ECONOMICS

Paper 9708/12
Multiple Choice

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

Key message

Candidates should pay attention to applying economic analysis in less usual contexts.

General comments

No question proved to be more difficult than expected, while one question (**Question 4**) proved to be easier than anticipated.

Candidates performed particularly strongly on demerit goods, the use of individual market analysis and policies for deficits on the balance of payments. More difficult areas proved to be subsidies, macroeconomic equilibrium, the terms of trade and tariffs. The diagrammatic questions produced the most successful responses.

Comments on specific questions

Candidates often find difficulty in analysing subsidies in a numerical form. This was the case in **Question 16** where the largest group of candidates chose option B over the key A. Option B implies that the full benefit of the subsidy accrues to the original demand of 150 units. In normal circumstances some of the benefit goes to the producer.

Candidates might have used the knowledge applied successfully in **Question 9** to establish the change in the equilibrium price caused by the subsidy and its impact on the expenditure of the original consumers. The

original consumers would face a price reduction of $2 (from $10 to $8) so spending $1200 instead of $1500. Hence A, a saving of $300.

With the exception of **Question 16** above, the analysis of changes in individual markets was very sound. Candidates did less well when moving to the macro context in **Question 20**. Here it was surprising that so many chose options B and D. Both of these suggest a move in only one curve when there were two distinct effects at work. In the short run education spending shifts the aggregate demand curve downwards and wage inflation shifts the aggregate supply curve upwards making C the key. The question also required recognition of the importance of the short-run context.

Knowledge of the terms of trade can sometimes be inexact. This was shown in **Question 25** where under half of the responses were correct. The key is A because the measurement of the terms of trade concerns the relative prices of imports and exports rather than the quantities or total values traded.

For **Question 30** almost a third of candidates chose option D rather than the key B. During deflation the intention would be to raise aggregate expenditure. Greater bank lending would allow consumers and producers to increase their spending power making B correct. A fiscal adjustment without any tax burden reduction (option D) would be unlikely to result in immediate higher spending.

ECONOMICS

Paper 9708/22
Data Response and Essay

Key messages

- It is essential that economic concepts be fully understood in order to ensure that all aspects of a question can be answered.
- The question requirements must be considered carefully in order to ensure that the answer produced is relevant. Full understanding of the meaning and significance of the directive or command word is essential to ensure this.
- In preparation for the examination, application of economic concepts should be practised and tested in a variety of contexts or case studies, to ensure that candidates are confident in the techniques necessary to ensure success on the data response question.
- Analysis must be developed sufficiently in order to move beyond a superficial explanation of the economic concept(s) tested.
- Candidates' ability to provide evaluative judgement will always be tested. Essays that do not include a conclusion are unlikely to demonstrate this skill fully, and will miss out on marks as a result.

General comments

Some candidates produced strong scripts that displayed the required knowledge and understanding of the economic concepts tested on this paper together with the ability to apply, analyse and evaluate material. These scripts gained a high mark.

Such scripts, however, were disappointingly few. A large number of scripts displayed incomplete or confused understanding of the economic concepts tested. In many candidates showed insufficiently developed examination technique resulting in many scoring poorly, despite the fact that they possessed the required knowledge and understanding.

A common weakness was a tendency to produce notes rather than answer the actual question set. This resulted in many responses that had only incidental relevance to the question. This was particularly the case in many of the answers to the data response question, where marks were often low.

Comments on specific questions

Section A: Data Response

Question 1

(a) Most candidates were able to draw a diagram of a production possibility curve. Most chose to illustrate the expected changes in the Venezuelan economy between 2014 and 2017 through an inward movement of the curve. The main weakness seen was that many of the diagrams were left unlabelled or given incorrect labels. Many, for example, labelled the axes 'price and quantity'. This indicated a lack of understanding of this important economic tool.

(b) A large number of candidates correctly stated that the price elasticity of demand for oil was inelastic, but many did not explain this – as required by the command word – and failed to score as a result. The data provided evidence that the fall in the price of oil resulted in a fall in the revenue of the Venezuelan government. This explains that the price elasticity of demand for oil must be inelastic because a fall in price resulted in a smaller percentage rise in demand and this would lead to a fall in revenue. Unfortunately, a number of candidates were unable to apply their knowledge of

this economic concept and mistakenly came to the conclusion that the demand for oil was price elastic.

(c) Some very good answers were provided to this question. It was necessary to draw an accurate diagram showing the establishment of a maximum price below the equilibrium price. The diagram also needed to be correctly labelled and show the extent of the excess demand that. The answer also needed to have an explanation of how the shortage had arisen. Unfortunately, some candidates were confused between a maximum and a minimum price and drew a minimum price above the equilibrium price but labelled it a maximum price. Some failed to show the shortage on the diagram, while others wrote no explanation of how the shortage had arisen.

(d) Most candidates were able to write about inflation in general terms and many clearly understood the distinction between demand-pull and cost-push inflation. However, many did not make a clear reference to the data, which was required by the question. For those who did make good use of the data, demand-pull inflation was usually explained in the context of an increase in the money supply. Many suggested that cost-push inflation was caused by the collapse of the bolivar currency that resulted in an increase in the cost of imported raw materials and products.

(e) Most candidates were able to identify some of the functions of money, but often some of the established functions were omitted. This meant that a full consideration of the impact of inflation upon these functions was incomplete. A further weakness was although candidates could often name the functions there was not always a full understanding of their meaning. Again, this made it unlikely that the question could be answered successfully. Some high-scoring answers were provided, however. These showed a clear understanding of how money functions as a medium of exchange, a store of value, a unit of account and a standard for deferred payments and then discussed how each of these was likely to be affected by the estimated rate of inflation in Venezuela. The best answers also provided a conclusion, making a judgement about the extent to which the bolivar would be able to continue to perform all of its functions. Unfortunately, some candidates did not focus on the question and wrote very generally about consequences of inflation, with little consideration of the potential impact of inflation on the functions of money.

Section B: Essays

Question 2

(a) Many candidates were able to explain the concepts of choice and opportunity cost faced by governments and used a range of appropriate examples to support the explanation. These candidates then included a production possibility curve to illustrate opportunity cost by a movement along the curve. Unfortunately, very few candidates went on to explain that since production possibility curves are usually drawn concave to the origin this indicated increasing opportunity costs, and fewer still provided an explanation of why this was likely to be the case.

(b) Most candidates attempted to discuss whether decision-making was more effective when undertaken by governments in a planned economy than by individuals in a free market economy. The decision-making process of central and regional planning was contrasted with the use of signals given through the price mechanism. Successful candidates provided a conclusion in which they made a reasoned judgement about which system was more effective. Unfortunately, some candidates simply offered a number of vague assertions about the two economic systems based upon descriptions of unsuccessful examples drawn from the past, without offering a discussion of the relative effectiveness of their decision-making processes. Many discussed whether merit and demerit goods and public goods were likely to be supplied in each type of economy, but very often assertions were made without any underpinning analysis. Similarly, some discussed which type of economy was most likely to suffer from unemployment, again with little analysis to support the assertion offered. The most usual conclusion reached was that the weaknesses of each type of economy made it preferable that a mixed economy was adopted, but again this was often advanced as an unexplained assertion.

Question 3

(a) Most candidates were able to provide an accurate formula to measure price elasticity of supply, although some got the percentage changes in price and quantity the wrong way round. Most candidates made an attempt to explain what was meant by either elastic or inelastic supply, although some of these explanations were not as clear or as precise as they should have been.

Most candidates were able to explain two factors that could affect PES, such as the number of producers in the market, whether there was spare capacity, the ease of storing stocks, the extent of factor mobility, the availability of unemployed resources, the nature of the product and the time period under consideration. Some good marks were awarded here.

(b) Many candidates displayed good knowledge of the various instruments of supply-side policies, but a common weakness was to describe a range of policies without directing them at the question set. Many showed little appreciation of how different policies could be targeted at increasing the stock of capital goods, while different policies were more appropriate to increase the supply of labour. Those who did link the different policies to the required increases in capital or labour tended to score well. Attempts to offer a conclusion were rather limited and needed to be developed more fully than they were. Many simply considered the effectiveness of supply-side policies in general terms, but this was not the question, so marks for evaluation were often poor.

Question 4

(a) The answers provided to this question revealed that many candidates did not completely understand the terms of trade. Many, for example, produced an incorrect formula, while others confused changes in the prices of exports and imports with changes in the total expenditure on exports and imports. This lack of understanding was evident in the attempts of many to explain what is meant by a rise in the terms of trade. Many candidates made an attempt to outline how a change in an economy's exchange rate and its domestic price level might each cause a rise in an economy's terms of trade. However, there was much confusion and a great deal of inaccuracy when linking the change in the exchange rate and the domestic price level with the rise in the terms of trade.

(b) Many of the errors that arose in the application of the concept in part **(a)** of this essay were repeated in part **(b)**. In addition, many of the answers provided were rather unbalanced in that they focused largely on the negative effects of a rise in the terms of trade such as how it would affect the international competitiveness of goods produced by the country. There was very little consideration of any potentially positives such as the effects upon domestic industry's costs of production with cheaper imported materials. The better answers explained both the advantages and disadvantages that might arise in an economy as the terms of trade rose and were able to reach a considered conclusion after a reasoned assessment. It was essential that this conclusion considered whether the impact would be of overall benefit rather than simply listing both the advantages and disadvantages. Some candidates did manage to offer a conclusion where they attempted an evaluation of the overall benefit of a rise in the terms of trade on a country's economy, but others made no attempt to offer an evaluative comment.

ECONOMICS

Paper 9708/32
Multiple Choice

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

General comments

The questions for which most candidates selected the correct answer were **1**, **2**, **4**, **11**, **13**, **14**, **15**, **18**, **20**, **21** and **23**. The questions for which the fewest candidates selected the correct answer were **6**, **8**, **10**, **17**, **26** and **27**.

Comments on specific questions

Question 6 was answered correctly by 19 per cent of the candidates who chose the key D. 33 per cent chose option A, 27 per cent chose option B and 21 per cent chose option C. Although the marginal and average values will change, because the tax is added to each unit produced the minimum of the average cost will occur at the same level of output as before tax.

Question 8 was answered correctly by 42 per cent of the candidates who chose the key D. Three per cent chose option A, 11 per cent chose option B and 44 per cent chose option C. Marginal cost is the cost incurred from producing an extra unit of output. It changes as does the variable cost. If there are only fixed costs, the variable cost must be zero and, therefore, the marginal cost must be zero. Profit maximising output is where marginal cost is equal to marginal revenue. The solution to the question is then to find the point at which marginal revenue is zero. In the diagram shown, when the marginal revenue is zero the price, as given by the average revenue line, is D.

Question 10 was answered correctly by 44 per cent of the candidates who chose the key A. 16 per cent chose option B, 14 per cent chose option C and 26 per cent chose option D. If average revenue is greater than average cost then supernormal profits are said to occur. If average revenue is lower than average cost

then subnormal profits occur. For normal profits to occur the average revenue must be equal to the average cost.

Question 17 was answered correctly by 41 per cent of the candidates who chose the key B. Nine per cent chose option A, 23 per cent chose option C and 26 per cent chose option D. If capital is becoming cheaper (option A) it is likely that the firm will replace labour with capital where possible. This would not increase the power of the trade union. Increasing wages will increase the firm's costs. With an elasticity of demand that is either equal to 1 or greater than 1, (options C and D), the firm will not be able to achieve higher revenue by raising the price of the product to pay for the extra labour cost.

Question 26 was answered correctly by 42 per cent of the candidates who chose the key D. 19 per cent chose option A, 32 per cent chose option B and six per cent chose option C. Income changes each time by an equal amount ($40 m) and consumption changes each time by an equal amount ($32 m). The marginal propensity is, therefore, constant for each change and is 0.80.

Question 27 was answered correctly by 35 per cent of the candidates who chose the key A. 43 per cent of the candidates chose option B, six per cent chose option C and 16 per cent chose option D. All the options, except A, use existing reserves of money so there would be no immediate increase in the money supply.

ECONOMICS

Paper 9708/42
Data Response and Essays

Key message

Candidates should focus the content of their answers on the precise question set, and not produce a 'rehearsed' answer on the general topic.

General comments

As last year, there were some good answers to this paper and those candidates are to be congratulated on the use of their studies to achieve such marks. They presented well-balanced and clearly structured answers, accurately directed to the question and enhanced by relevant examples and applications where appropriate. Sometimes, unfortunately, candidates presented answers that repeated information that had been learnt about a topic but which was not directly relevant to the particular question asked.

It has been mentioned in these reports that diagrams have been drawn that detracted from, rather than enhanced, the answer. It was pleasing to note that many diagrams were much better presented, were clearly labelled and the narrative gave an explanation of the diagram. There were far fewer answers that included a diagram with no explanatory text. There were a few exceptions to this improved trend that occurred with **Question 2**. Candidates occasionally endeavoured to explain the difference between normal and inferior goods but did so by using a diagram that was very difficult to follow because either it was very small or the changes in the budget and indifference lines were drawn too closely together. Overall, the candidates' responses were of a high standard.

Comments on specific questions

Section A: Data Response

Question 1

(a) Most candidates were able to indicate some of the parts to the answer but only a few mentioned all aspects. It was expected that candidates would refer to an increase in the amount of goods and services produced, per head of the population, taking account of price changes, over a period of time. The most commonly omitted aspect was the time period.

(b) This question did not cause any problems for candidates who were able to explain that variable costs change with output while fixed costs do not – and are constant in the short run. The change in steel prices could affect either fixed or variable costs, depending on what the steel is used for but the price change is more likely to affect variable costs. A suggested change in either variable or fixed cost was accepted as long as a reason for the choice was given.

(c) This question presented a challenge to many candidates. Steel is a key material used in manufacturing. Firms which buy steel have benefited from lower world prices (45 per cent lower in a year). There was an excess of world supplies and this caused prices to fall. When there is excess supply, buyers have more power over market and are likely to have more influence than when supplies are scarce.

(d) Candidates were able to explain what was meant by market failure: an inefficient allocation of resources – maybe due to monopoly, information failure, externalities or need for public goods. They also presented good discussions of whether there was market failure in the information given.

One case for government intervention was based on the need to preserve jobs and help sustain the local economy near steel plants. In the short run the government could subsidise production until such time as world demand increased and prices of steel rose. This was due to the imbalance between demand and supply but it was not a case of market failure.

If the steel industry is a high cost industry with overcapacity it could be unsustainable in the long run. If supported, it would require public funds that would mean less could be spent on other projects. There was no evidence that such a subsidy would improve efficiency because of market failure. Most candidates explained this well.

The danger of foreign suppliers that undercut UK steel prices is also not really a case of market failure but market forces working. Local industry costs were too high; the industry was uncompetitive. However, it was mentioned that there was 'dumping' of Chinese steel. This can be presented as a case of market failure and many candidates recognised this.

Section B: Essays

Question 2

The theory states that consumers maximise satisfaction by relating utility to price; this is shown by indifference curves and budget lines. Income changes shift budget lines parallel to the original line; a price change of one good causes the budget line to pivot. Equilibrium is changed – the extent and direction of that change depends on the type of good. It was usual that candidates explained the theory and presented the information with the help of diagrams. There were still some candidates who made the diagrammatic presentation very difficult to follow by making the diagram too small. Others confused the direction of the change of the income and substitution effects.

Nudge theory seeks to persuade consumers rather than dictate by means of legislation or regulation. Most candidates presented a good explanation of nudge theory. This could be represented by a change in perceptions or taste shown by a change in the shape of the indifference curve. It could be argued that this would not invalidate the notion of equilibrium and maximising satisfaction according to the new shape of the curve. The better answers presented a clear argument about the link of nudge theory to consumer satisfaction.

Question 3

(a) Many candidates answered this question and were able to explain what was meant by allocative efficiency and Pareto optimality without any problems. The idea of equity did present a challenge to some who confused equity with equality. Equity is based on the idea of fairness, not necessarily equality. The discussion on the link between the three terms was often briefly explained and some confused the relation between Pareto optimality and equity. Pareto optimality does not necessarily have any link to equity. A competitive equilibrium, for example, is not necessarily equitable.

(b) Most candidates who answered this question presented a clear discussion. The weaknesses were that the discussion was sometimes not very well developed. It was hoped that candidates would discuss the merits of small firms, indicating which type of market makes them successful, and also discuss the merits of larger companies – for example, because of economies of scale – with a conclusion about the relative strengths and weaknesses of both small and large firms. The conclusion was often omitted and the reader was left to decide what the conclusion might be.

Question 4

(a) Candidates needed to explain the marginal revenue productivity theory and the equilibrium position of the firm. The information stated that the company was large so it could be presumed that the market was imperfectly competitive. Candidates were able to give a good presentation, according to the theory, of the initial equilibrium position. A common error was to say that the marginal revenue productivity was calculated by multiplying the marginal physical product by the average revenue, rather than by the marginal revenue. The former is only the case, by default, in perfect competition because the two revenue curves are the same.

The challenging part of the question involved an understanding of the link between what happens in the product market when demand decreases and the equilibrium in the factor market. In imperfect competition if demand decreases, the demand (average revenue) curve shifts. This

would also cause a shift in the marginal revenue curve. This, in turn, would result in a different marginal revenue product curve in the factor market. The analysis of these links was often not well presented.

(b) Most candidates recognised that if price were above average total cost then the firm would be making supernormal profit. Candidates often accurately contrasted that position with a situation where the price might fall and the firm made normal profit. Here average total cost would be equal to average revenue. What many did not do was to consider what might happen if the price (average revenue) fell further and was lower than the average total cost. In the latter situation the significance of the average variable cost becomes important. All this assumes that the firm is wishing to maximise profits. The firm might have other aims besides profit maximising and the better answers presented and discussed these aims. The different aims might result in different decisions about the viability of the firm should price fall below total average cost.

Question 5

(a) This question required candidates to explain that the transactions demand is a demand for an active balance. It depends upon the level of income and the frequency of income payments. It is interest inelastic. The speculative demand for money, by contrast, is determined by expectations of the future rate of interest of long term government securities. These are known as idle balances and can be closely related to changes in the rate of interest. The importance of the two demands for money will vary depending upon the state of economy, the level of income and the rate of interest. The question was popular and the answers were clear and accurate. Weaker responses did not develop the speculative demand to show the relevance of interest rates or did not give an opinion as to which type of demand was more important – as asked in the question.

(b) It was expected that candidates answering this question would explain the meaning of a budget deficit and then identify the potential effects of large budget deficits on an economy. Many answers did this very well and made the distinction between the short-run effects associated with financing a budget deficit and the potential long-run effects of deficits on national income. Some candidates were clearly able to suggest how budget deficits might affect national income or government policy towards interest rates. These in turn could affect the demand for money. It is likely that in the short run the speculative demand will fall due to rising interest rates while in the long run transactions demand will rise due to a rise in the level of income. A few candidates confused government budget deficits with deficits on the balance of payments.

Question 6

(a) This was not a popular question but those who answered it were able to distinguish between autonomous investment and induced investment, recognising that the former will come from outside the circular flow of income while the latter will depend upon changes in the level of income. The weaker part of the answer was that which dealt with the link between the two types of investment. It was expected that candidates would explain the link by commenting on the relationship between the multiplier effect on income and the accelerator effect on investment.

(b) The main focus of this question was to discuss the opinion that all investment in an economy should be carried out by private sector firms. Candidates were able to identify and explain the key policies introduced by governments which might promote investment in the private sector. These included low interest rate policy, favourable taxation and direct government support. The subsequent discussion on whether the private sector should be solely responsible for investment was the weaker part of many answers. It was hoped that there might be a discussion of the circumstances in which public sector investment would be needed, for example providing public/merit goods. It was expected that a conclusion would be provided based on the preceding discussion.

Question 7

This was a very popular question for which candidates produced well-reasoned answers with good development of the topic with clear explanations. Answers considered the alternative ways of achieving growth by internal means or by encouraging external foreign investment. The policies that might be used by developing economies in attempting to achieve export-led growth were mentioned. These were compared with the costs and benefits of stimulating growth using policies to promote investment by multinational

companies that might include the displacement of local labour or the loss of funds as finance was returned to the multinational's home country.