

GCE O Level  
Edexcel GCE O Level  
Economics (7120)

Summer 2006

Examiners' Report

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## Contents

1. Paper 7120: Section A
2. Paper 7120: Section B



## Economics 7120

### June 2006

Each year sees a noticeable improvement in the standards achieved by the majority of candidates. Teachers are to be congratulated on the high quality of answers produced. Candidates are being taught not only the basics of economics but also the good practice of organising their answers so that they are easy to read, emphasising the key points and then developing them. Those who were well prepared, both in terms of understanding sufficient economics and having a grasp of what is required for the examination, scored well. Inevitably and regrettably, there were candidates and even centres with very little economics and no evident understanding of examination technique. It was possible for such candidates to score few marks.

This report should be useful to teachers if they read it thoroughly. It can help identify common mistakes and the answers it contains can be given to future candidates as examples of good practice. Some of the most common mistakes which occurred in several questions are listed below:

- Candidates sometimes answer the question they have prepared in class rather than the question set on the paper. E.g. in question 7(b) where the question asked 'why small firms still exist' some weaker candidates gave answers to the question 'what are the advantages of small firms?'
- Too many points are frequently listed with no development. In 9(d) a list of ways in which a country could reduce imports with no development could not achieve maximum marks. Command words such as "Discuss" and "Explain" require more than a list.
- Misreading the question is fairly common. In 11(c) the question asks for monetary and fiscal measures but many candidates only discussed one measure.
- Grasp of definitions is often hazy, e.g. for 6(a) ageing population.

Teachers should try to help their candidates to overcome these common faults so that in future this report will be able to focus even more on praising the efforts of the teachers and their candidates.

## Section A

### Question 1

This question should have provided the opportunity for most candidates to score maximum marks. However, there is still some confusion concerning the type of company that issues shares to the general public (a). Incorrect answers included 'private limited company' and 'public sector' instead of the correct response, 'public limited company'. In (b)(i) candidates needed to ensure that their answers were precise. Advantages of increasing income or increasing profits are incorrect. However, the company will benefit from an inflow of capital.

### Question 2

The majority of candidates were comfortable with this question. Unfortunately candidates in some whole centres seemed not to have met the concept of cross elasticity of demand, which left them struggling. In (b) claims that cross elasticity was elastic/inelastic or inferior/normal indicated confusion and a lack of understanding. Some candidates spent too much time on complex but unnecessary calculations which wasted valuable time.

### Question 3

This question proved accessible to the majority of candidates with most correctly identifying the type of unemployment caused by the closure of the MG Rover car factory. Whilst most correctly identified the effect on ancillary industries in (c)(i) as being the cause of further job losses, too many went on to consider the effects on government revenue rather than government expenditure in (c)(ii). However, the biggest weakness was the confusion between occupational and geographical immobility in (d)(i) with the result that the measures given for the government to overcome occupational immobility (d)(ii) were incorrect. A good response to (d)(ii) is given below:

*"The government could create retraining centres to enable the unemployed to acquire new skills (such as those needed for jobs in expanding industries). The government can also encourage firms to locate in areas of high unemployment and give grants to them for retraining. It can also set up job information centres so that the unemployed can find new jobs in other industries or in other parts of the country."*

### Question 4

International economics often appears to be an unpopular part of the specification, yet many answers to Question 4 were excellent. Weaker students tried generalisations rather than calculations in part (a) and so did not score marks. In (c), references to the weather commonly had little development. However the following gained maximum marks.

*"Agricultural products are primary products and are dependent upon the weather. As weather conditions are extremely volatile there is a high level of risk. Bad weather conditions will ruin harvests and lead to a loss of earnings for farmers."*

*Primary products are subject to large price fluctuations as they have inelastic supply curves so if demand changes this leads to large changes in price and revenue. This can lead to adverse effects on the balance of payments.*

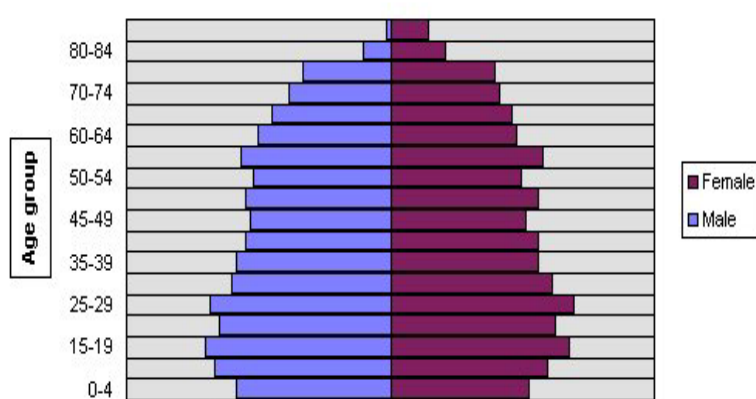
#### **Question 5**

The weak point in answers to this question concerned the functions of the International Monetary Fund. Many candidates had little idea and tried guesswork in their attempts to identify its main functions.

## Section B

### Question 6

This was a popular question, especially with weaker candidates. Population pyramids in (a) were often drawn with little subtlety but the essential feature was normally evident. Some drew elaborate pyramids which probably took far more time than the 2 marks allocated to it required. The pyramid should have borne some resemblance to the diagram below which clearly shows a narrow base, a wider middle and a narrowing top which corresponds to low numbers in the younger age groups, more in middle age groups and a smaller [but rising] number in the oldest age groups i.e. the average age of the population is increasing.



In (b) weaker candidates considered only the fall in the death rate neglecting the falling birth rate. Candidates who did this often went on to produce answers to (c)(ii) which replicated or mirrored (c)(i) rather than add any new ideas. Good responses to (c)(i) and (c)(ii) are given below.

*(c)(i) "An ageing population generally leads to a fall in aggregate demand, as older people tend to have lower incomes as many depend upon benefits like pensions given by the state. Because the state provides pensions, taxes will have to increase and this will lead to a fall in disposable income of workers so they too will have less to spend and demand will fall.*

*The pattern of demand will also change as the older people will demand more medical items like wheelchairs and medicines and services like hospitals. Even the type of goods will change, the older people will want slow economical cars whereas the younger age group will want fast cars. The demand for goods and services that young people will not decline. There will be fewer toys wanted and the government will won't need to spend as much on schools."*

*(c)(ii) "An ageing population leads to a reduced number of people in the working population of a country. This would mean that there are less people to produce goods and services and this means that supply will fall.*

*To respond to the changes in demand firms will have to switch production to satisfy the demand of the older generation. However, the workers are also getting older and will be less adaptable to change and so firms may not be able to introduce new machinery, so supply may fall as they switch from prams to wheelchairs.*



*Existing workers may demand higher wages as their disposable income falls and they become fewer in number. This will lead to an increase in a firm's costs and this could lead to a fall in supply as the supply curve shifts to the left."*

### Question 7

Many candidates knew the textbook answers to parts (a) and (b) and showed little difficulty in reaching full marks, or very nearly full marks, for these parts. There was some confusion where weaker candidates focussed on the advantages of small firms rather than why they exist.

*(b) "Small firms still exist in Pakistan because they are easy to set up. They require very little capital. A person can open a small shop using his own savings or can borrow from friends and family. There are no regulations to follow so even those with little education can set up a small business. Many firms remain small because there is a lack of capital because banks may be reluctant to lend to them. The owner may prefer the business to remain small so that he has complete control. The markets for some goods and services like hairdressers may be small and localised so it doesn't make sense to expand. The desire for personal service creates a demand for the small firms as large firms become impersonal and detached from their customers."*

Part (c) proved to be more challenging with many candidates failing to develop their ideas. Too many focussed on financial help to firms ignoring the many other ways a government can encourage small firms.

*(c) "Because small firms benefit the economy by increasing competition, creating employment and responding quickly to demand changes, the government may want to encourage them to set up. It can do so in a variety of ways. The government can offer a variety of financial incentives including tax breaks which give small firms a time period when they don't have to pay taxes. Capital grants from the government do not have to be repaid and so will also help small firms. The government can tell the banks to give loans at low interest rates to those who wish to start small firms.*

*Apart from financial incentives the government can also give help and advice to those who wish to set up a small firm. This might include advice on keeping accounts or training to use computers. In some countries the government sets up enterprise zones with small units where the small firm can carry out its trading. These areas usually have good transport links and cheap rents."*

### Question 8

The definitions for this question were accessible to most candidates and answers to part (b) were normally sound. A difficulty with part (c) was that many candidates treated "government" as the employer and imagined that such things as wage rates and working hours were entirely government controlled. Sometimes candidates correctly defined productivity in (a)(ii), only to go on to discuss ways of increasing total production in (b) and (c). The car factory proved to be the most popular choice in (b). Examples of both the car factory and tea plantation are given below.

(b) Car factory: *“New technology could be introduced to increase productivity. This could come in the form of computerised systems or robots being used in car assembly. Along with new technology the factory could do away with a large unskilled workforce and use a smaller skilled workforce to operate the machinery. So that workers are motivated and don’t become bored they can be put into teams. Piece rates are another way of motivating them to increase their productivity.*

*Finally the car factory could be turned into a car assembly line with different parts coming from different places and assembled in the assembly plant.”*

(b) Tea plantation: *“Productivity can be increased in a tea plantation by buying new machinery for picking the tea. The work will be done faster than by hand and productivity will increase. It can also be increased by motivating the workers. This could be done by giving them financial rewards e.g. bonuses linked to the amount of tea picked and non-financial e.g. providing them with housing. Productivity can also be increased by planting tea which gives a higher yield or applying fertilisers and pesticides to increase the amount of tea produced by each bush.”*

In (c) relevant points dealing with the workforce included the opening of training centres, legislation to improve conditions at work which would help motivate workers and the reduction of income tax. Measures to increase the use of modern machinery included a range of financial incentives ranging from low interest rates to capital grants. Some even explained how increasing competition by privatisation and reducing trade barriers can lead to greater efficiency and increased productivity.

### Question 9

The attractions of the later parts of question nine drew in some candidates who had little idea of the meaning of either ‘a non-market economy’ or ‘dumping’. Part (c) was almost always done well and this was often also true of part (d), though some candidates spent time on “taxes on imports” despite ‘other measures’ being specified in the question.

Correct answers to (a) and (b) are given below.

(a) *“A non market economy’s main feature is the extent of government involvement. All decisions regarding the factors of production and how they are used are made by the state. The state fixes the prices of goods and services so that if there is a shortage it would impose rationing whereas in a market economy prices would rise.”*

(b) *“Dumping means a country sells its products in another country below the cost of production. E.g. Russia sells jeans at \$6 even though it costs \$8 to make them. Such countries use this method to weaken local producers and once they are removed from the market the Russian producer may increase the prices.”*

### Question 10

Whilst answers to this question were generally sound, weaker candidates lost sight of South Africa in part (b) and only wrote about Nigeria.

(b) *“Nigeria may have found large deposits of minerals e.g. oil which will add to the resources of the country and generate more income and more economic growth. In South Africa no new deposits may have been found so the economy will not grow. Investments into Nigeria may have been higher than those into South Africa so Nigeria may have had more money invested into capital projects than South Africa and so the economic growth would be higher. More money may have been spent on education and training so the labour force in Nigeria may be more productive than the labour in South Africa.”*

It was disappointing that some candidates saw economic growth as exclusively good or exclusively bad, the best answers to part (d) showed some balance.

### Question 11

There were many good answers to this question, though it was foolhardy to tackle this question if candidates had no idea of the distinction between monetary and fiscal measures - especially as this section carried 12 marks.

The most popular problems identified as likely to result from inflation included balance of payments deficit, unemployment and the decrease in the standard of living for fixed income earners. Such an answer is given below.

(b) *“A current account deficit may arise. If a country is experiencing a higher rate of inflation than its trading partners the country’s exports will become more expensive in the foreign markets while imports will become cheaper in the home market. Exports will fall and imports will rise. Investment and employment will decline. Inflation distorts prices and managers will not be able to estimate the revenue and costs of future projects, so less will be invested. Since exports fall and locally produced goods will be less competitive in the home market local firms may go out of business, increasing unemployment. Fixed income earners like those dependent upon pensions will suffer. Inflation reduces the purchasing power of money so with fixed incomes these people will have to decrease their consumption of goods and services so their standard of living will fall.”*

As mentioned earlier, too many candidates discussed only one policy. However, some good candidates gave thorough explanations of the workings of monetary and fiscal policy as instruments of government policy to try to control inflation.

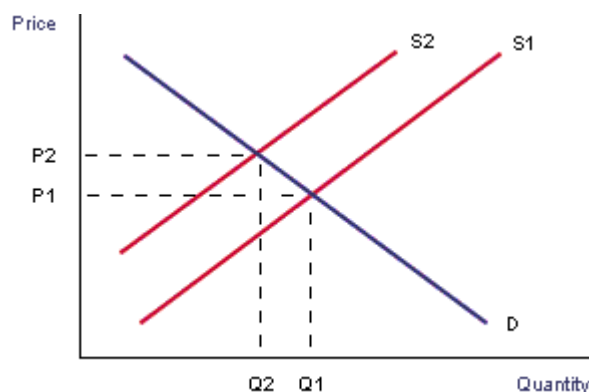
(c) *“By implementing monetary policy the level of spending in an economy can be decreased. When interest rates are high people will borrow less as the cost of borrowing increases. This will decrease the level of spending and thus reduce the rate of inflation. High interest rates will provide an incentive for people to save, especially if the rate of interest is higher than the rate of inflation. This will cause people to spend less as the reward for their savings will be high. Other monetarist policies include directives: where the central bank issues a request to commercial banks to reduce the level of borrowing. Special deposits where commercial banks are requested to maintain an account with the central bank. Fiscal policy involves adjusting the level of taxation and reducing its expenditure. However, if the level of indirect taxes e.g. VAT are increased inflation will speed up even further as the retail price index will rise. It is more advisable for the*

government to increase the tax on income (income tax) as this will reduce the disposable income and therefore spending and in turn reduce demand in the economy.”

### Question 12

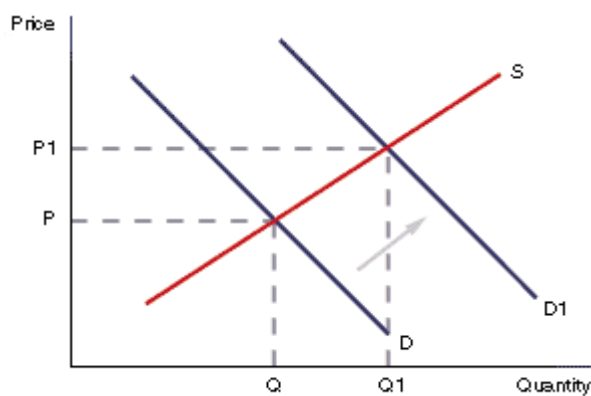
This was perhaps the least popular question though students confident on supply and demand found the first eight marks easy to acquire.

Diagram for (a)(i) an indirect tax on aviation fuel.



*“The increase in tax will move supply to the right and so the price of fuel will increase. As aviation fuel is needed by planes which take people on foreign holidays the price of these holidays will increase.”*

Diagram for (a)(ii) a decrease in income tax.



*“The decrease in income tax will lead to an increase in disposable income. This will lead to an increase in the demand for foreign holidays. As the demand curve shifts to the right the price of foreign holidays will rise.”*

Answers to part (b) often treated increasing indirect taxes and decreasing direct taxes as two unrelated policy choices, whereas we hoped for this pair as a combination. It proved possible to reach good mark totals whichever interpretation was used.

*(b) “Indirect taxes have a wide tax base, all people rich and poor, young and old pay this tax when they buy a good. The government can also use this tax to reduce demand for goods such as to discourage smoking. Indirect taxes are also flexible as the government can change them easily.*

*Direct taxes act as a disincentive to work so reducing them could reduce unemployment. They also decrease the rewards of starting businesses as they tax the profits of companies. Reducing direct taxes would therefore increase the number of firms starting up and boost economic growth.*

*There are however arguments against increasing indirect taxes and decreasing direct taxes. Indirect taxes are regressive so the poor would pay proportionately more of their income and this would be considered unfair. Direct taxes are progressive, the rich pay proportionately more of their income than the poor, so reducing them would also have an unfair effect on the poor. Indirect taxes add to the cost of goods and services so could lead to inflation in the economy. Decreasing direct taxes, like income tax, can lead to an increase in expenditure and this too could lead to inflation in an economy."*

## **ECONOMICS 7120, GRADE BOUNDARIES**

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<b>Grade</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>
<b>Lowest mark for award of grade (Max=100)</b>	<b>67</b>	<b>55</b>	<b>44</b>	<b>39</b>	<b>33</b>

**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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