

# Examiners' Report January 2008

GCE O Level

## GCE O Level Economics (7120)

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January 2008

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### Economics 7120

The standard of the January candidates continues to improve with the best candidates scoring full marks in some of the questions in section B. Not only should those candidates be commended, but also their teachers for their dedication and expertise in the teaching of economics. As always, included, in this report are examples of good responses which teachers should use with their students.

The main areas of concern in this examination, apart from the usual inability to provide correct, succinct definitions when required, were

- The failure of some candidates to read questions correctly. In several questions e.g. 6(a)(b)(c) the question asks for a certain number of causes/problems/measures but many candidates ignored this instruction and simply wrote all they knew, with no structure to their answers.
- The inability to apply economic theory. In several questions e.g. 2(b)(ii) candidates could not apply elasticity to the revenue of farmers.

Centres should continue to look to their own economies for examples of the application of economic theory and government economic policies. Teachers and candidates should always be aware of the role of economics in the real world.

## Section A

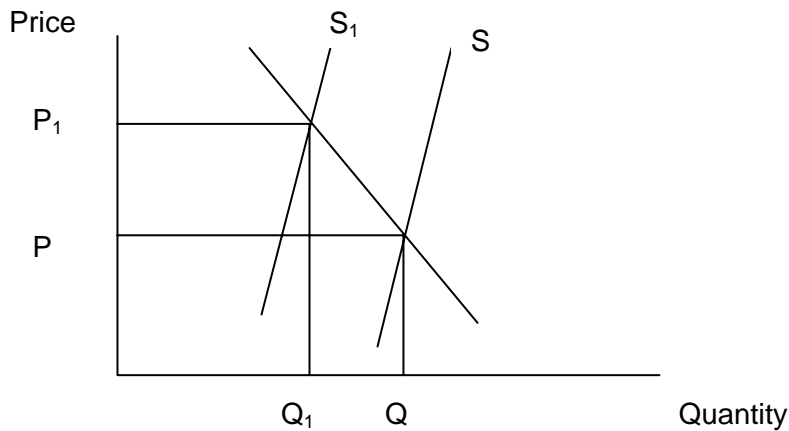
### Question 1

Candidates had few problems identifying the four factors of production in (a) with most giving the list in the same order as taught by economists all over the world i.e. land, labour capital and enterprise! The definitions required in (b) proved more difficult. The inability of candidates to provide simple, succinct definitions should to be addressed by centres.

### Question 2

Demand and supply diagrams should provide the basis for teaching the price mechanism. Whilst the majority of candidates correctly draw and label the axes and demand and supply curves too many were not able to show the shift to the left of the supply curve caused by the drought and the subsequent change in price and quantity, see Figure 1.

Figure 1



Elasticity 2(b) is still being confused with the inverse relationship between price and demand (price rises, demand falls and vice versa) instead of the relationship between the degree of responsiveness of a change in price on the quantity demanded. Part 2(b)(ii) proved a useful discriminator as only the better candidates were able to explain that the rise in price would increase farmers' revenue because when demand is price inelastic the change in price results in a less than proportionate change in quantity demanded.

### Question 3

Most candidates recognised that the US\$ depreciated against the Icelandic Krona and went on to correctly perform the simple exchange calculations. However, candidates are still too easily confused about the effects of changes in the exchange rate on imports, exports and the balance of payments. An example of a good response is shown below.

*"The rise in the exchange rate of the Icelandic Krona has led to an increase in the price of Icelandic exports so demand will fall. At the same time imports into Iceland will appear cheaper leading to increased demand. The fall in the demand for exports and the rise in the demand for imports will have a detrimental effect on the balance of payments."*

### Question 4

The definition of Gross Domestic Product 4(a), required reference to a time period to achieve full marks. The majority of candidates scored highly on part (b) giving sound definitions and relevant examples. It was pleasing to see that candidates understood the GDP data in the graphs and could correctly identify the sectors with greatest growth. Unfortunately many candidates were unaware that a developed country, Bulgaria, could be characterised by growth in the tertiary industry and a decline in the primary and secondary industries.

## Question 5

Vague, inaccurate definitions of visible and invisible trade, 5(a), did not gain marks. It was obvious that candidates understood the difference between the two as they gave correct examples. Defining the balance of trade 5(b), visible exports - visible imports, proved too difficult for all but the best candidates.

## Section B

### Question 6

The topic, population, is always very popular with candidates and this question was chosen by over 50% of the entrants. Common mistakes centred on candidates ignoring the requirements of the separate parts of the question. Part (a) asked for “three possible causes of a fall in the population”, part (b) required “two economic problems” and part (c) “two measures to overcome the problems” but candidates took no notice of these requirements and this was detrimental to their scores.

The most obvious causes of the fall in the population are decreased birth and death rates and net migration (emigration greater than immigration). Reasons for these could be kept brief e.g.

*“A fall in the birth rate due to increased use of contraceptives. A fall in the death rate due to improved health care services and more people emigrating than immigrating due to the search for a better standard of living abroad all lead to a fall in the population of a country.”*

Many candidates ignored the link between parts (b) and (c). The most common problems identified in (b) were the lack of workers, fall in economic growth, fall in government revenue and standard of living. However, in (c) few linked these problems with the measures the government could use to overcome them. Candidates were awarded marks for measures to increase the population as this was the underlying problem.

(b) *“A fall in the population will probably lead to a fall in the supply of workers which in turn leads to a fall in output as labour is an important factor of production. The fall in output will reduce the economic growth of the country.*

*A second problem might be a fall in government revenue. As the number of workers fall so will the amount of tax the government receives from their income. There will also be less spent as there are fewer people so the revenue from indirect taxes on goods and services will fall. Without revenue the government will not be able to provide services for the public like health care and schools so the standard of living will fall.”*

(c) *“The fall in output can be overcome by the government encouraging firms to invest in improved production processes. The introduction of labour saving machines will reduce the demand for labour and at the same time*

*increase output. By lowering interest rates, lowering tax rates on investment expenditure and giving grants to firms the government can increase the amount of machines in factories which will increase output. The fall in government revenue can be overcome by increasing taxation. The government can increase direct taxes like income tax but this might lead to more workers emigrating. An increase in indirect taxes will increase prices which in turn will lead to inflation and a fall in the standard of living. Perhaps the best way of increasing revenue would be to attract foreign workers into the country, raise the retirement age and reduce the school leaving age so that the working population increases and so too will tax revenue."*

### Question 7

A budget deficit 7(a) occurs when *"government revenue is greater than government expenditure"* not *"imports greater than exports"*! Candidates performed better on 7(b) referring to expenditure on education leading to a more efficient labour force increasing productivity and generating economic growth. The most common disadvantage identified related to opportunity cost: the increased expenditure on education resulting in less being spent on other items e.g. health which could lead to more days being lost from work and a fall in production.

The term *"fund"* was not understood by some candidates in 7(c)(i) and was incorrectly interpreted as *"how money should be spent"*. A correct response for 7(c) is given below - notice how the candidate has linked 7(c)(i) to 7(c)(ii) as required by the question.

(c)(i) *"The two ways are direct tax and indirect tax."*

(c)(ii) *"Generally income tax and wealth tax are regarded to be direct taxes. Direct taxes tend to be progressive which means the rich people pay a higher proportion than the poor which may help to reduce the gap between them. This type of tax can also be used by the government to achieve economic policy objectives such as fighting inflation by reducing demand in the economy. However increasing income tax can also discourage extra work by employees as when employees earn more they pay a higher percentage of their earnings to the government. This might lead to tax evasion by submitting false returns or even working on the black market where no tax is paid.*

*Indirect tax e.g. VAT is automatically paid when someone buys goods and services. The buyer doesn't feel the burden of the tax. It can also be levied on demerit goods like alcohol and cigarettes which are harmful to the health. Imposing indirect taxes increases price. This can lead to inflation in an economy. They may also increase the gap between the rich and the poor as the tax is regressive so the poor pay a higher proportion of their income than the rich."*

## Question 8

A popular question but one in which the majority of candidates did not perform well. Most identified correctly the type of integration in 8(a)(i) and correctly identified economies of scale and decreased competition as the main advantages in 8(a)(ii). Problems arose in 8(b) as candidates failed to give three reasons with some development. A good response is shown below.

(b) *"The tax rate and rent in Poland may be lower than in Britain. This will reduce costs and enable the firm to make more profit.*

*There may be a pool of cheap, skilled labour which will make costs lower than in England and increase profits.*

*There may be a large market with few competitors. By locating in Poland Cadbury Schweppes will save on transport costs as it will be close to the market."*

In 8(c) candidates should have identified one advantage and one disadvantage for the economy of Poland. Too many produced lists with no development whilst others gave the advantages and disadvantages to the firm rather than the country.

(c) *"MNC's like Cadbury Schweppes employ local workers. This will increase employment and raise the standard of living of the people. The government will spend less on unemployment benefits and be able to spend more on other items which will also increase the standard of living in Poland.*

*A disadvantage arises when the foreign firm takes the profits back to their home country. This is an outflow of money and will have an adverse effect on the balance of payments of Poland."*

## Question 9

Another popular question with candidates having little problem defining disposable and real income. Similarly in 9(b)(i) candidates correctly explained how inflation affects foreign trade by increasing the price of exports and reducing the price of imports. In 9(b)(ii) instead of answering the question set, many candidates interpreted it as 'How are borrowers and lenders affected by an increase in interest rates?' which meant they scored zero! Part (c) produced very poor responses, with candidates confusing fiscal and monetary policy, identifying the results of decreasing inflation or simply stating that the money supply should be reduced with no development. One of the few good responses is given below.

(c) *"The government can use the main instrument of monetary policy, interest rates, to control inflation. By increasing the rate of interest savings are increased because the reward to savings is high. As a result consumption falls as people tend to save more and spend less. This leads to a fall in aggregate demand and would lead to a fall in prices. At the same time the increase in interest rates leads to an increase in the cost of borrowing and so the demand for loans fall. This also leads to a fall in demand in the economy*

*so inflation is reduced. The government can also make it more difficult for people to borrow by asking for bigger deposits or reducing the time in which the loan has to be repaid."*

### Question 10

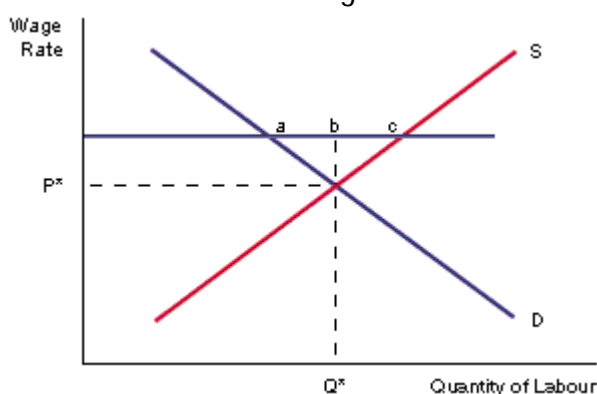
This proved to be the most popular question. However, there is still confusion between public limited companies (owned by shareholders) and the public sector (owned by the state). Candidates also felt compelled to list the advantages of the sole trader/small firm to consumers even though this was not asked for in any part of the question.

The main factors influencing the location of a small retail shop 10(b) could have included proximity to the market and wholesalers, cheap rent and business rates (local taxation), and the amount of competition in the area. In 10(c)(i) relevant reasons for a government wishing to increase the number of small businesses include increase employment, increase competition, future growth of firms and economic growth. In 10(c)(ii) measures which could have been given included, financial incentives like grants, cheap loans, lower taxation and practical advice concerning keeping accounts, business plans and how to comply with employment law and health and safety.

### Question 11

Many high ability candidates achieved maximum marks in this, the least popular, question in section B. The diagrams required were straightforward with the effects on the economy providing the opportunity for better candidates to apply their knowledge of economics.

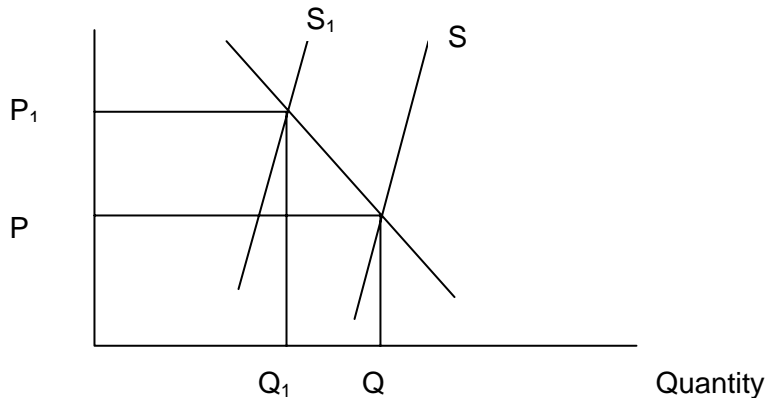
(a) Introduction of minimum wage:



*"The wage rate rises above the equilibrium and this leads to excess supply and unemployment as firms need to reduce costs. If the increase in wage rates is passed on in the form of increased prices then inflation will result. The workers who are employed at the higher wage rate will benefit but those made unemployed will see their standard of living fall. Firms may decide to replace workers with machines when the wage rate rises leading to even more unemployment."*

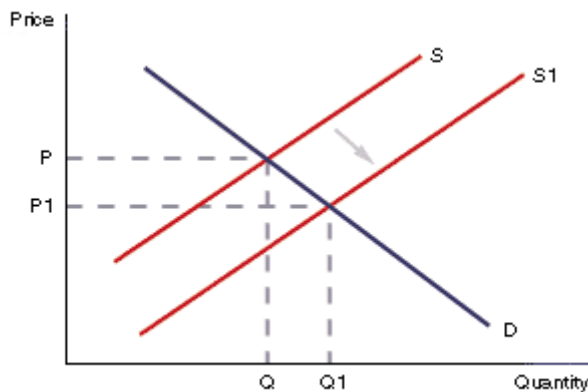


(b) Decrease in subsidy



*“The supply of goods will fall as the government removes subsidies to farmers and the prices will rise leading to inflation. As the price of domestic foodstuffs rises consumers will buy more imports. This will have an adverse effect on the balance of payments and domestic farmers may go out of business.”*

(c) Discovery of additional oil supplies.



*The increase in supply will lead to a fall in the price of oil. As oil is an important commodity the standard of living will rise. The economy may export oil and this may lead to a balance of payments surplus. The discovery of new resources will lead to economic growth in the economy.*

## Question 12

‘Specialisation of labour’ in 12(a)(i) can also be termed ‘division of labour’. Examples from everyday life are numerous yet many candidates who attempted this question used the old, much quoted “*pin factory*” International specialisation 12(a)(ii) by a country proved more difficult to define but some candidates did respond with excellent answers.

(a)(ii) *“International specialisation by a country is said to occur when a country devotes itself mainly in producing a few major products and becomes*

*efficient at producing these products. e.g. Bangladesh specialises in jute and garments."*

International specialisation brings with it advantages and disadvantages. However, these are not the same as advantages and disadvantages of free trade, a common mistake made by many candidates. The following candidate did not make that mistake:

*(b) "International specialisation allows countries to produce on a large scale and thereby obtain economies of scale which reduces average costs of production. Such a reduction in average costs makes their products more competitive in the world market thereby increasing their export earnings and employment. However if this world demand for their goods falls the country would be deprived form earning foreign currencies which may result in a balance of payments deficit and unemployment. Specialisation may also lead a country to depend upon other countries to obtain other necessities and this may lead to the country being badly affected due to political changes in those other countries. The country may also suffer the depletion of its natural resources which are used to produce the items in which it specialises."*

Knowledge of the work of the World Trade Organisation (WTO) appears very vague when explained by candidates. There are several misconceptions, notably that the WTO organises trade fairs and provides loans and aid to countries.

*(c) "The WTO's main objective is to promote free trade. This can be done through by meetings called "rounds" where member countries agree to reduce trade barriers e.g. tariffs and quotas. When barriers to trade are reduced, developing countries find it easier to export their goods to other countries. Often their goods are cheaper than those of developed countries due to lower labour costs so they see an increase in sales. The WTO also tries to settle trade disputes which often occur between developed and developing countries. Usually the dispute arises because the developed country is trying to protect its domestic firms from the foreign competition of developing countries. The WTO can try to resolve the disputes so that both countries benefit."*

## O level Economics Grade Boundaries

	<b>Max Mark</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>
7120	100	70	60	50	45	40

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