
4. (a) In (a) as well as “improve” and “worsen” also acceptable are “surplus” and “deficit” and “positive” and “negative”.
 Not acceptable: “go up” and “go down” or “increase” and “decrease” - too vague.
- (i) Less spent on (invisible) imports (1 mark), improve current account (1 mark). 2
- (ii) More demand/spent on (visible) imports (1 mark), worsen current account (1 mark). 2
- (iii) Imports more expensive (1 mark) or exports cheaper (1 mark), improve current account (1 mark). Accept reasoning “that the strengthening may decrease price of exports/increase price of imports” (1 mark) and this can have either effect (1 mark). 2
- (b) One currency is worth more in terms of another (1 mark). Accept “exchange rate changes” for 1 mark.
 Example = 2 marks.
 eg 1 Dollar = 1.5 Euros
 1 Dollar = 1 Euro 3
5. (a) Money incomes with the rate of inflation taken into account. (2 marks). Purchasing power of money (2 marks). Also acceptable: “the amount of goods and services which can be bought” for “purchasing power” (2 marks).
 Candidates confuse disposable income with real income and this leads to some tricky answers, eg “the amount that can be purchased by disposable income (purchasing power)” (1 mark).
- “Real income is the amount of goods and services which the households can buy from their disposable income” (1 mark)
 - “Income left after paying taxes and adjusting for inflation, eg income increases by 10%, inflation 5 % therefore real income increases by 5%”. Example is perfect, this candidate does understand therefore award 2 marks. 2

- (b) Venezuela = -7.7% or -5.6%
Need to indicate a fall (-) for both marks.
Accept 92.3% or 94.4% for 1 mark. 2
- (c) UK 1
6. (a) Firms in the public sector: 1 mark for each characteristic e.g. state owned, public interest objectives. 2
- (b) Producers' co-operatives: producers join together (1 mark) to produce/package or market commodity (1 mark). Also acceptable are: control prices, work together, profit motivated, sell in bulk but do not award marks for workers' co-operative. 2
- (c) Sole traders: 1 mark for each characteristic, eg owned by one person (1 mark), profits go to owner (1 mark). 2

Section B

7. (a) Each reason 1 mark, development 1 mark, eg cheap labour, skilled labour, cheap land for offices. Accept “cheaper raw materials” as it could refer to electronics etc. 3 x 2 marks. **6**
- (b) Each measure identified 1 mark. Development 1 mark, eg re-training (1 mark) to make them more occupationally mobile (1 mark). Not acceptable “decreasing benefits to decrease unemployment”. **4**
- (c) Each advantage 1 mark. Development up to 2 marks, eg more jobs, less unemployment (1 mark) will reduce government expenditure on unemployment benefits (1 mark). Other advantages may include increased technology, increased skills.
Each disadvantage 1 mark. Development up to 2 marks, eg profits go back to other country (1 mark), worsening current account (1 mark). Other disadvantages may include eg externalities, using up non-renewable resources. Problem if firm leaves country.
Not acceptable: advantages/disadvantages which are not relevant, eg “provide greater variety of goods” or “domestic firms will close down”.
Must have advantages and disadvantages for full marks, any combination acceptable, eg 8 + 2, 6 + 4
If only refer to advantages or disadvantages maximum = 6 marks. **10**
8. (a) One mark for “ageing population” if mentioned in either (i) or (ii).
- (i) Each problem identified 1 mark, development up to 2 marks, eg increased expenditure on health care and pensions. **5**
- (ii) Each problem identified 1 mark, development up to 2 marks, eg fewer workers available (1 mark) may lead to higher wages (1 mark) and increased costs/lower profits (1 mark). Other problems may include those associated with changing pattern of demand. **5**
- (b) (i) Each action identified 1 mark, development up to 2 marks, eg fund increase in expenditure on pensions (1 mark) by raising taxes (1 mark) or reducing expenditure on other items (1 mark). Other actions may include eg increase retirement age, incentives to increase birth rate. **5**
- (ii) Each action identified 1 mark, development up to 2 marks, eg market research to identify new demand patterns (1 mark) and change the production process (1 mark) prams to wheelchairs (1 mark). Other actions may include eg replace workers with machines. **5**

9. (a) Each reason 1 mark, explanation 1 mark. 2 x 2 marks, eg to increase profits by increasing market share, diversification, “to be able to get capital/finance more easily”. Detailed answers on economies of scale can obtain 4 marks. 4
- (b) (i) Each advantage identified 1 mark, development 1 mark, eg cheaper prices due to economies of scale. Price increase and/or price decrease in same answer must be explained for 2 marks.
Each disadvantage identified 1 mark, development 1 mark, eg less personal service.
Must have advantages and disadvantages for full marks.
Maximum 3 marks for only advantages and disadvantages. 6
- (ii) Each advantage identified 1 mark, development 1 mark, eg more efficient use of resources. Each disadvantage identified 1 mark, development 1 mark, eg monopolies might arise, less efficient due to less competition, negative externalities.
Not acceptable: economies of scale as an effect on economy instead effect of economies of scale on economy is acceptable, eg “increased efficiency” and “economic growth”.
Must have advantages and disadvantages for full marks.
Maximum 3 marks for only advantages and disadvantages. 6
- (c) Advantage 1 mark, development 1 mark. Disadvantage 1 mark, development 1 mark, eg Issuing shares rather than take a loan means there are no regular instalments to pay to the bank (1 mark) but instead the company must pay dividends (1 mark) from the profits to shareholders (1 mark). 4
10. (a) (i) Definition 1 mark, eg progressive: as income increases/decreases the percentage paid in tax increases/decreases, 1 mark. Not acceptable: “increasing tax as income increases for progressive”. Need % or rate of taxation.
Example 2 marks.
eg,

Income	Tax paid	%
10000	1000	10%
20000	2500	12.5%

Don't need to calculate % for 1 mark. 3
- (ii) Definition 1 mark, eg regressive: as income decreases/increases the percentage paid in tax increases/decreases. Cannot accept “increase income, decrease amount paid in tax”.
Example 2 marks.
eg,

Income	Tax paid	%
10000	1000	10%
20000	1000	5%

3
- NB A diagram could be used instead of definitions of progressive and regressive. One mark for each type of tax if diagram showing income and rates of tax is correct.

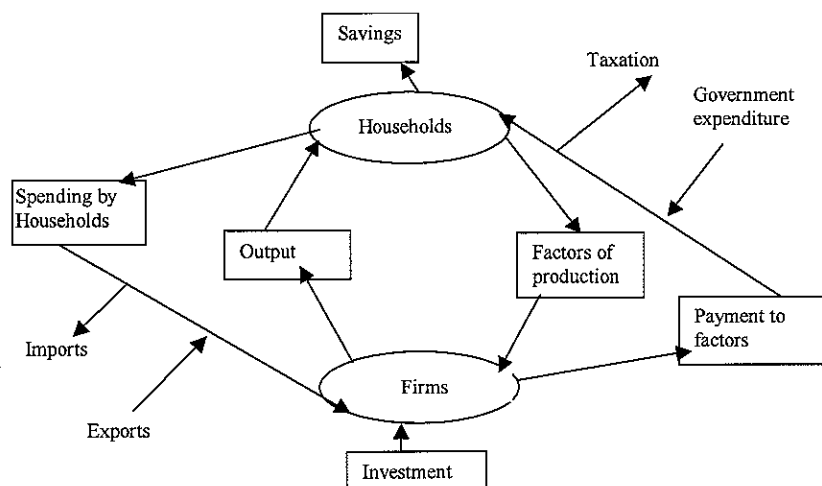
- (b) (i) Each advantage identified 1 mark, development up to 2 marks, eg equity 1 mark, rich pay a higher proportion than the poor 1 mark. Also acceptable: increased income for government and redistribution and macroeconomic affects - decreased disposable income (can be advantage or disadvantage). Also acceptable: "decrease rate of inflation" for an advantage. Each disadvantage 1 mark, development up to 2 marks, eg disincentive effect 1 mark, workers may pay higher levels of tax 1 mark. Also acceptable: increase in undeclared income / higher wage demands etc. Must have advantages and disadvantages for full marks. Maximum 5 marks for only advantages and disadvantages. **7**
- (ii) Each advantage identified 1 mark, development up to 2 marks, eg increased revenue for government 1 mark, increase spending 1 mark. Also acceptable: the argument against demerit goods like cigarettes and increased income for government and redistribution etc. Each disadvantage 1 mark, development up to 2 marks, eg not equitable 1 mark, the rich pay a smaller proportion of their income on the tax 1 mark. Also acceptable: the effects of the fall in demand for cigarettes. Must have advantages and disadvantages for full marks. Maximum 5 marks for only advantages and disadvantages. **7**
11. (a) Each reason identified 1 mark, development up to 2 marks, eg risk of specialisation in one product: if demand falls - unemployment, loss of exports etc. Acceptable arguments for diversifying into new areas, eg "increase employment", "increase exports" etc as well as original arguments of the problems of specialising. Don't credit candidates who miss the point and become confused with specialisation/division of labour and give reasons like "to reduce monotony of labour". **6**
- (b) Each measure 1 mark, development 1 mark, eg tariffs - increase price of imports (1 mark), decrease demand (1 mark). 3 x 2 marks **6**
- (c) Each problem identified 1 mark, development up to 2 marks, eg inability to pay, interest payments take up much of export earnings. Debt repayments could have been used for better purposes. **8**
12. (a) Each relevant reason 1 mark, development up to 2 marks, eg more training needed for computer programmers (1 mark), fewer programmers (1 mark), nurses in public sector (1 mark) with no competition (1 mark). Reward focus on demand and supply factors. **8**
- In (b) and (c) accept the macro effects. Candidates tend to give macro economic effects of increasing wages generally. Accept this reasoning and ways of controlling inflation.
- (b) Each problem identified 1 mark, development 1 mark. Problems can be about markets for programmers and nurses - more people will want to be programmers so a shortage of nurses, or, macroeconomic effects of pay rises - inflation. **6**

- (c) Each measure identified 1 mark - up to 2. Development up to 2 marks. 2 x 3 marks, eg problem - fewer people becoming nurses - government could try to increase the supply of nurses - increase the wages of nurses or make conditions of work better, advertising campaign. Also acceptable is how to combat macro effects, eg ways of controlling inflation caused by increased wages. 6

13. (a) (i) Income per head = the sum of all the incomes within an economy (1 mark) divided by the population (1 mark). Accept GNP/population - 2 marks. 2

- (ii) Standard of living: amount of goods and services/quality of life (1 mark) an individual consumes/benefits from (1 mark). 2

- (b) Households and Firms (1 mark)
 Flows: goods and services/household expenditure (1 mark)
 Factors of production/incomes of factors (1 mark)
 Investment (in) Savings (out) (1 mark)
 Government expenditure (in), taxation (out) (1 mark)
 Exports (in), imports (out) (1 mark). 6



- (c) Each point identified 1 mark, development up to 2 marks, eg real national income per head may indicate an increase in the standard of living but it depends on the distribution of income throughout the population (1 mark). It may be that a few people are getting richer (1 mark) and the poor are becoming poorer and experiencing a fall in their standard of living (1 mark). Other points include eg quality of life indicators - education and health, stress and pollution. Need arguments for and against real national income indicating an increase in the standard of living for full marks. If argument one sided, ie it does or does not indicate an increase in the standard of living, maximum = 6 marks. 10

ECONOMICS 7120, CHIEF EXAMINER'S REPORT

General Comments

The examination allowed well prepared, able candidates to achieve the highest grades. They and their teachers deserve not only their excellent results but also praise from the examiners for their efforts, which were a pleasure to mark. However, as in previous series there appeared to be some candidates who were at a disadvantage by not being familiar with certain parts of the specification. It must be emphasised that the nature of the examination, which allocates 40% of the marks to the compulsory Section A, means that candidates must have at least a basic knowledge of all parts of the specification if they are to have the opportunity to achieve C grade and above.

International Trade, as has been mentioned in previous reports, appears to be a topic not taught by some centres. Teachers should address this issue. The new Economics Study Guide should prove to be a useful resource for teachers and students who have difficulty with not only International Trade, but any other part of the specification.

Candidates often become confused between terms which are similar and it is up to teachers to try to identify these terms and distinguish between them. The government of a country may have a budget surplus (government revenue greater than government expenditure) or a budget deficit (government expenditure greater than government revenue). The foreign trade of a country may have a surplus (inflows of money greater than outflows of money) or a deficit (outflows of money greater than inflows of money). Unfortunately some candidates cannot distinguish between these two sets of deficits and surpluses. Many credited all export earnings to the government, giving the government a 'surplus'. The term 'balance of payments' caused more confusion over the relationship between the government and foreign trade. It led to candidates assuming that a decrease in tariffs in Question 4 (a)(ii) would lead to a decrease in the 'government's balance of payments'. If the candidates understand what is meant by the Balance of Payments then they will not become confused or make these simple mistakes.

Even those candidates who have a sound knowledge of the subject sometimes make careless mistakes which could be avoided through examination practice and reading questions carefully. Several questions asked for examples but some candidates left these out of their answers and therefore lost marks. Similarly, time is an important resource that should not be wasted. Candidates would do well to look at the mark allocation for each question and write an appropriate amount. Some lose time by writing far more than is necessary. In this examination this was particularly noticeable in questions 1 and 2 in Section A.

Recent experience has shown that candidates are increasingly aware of their own countries' economies and can give real life examples. However, sometimes their examples of policies can be a little far-fetched, notably in Question 8. Candidates should be reminded that real life examples are given credit, but unrealistic ideas, though they may amuse the examiners, will not add to their final mark and grade.

Section A

The questions in Section A allowed the well prepared student to score very high marks and the majority to experience substantial success.

Question 1

Fundamental to part (a) is the knowledge of what is meant by a 'free market economy'. Candidates who understood this had no problem giving the correct answer. Part (b) proved a little more demanding as some responses dealt with *why* the government interferes and not *how* it interferes.

Question 2

"A capital good is used to produce other goods, eg machinery whereas consumer goods satisfy consumers' needs and wants, eg television sets."

Part (a) should have been succinct as in the above answer. There was no need to write about fixed and working capital nor durable and non-durable consumer goods. A few candidates showed their confusion by writing about capital and public goods. For part (b) the following is an example of a good response.

"The production of capital goods will have an opportunity cost of a reduction in consumer goods. Hence supply of consumer goods will fall and this may lead to an increase in price of consumer goods and a fall in the standard of living."

Question 3

Although the question refers to income elasticity of demand, too many candidates did not understand this and tended to focus on price elasticity of demand. Amongst those who did read the question correctly there were some that gave an incorrect relationship between income and demand, stating that it is *"the response of income to a change in demand"*!

Fortunately, those who could calculate elasticity, whether price or income, managed to arrive at the correct answers in part (b) although too often the important negative sign was omitted in part (b)(ii) (Product B). It was a pity that some candidates did not show their calculations, as sometimes wrong answers might gain marks if the correct formula is used. In part (c) price elasticity again replaced income elasticity in the minds of many of the candidates. Instead of identifying Product A as a normal good and Product B as an inferior good, they wrote about inelastic and elastic goods. Good examples included colour televisions and cars (Product A, normal good), and black and white televisions and public transport (Product B, inferior good).

Question 4

This compulsory International Trade question (9 marks) was completely omitted by some candidates. Too many of those who did attempt it did not to gain maximum marks as they missed out the effect on the balance of payments on current account. The use of *"up"*, *"down"*, *"increase"*, *"decrease"* should be discouraged when candidates are trying to describe the effect on the balance of payments. Instead the terms *"surplus"*, *"deficit"*, *"favourable"* and *"unfavourable"* should be used. The following should help candidates to understand what was expected for maximum marks:

(a)(i) *“If fewer US citizens travel abroad there will be less money leaving the US (invisible imports) and this will have a favourable effect on the balance of payments on current account.”*

(ii) *“A reduction of US tariffs on imported steel will decrease the price and increase demand for this visible import. This will have an unfavourable effect on the balance of payments.”*

(iii) *“If the Euro strengthens against the dollar imports will become more expensive in the US than the goods locally produced, so people will demand fewer imports. Since the dollar has decreased in value, the exports will become cheaper for foreigners, so exports increase, which has a favourable impact on the balance of payments.”*

The strengthening of a currency relates to one currency increasing in value against another. However, in part (b) some candidates complicated this by using three currencies whilst others tried to simplify it by just showing an exchange rate and no change. Although many attempted to give an example, they sometimes lacked a sentence stating which currency had actually strengthened.

To give the example: “\$1 = 2500 leones” only shows an exchange rate, not a strengthening of the currency. The correct answer would be:

“If the dollar were to strengthen (appreciate in value), then it could buy more than 2500 leones, eg \$1 - 2750 leones.”

Question 5

Real incomes take into account inflation. This is not the same as disposable income, which is money income - compulsory deductions like tax. In part (b) the simplest acceptable calculation for the change in the real average income for Venezuela was:

$$28.9 - 36.6 = -7.7\%$$

It was very important to indicate the fall either by the minus sign or by stating that it fell by 7.7%.

In part (c) the choice was between the UK and Venezuela so it was surprising to find some candidates giving other countries as their answer.

Question 6

This question dealt with the main characteristics of three types of business organisation. The most common problem with ‘firms in the public sector’ was the inability of candidates to distinguish between public sector (state owned) and public limited company (owned by shareholders). Few candidates gave characteristics of producers’ co-operatives, instead many wrote about worker co-operatives. Fortunately, most managed to give two main characteristics of sole traders.

(a) *“Firms in the public sector are owned and controlled by the government.”*

(b) *“Producers’ co-operatives help producers to gain economies of scale, sharing the use of machinery and the costs of marketing.”*

(c) *“Sole traders are owned by one person who bears all the losses (unlimited liability) and receives all the profits.”*

Section B

Question 7

A very popular question. As it would be very unusual for profit making firms to relocate to developing countries to act for the benefit of that country, it was surprising that many candidates seemed to think this might be the case. The data in the question refers to call centres in the banking sector, ie in the service industry. Too many candidates did not use the data, but instead produced well prepared but, to some extent, irrelevant answers which referred to goods instead of services.

In part (a) three relevant reasons could have been included:

- Cheap yet skilled labour, which would reduce costs,
- Government incentives, such as grants to foreign firms setting up in these countries,
- Lower tax rates, together with less government interference.

Two measures to overcome the problem of unemployment resulting from the call centres leaving the UK could have included:

- Improving occupational mobility of labour by retraining the call centre workers,
- Improving the facilities (e.g. job centres, web sites) for giving the unemployed information about other jobs.

In part (c) many candidates gained maximum marks whilst others spent too much time writing about manufacturing firms rather than service industries. A good response is given below:

“Countries like India, Malaysia and China will benefit from call centres, as these provide employment for the workers. The firms may train the workers and these skills may benefit the economy. The standard of living in the country will rise as more people are employed. The firms will bring in foreign currency which will improve the balance of payments. They will also pay taxes, which will bring revenue in to the government, which might be spent improving the country.

However, there are some disadvantages. The firms may pay low wages and expect the workers to work long hours. Their profits will be sent back to the home country, and this will have an adverse effect on the balance of payments. Sometimes firms may be so powerful that they expect the government to give the preferential tax rates or grants, which will increase government expenditure but which may not improve the standard of living. The firms may increase congestion in the country as workers migrate from the rural areas to the cities. Just as HSBC moved out of the UK, so it might move out of these countries, leaving large numbers of people unemployed.”

Question 8

A decrease in the death rate, together with a decrease in the birth rate in a country, will result in an ageing population. Some candidates did not recognise this and wrote of increasing populations caused by birth and death rate increases. The problems which might arise from the ageing population are numerous.

For the government:

“There would be an ageing population as the birth and death rates fall. The government would have to spend more on pensions and health for the elderly population. This might mean less being spent on other projects. As the number in the working population falls, so there will be fewer people to tax so government revenue might fall, leading to even more cutbacks. The older people may not have much money, so spending will fall, leading to a decrease in demand in the economy and further falls in tax revenue.”

For the firm:

“There will be fewer people of working age and so firms may not be able to find enough workers. This may lead to higher wages and increased costs for the firms. The older workers are less geographically and occupationally mobile and may not be able to learn new skills. The pattern of demand may change with fewer baby clothes, toys and pushchairs being demanded so firms will have to find out what the old people will need.”

Some candidates underestimated the potential and abilities of older workers.

In part (b) the action taken to overcome these problems again brought forth many correct responses.

The government:

“The government may have to increase taxes and borrow more to pay for pensions and health care. It can increase the retirement age and reduce the school leaving age, so that there will be more people in the working population. It could also attract more people from abroad to work in the country and lower the immigration barriers. To increase the birth rate it could give financial incentives to families to have more babies.”

The firm:

“Firms who have not been able to get enough workers could advertise abroad for foreign workers and give them good pay and housing. If they didn't want to do this they could buy some machines so that they won't need as many workers. Because demand may change they would have to change their production and produce fewer things that young people might want and more things, like wheelchairs, that old people will buy.”

Question 9

Another very popular question and one which brought a wide range of responses including those from candidates who assumed the firm must be a retail shop rather than a manufacturing firm. In part (a) candidates chose the most popular reasons for expansion, ie to increase profits by increasing market share, to take advantage of economies of scale, and to spread risks by diversification. It should be noted that producing more economies of scale may reduce the average costs of production, but not the total costs of this expansion.

In order to achieve maximum marks for each part of (b), candidates needed, as the question clearly stated, to look at both the advantages and disadvantages of expansion. If they ignored this request then they were unable to achieve full marks for this part of the question. Marks were only awarded for referring to a rise or fall in the quality of goods if candidates developed plausible reasons for these two assertions.

Good responses for parts (b)(i) and (b)(ii) are given below:

(b)(i)

“Consumers can enjoy lower prices if the firm passes on the benefits of economies of scale. They may have an increased variety to choose from if the firm diversifies. However, prices may rise if the firm drives out smaller firms and becomes a monopolist and controls the price. In this case quality too may suffer. The products may become standardised so that there is less variety.”

Notice that the candidate has concentrated on the consumers, as the question asked, and not on the workers, a mistake that many candidates made in this question.

(b)(ii)

“Larger firms employ more labour and invest more capital. They form an important part of the economy as they affect wage rates, consumer expenditure, investment and the level of employment. They can have positive and negative effects. Large firms help economic growth as they make good use of capital goods and can be more efficient, taking advantages of economies of scale. As they buy in large amounts they may create jobs in other parts of the economy as subsidiary industries grow around them. They have to pay large amounts in taxes so government revenue increases and this could be used by the government to improve infrastructure.

A large firm may have too much control, and a large firm which goes bankrupt could cause severe repercussions to the economy, eg mass or regional unemployment. If they become monopolies they will become less competitive and less efficient, causing economic growth to fall. Another disadvantage is that large firms can waste resources and pollute the country. This will damage the environment and reduce the living standards.”

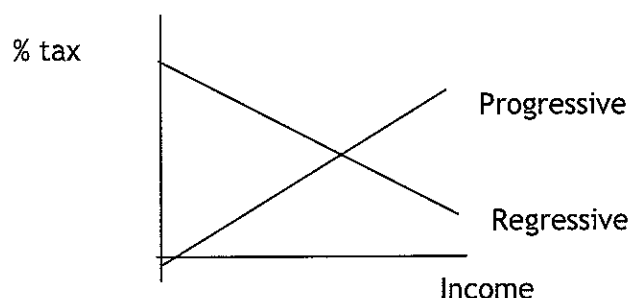
In part (c) only one advantage and one disadvantage were required, so this question could have been answered with ease if candidates first understood the difference between issuing shares and taking a bank loan. The advantages to choose from include: the money raised from shares does not have to be paid back, no interest is payable, no collateral has to be given. The disadvantages include the fact that the profit, in the form of dividends, has to be divided among more shareholders. The cost of raising capital from shares is expensive as it involves the publishing of a prospectus and paying financial institutions to look after the share issue. This also makes the process time consuming compared to a bank loan.

Question 10

“A progressive tax is one where the rate/percentage of tax increases as income increases.”

Too often the word ‘rate’ or ‘percentage’ was omitted; these answers thus did not exclude the possibility that the tax could in fact be proportional. This problem does not arise with the definition of a regressive tax where the tax falls with a rise in income. The question asked for examples which, if omitted, meant marks thrown away. Some candidates explained the two types of tax with the aid of a diagram. Diagrams, when used in this way, must be correctly labelled.

Diagram showing progressive and regressive taxes:



The examples could have been in the form of a table:

Income	Progressive tax rate	Regressive tax rate
\$10000	5% (\$500)	15% (\$1500)
\$15000	10% (\$1500)	10% (\$1500)
\$20000	15% (\$3000)	5% (\$1000)

Once again candidates were asked for advantages and disadvantages in part (b) and could not obtain maximum marks if the answer was one sided.

“Increasing rates of progressive income tax may be an advantage to the economy. Firstly, it is a fair tax since proportionately more will be paid by those with a higher income. It will not make low income workers worse off but will help to achieve lower income differentials. Furthermore the increase in revenue for the government might be used to provide merit goods like free health care and education from which the less well off can benefit. The revenue might also be used to improve the country’s infrastructure and increase investment in capital projects which benefit the whole economy and lead to economic growth.

However, a rise may have disadvantages. First of all it may reduce the incentive to work since if more is earned the more will be taken in tax so workers decide to work less. This might decrease productivity in an economy. It may also encourage people to do more unregistered work, increasing the black economy. As people have less disposable income they may demand higher wages and this could lead to cost push inflation.”

Increasing the tax on a packet of cigarettes also needed to be considered from both sides.

“An increase in tax on cigarettes might be of benefit especially to cigarette smokers, since they can’t afford to pay more for cigarettes, then the consumption of these demerit goods might decrease, which will benefit their health. A healthier workforce could also lead to a much more productive society, leading to economic growth. This could also lead to a fall in the death rate due to cancers caused by smoking. This will result in less money being spent by the government on medical services and this money could be spent elsewhere, e.g. on education.

However, since cigarettes are addictive, an increase in their price might not lead to a decrease in smoking and so cigarettes may still harm the economy’s workforce. These smokers will still buy cigarettes even though the price has risen and so these people will have less to spend on other goods and services and their standard of living will fall. As the tax is regressive this will harm the poor more than the rich. If the cigarettes are imported then a fall in demand will benefit the balance of payments. However, if they are produced in the country it might lead to unemployment in the industry as demand and production fall.”

Question 11

This question was not very popular, probably as candidates associated it with international trade, a topic avoided by many. There were, however, some very good responses.

(a)

“Diversification brings advantages of internal economies of scale. It reduces the risk of collapse in the economy due to the specialisation of tobacco. When a country specialises, it develops a large export market for that product but in time demand might change. In many countries governments are trying to reduce the consumption of tobacco products due to the health risk. The economy which is dependent upon its export earnings will be in jeopardy. This might lead to unemployment in that industry, a fall in the standard of living and a balance of payments deficit. By diversifying the economy is less vulnerable to change.”

In part (b) some candidates mistakenly explained why new industries should be protected not how they should be protected. A typical correct response was,

“To protect new industries in a country the government should impose barriers to foreign trade. These can include tariffs, which are a tax and as such increase the price of foreign goods, giving the home industry an advantage.

Quotas restrict the amount of foreign goods coming into the country, again leading to a price rise as supply is limited. Consumers will turn to home firms to satisfy their demand.

Subsidies can lead to a reduction in the price of the home produced good making it more competitive, giving it an advantage over foreign firms.”

As in previous examinations, candidates from developing countries are aware of the problems of international debt. There were some excellent responses to part (c) of

this question and teachers and candidates are to be commended for their use of examples from their own countries.

Question 12

The majority of responses to this question were disappointing. It had been hoped that candidates would apply their economic knowledge of how wage rates are determined to explain why computer programmers receive higher wage increases than nurses. It was not to be. Few candidates used demand and supply analysis, using relevant diagrams to show that the demand for computer programmers has outstripped supply in recent years, whereas the demand and supply for nurses has remained static in many economies. Even fewer noted that computer programmers are usually employed in the private sector, where wage rates reflect the changes in demand and supply as compared to the public sector, the major employer of nurses, with its government spending constraints. Some candidates underestimated the demand for nurses and the difficulties of nurses' work. Candidates in general did not recognise the gender issue. The majority of nurses are female whereas computer programmers tend to be male and this could be a reason why their wage increases differ.

In part (b) the possible problems associated with the pay rises centred, for most candidates, around the macro economic effect of inflation caused by the increase in demand. This is a valid problem but is not specific to nurses and computer programmers. A minority of candidates did refer to the fact that as the wage rate of computer programmers increased by more than that of nurses there would be a change in supply, as more people were attracted into computing and fewer into nursing. This could cause a shortage of nurses in the future as well as industrial unrest at present, caused by the differences in wage increases.

Part (c) depended upon the problems identified in (b) and once again candidates felt most comfortable tackling inflation, rather than the other problems brought about by the wage rate changes.

Question 13

Candidates who had spent time learning definitions needed only a little time to achieve maximum marks for part (a). However, the following was not accepted: *"income per head is how much each person earns"* as it is simply repeating the phrase with slightly different wording and it is also incorrect. The correct definition can be found in the mark scheme. The standard of living also produced the inevitable *"the standard at which people live"* and this too was not accepted.

Over 25% of the marks for the question were allocated to the circular flow of income diagram in part (b). This part of the question made the examiners wonder why so many of the candidates attempted this question when they had no idea about the diagram. Some drew demand and supply diagrams or circular flows which only included the government and foreign trade, and even included wholesalers and retailers. The correct diagram is to be found in the mark scheme and clearly shows the flows between households and firm (consumer expenditure/goods and services, factors of production/the rewards) as well as injections into the flow (government expenditure, investment, exports) and withdrawals (taxation, savings, imports).

The term 'discuss' should have led candidates to consider the data of real national income per head in Azerbaijan and decide whether or not it indicates an increase in the standard of living. This should have involved looking at the factors which support this conclusion but also at those which might oppose the conclusion that a rise in the standard of living has taken place. One-sided answers did not receive maximum marks.

However, some candidates did provide excellent responses:

“The real national income per head has risen in Azerbaijan. The term “real” shows us that inflation has been taken into account and because it is “income per head” population changes have also been accounted for. This means that on average, people in Azerbaijan have more money to spend on goods and services and therefore we can say that their standard of living has improved.

However, national income includes government spending and if this is spent on education and health it will increase the standard of living but if it is spent on defence the standard may fall. Similarly the increase may have come from an increase in the earnings of the rich and may bring about a gap between the rich and the poor, so only some of the population have benefited. The increase in the national income may have been due to firms in the economy expanding. This may have adverse effects on the quality of life as they may pollute the water supplies and increase congestion in the cities. If the increase has come about by a change in the pattern of goods from consumer goods to capital goods, then people’s standard of living will fall. If the quality of goods and services falls then the standard of living will fall even further.”

ECONOMICS 7120, GRADE BOUNDARIES

Grade	A	B	C	D	E
Lowest mark for award of grade	65	53	41	36	30

Note: Grade boundaries may vary from year to year and from subject to subject, depending on the demands of the question paper.

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