Examiners' Report January 2008

GCE

GCE Economics (8121-9121)

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January 2008

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January 2008

General

The structure of the paper has not changed for some years. This is reflected in the ever improving performance of a number of candidates, although there continue to be a large number of candidates who enter for this during this session with what appears to be little or no preparation or understanding of the higher order skills, in particular AO4, required for a top mark. It is delightful to report that the mean has increased significantly to 25.7 (Jan 2007 23.8) and the standard deviation has narrowed to 6.6 (Jan).

Based on those scripts marked online about two-thirds of candidates chose to attempt question 9 on oil (mean mark 11.22) and the remainder attempted question 10 (mean mark 11.82).
Almost universally candidates failed to react to the command words directing them to AO4 and therefore evaluate their responses. Up to 6 marks for evaluation are included in the data response component of this paper. This area was particularly poorly done and centres would do well to focus their candidates' attention to the need to evaluate in the final stages of the data response.
The transition to Epen appears to have been completed satisfactorily, and the number of scripts that have to be marked traditionally continues to decline. Centres should make use of the statistical tools available from Edexcel (Results Plus) which allow them to identify how individual students and the centre as a whole have performed on particular questions.

Supported Choice
Question 1

Mean: 3.21 Standard Deviation: 1.72

The majority of candidates were able to successfully define a Production Possibility Frontier as showing the maximum combination of two goods that an economy can produce given a finite set of resources. It was reassuring to see candidates being able to explain how the natural disaster would reduce the number of factors of production and therefore shift the PPF to the left.

A number of candidates misread the question and assumed that it was seeking an explanation of how the PPF had shifted to the right. It cannot be stressed enough but candidates must take their time to ensure that they have read the question fully and correctly identified the requirements before attempting to answer.

Question 2

Mean: 3.63 Standard Deviation: 1.29

This style of question is one that students have become quite familiar with, though there are still a number of candidates that are unsure of the definition of a normative statement. The acceptable definition of a normative statement is one that concentrates on the value judgement nature of the statement, and identifies that it cannot be tested. This is of course at odds with a positive statement which can be tested and verified. Candidates were expected to support their selection with reference to the text and in particular identifying that "good thing" suggested a normative statement.

Question 3

Mean: 4.48   Standard Deviation: 0.95

Candidates were able to do this question very well, although a number did not have a precise definition of opportunity cost to hand. Many candidates were unable to answer this question in the context of the benefit associated with the next best alternative foregone. Precision, particularly with definitions, is essential in guaranteeing success in the supported choice element of the paper.

Although answers lacked precision the majority of candidates were able to explain that by opting for the school then the government were clearly foregoing the hospital and the associated benefits.

Question 4

Mean: 3.55   Standard Deviation: 1.62

It is pleasing to see so many candidates confident with the concept of consumer surplus. Clear definitions were provided and used to support their discussion of why the consumer surplus had fallen. A sizeable number of candidates used a diagram to support their answer, showing the original consumer surplus and the now reduced consumer surplus, which was to be welcomed.

Question 5

Mean: 2.90   Standard Deviation: 1.65

Price elasticity of supply continues to cause great difficulties, although many candidates were able to identify the correct key and provide the definition of price elasticity of supply. Many candidates were not able to satisfactorily explain that farmers could not increase their supply of bananas immediately in response to a rise in price as it took time for farmers to plant more bananas and few if any could be stored for a long time.

Question 6

Mean: 3.81 Standard Deviation: 1.62

It is clear that candidates are now quite familiar with the application of elasticity. Many candidates obtained two marks for correctly stipulating the formula for cross price elasticity of demand. The vast majority were able to successfully explain why a positive relationship suggested that the two goods in question were substitute goods, referring to numerical examples or explaining how one product would react to a change in the price of the other and therefore why the correct key was D.

Question 7

Mean: 2.84 Standard Deviation: 1.59

Many candidates provided an understanding of a subsidy, but this was not always an accurate explanation of how a subsidy would seek to increase output by lowering the costs of production. Of those getting the correct key, many were able to successfully support their answer by shading in the correct area on the diagram provided and referring to the size of the subsidy as being the vertical distance between the two supply curves.

A large number of candidates identified the wrong key, selecting instead B, and shading this area, although they were still able to score some credit by defining a subsidy.

Question 8

Mean: 3.75 Standard Deviation: 1.55

This is a familiar style of question and many candidates have grown to expect this sort of question, although they still continue to do less well in this than might be expected.

Almost all candidates were able to link the increased demand for rugby balls with a shift to the right in the demand curve, although a large number were not able to see that movement to a low wage economy would lower costs and shift the supply curve to the right also. Many drew the conclusion that employees would be less motivated by a move to a low wage economy and therefore there would be a shift to the left as productivity declined.

It is essential that candidates refer to the shift from the old to the new demand and supply curves (or the points on the curve) if they are to access the full range of the marks. A good number still do not do this and therefore fail to achieve full marks.

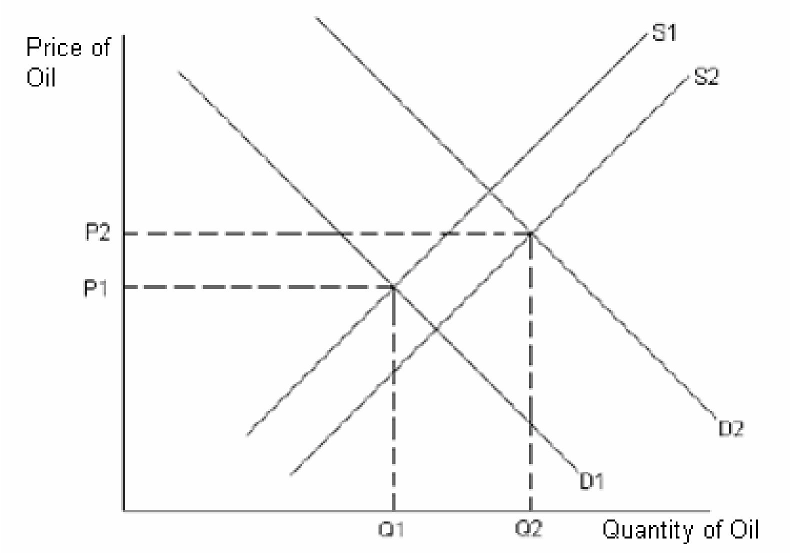
Question 9a

Mean: 1.59 Standard Deviation: 0.61

This represented a very simple introductory question which caused few candidates any problems, although a number of answers offered only one reason or discussed supply factors which would cause price to rise.

Question 9b

Mean: 2.77   Standard Deviation: 1.14



The majority of candidates could see from the text that global demand for oil had increased and correctly reflected this in their diagram. There were a number of candidates that concluded that the low levels of investment during the 1980s and 1990s had resulted in a fall in overall supply of oil contributing to the price change. Clearly the correct conclusion to be drawn from the text was that supply had in fact increased but had not managed to keep up with demand, perhaps due to the lack of investment in the past, which contributed to the “mismatch” between demand and supply referred to in the extract.

Question 9c

Mean: 2.46   Standard Deviation: 1.02

The majority of candidates were able to score well in this answer, offering the definition/formula of price elasticity of demand, and explanation of why oil was an inelastic product.

Better candidates were able to question whether or not oil would be inelastic in demand in the future and concluded that this depended on whether substitutes would be available in the future.

Question 9d

Mean: 2.13 Standard Deviation: 1.01

The majority of candidates could see that with an inelastic demand and increasing prices the revenue of the oil producer was bound to increase. Candidates accessed the full range of marks through a number of routes, referring to Price x Quantity or drawing a diagram showing demand shifting to the right and therefore the revenue before and after.

Question 9e

Mean: 2.27 Standard Deviation: 1.87

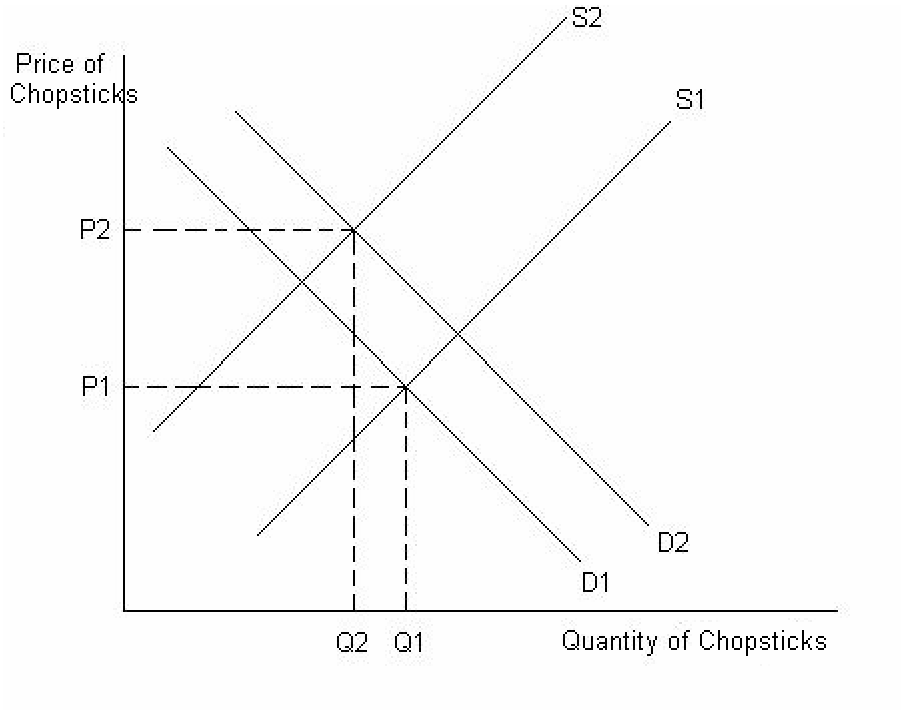
The majority of candidates were able to offer the correct formula/definition of price elasticity of supply but were not then able to draw the necessary conclusions to further their answer. Many for example could not discuss short run increases in supply and the reasons why these may have been limited versus long run increases in supply.

Evaluation might have considered the likelihood of oil producers increasing supply in response to a potentially short lived spike in prices, or that the price elasticity of supply for oil tends to be relatively inelastic in the short run due to the time lag in locating and extracting new sources of oil. Other candidates correctly discussed the use of stocks of oil (referring to the United States' strategic oil reserve) to mitigate the impact of higher oil prices on the demand for oil, although they correctly concluded that this would only be a short-term fix and it largely depended on the size of any stocks.

The weakest candidates completely misinterpreted the question and considered the price elasticity of demand for oil and discussed whether or not it was elastic or inelastic in demand.

Question 10a

Mean: 3.57   Standard Deviation: 1.32



Similar to the opening part of the question on oil, this required shifts in both the demand and supply curves.

The majority of candidates correctly shifted the supply curve to the left to reflect the increased taxation levels and then went on to shift the demand curve to the right illustrating the increase in demand referred to in the text.

Question 10b

Mean: 2.66   Standard Deviation: 1.38

Whilst candidates could see that the cost of chopsticks had risen, few necessarily were able to explain what the impact for restaurateurs would be. Candidates could have discussed the loss of revenue, loss of custom in response to higher prices, falls in profit, potential bankruptcy in the long run.

Evaluation was required in this question, and few candidates managed to achieve full marks in this higher order skill. Candidates could have discussed alternatives such as plastic and paper chopsticks, the ability to source chopsticks from alternative countries (Vietnam is mentioned in the extract), the option for government to subsidise chopstick imports or the proportion of total costs to a restaurant of chopsticks and therefore questioning whether or not there would be any impact at all.

A number of candidates eluded to the fact that Japanese consumers may wish to substitute disposable chopsticks for knives and forks.

Question 10c

Mean: 1.82 Standard Deviation: 0.98

Many candidates were able to correctly explain why there has been trade between China and Japan. Although there remain a sizeable number of candidates that are not able to define comparative advantage satisfactorily. An acceptable definition may read something like “If the opportunity cost ratios between two countries differ, it is mutually advantageous to specialise and trade”.

Candidates were expected to give reasons for China having a comparative advantage and then consider whether these would remain in the long-run or whether other factors would play a more important role in the future in determining trade between the two countries as part of their evaluation.

Question 10d (i)

Mean: 1.54 Standard Deviation: 0.77

Almost all candidates were able to explain the difference between a normal good and an inferior good in the context of income elasticity of demand. This question posed very few difficulties.

Question 10d (ii)

Mean: 1.23 Standard Deviation: 1.30

Most candidates could see that chopsticks were a normal good, and had seen a steady increase in demand despite fluctuations in income. Better candidates made the distinction between luxury and necessity goods.

Evaluation was required and this could have taken the form of a discussion as to whether or not chopsticks truly fitted the mode of over goods. Candidates were also able to discuss why chopsticks had exhibited the behaviour illustrated in figure 1.

Principal Examiner's Report 6352 – Markets – Why They Fail

January 2008

General:

This paper followed a similar format to those set in recent sessions with two data responses each containing stepped questions. The marking scheme was designed to ensure that the full range of marks could be accessed. In the event, the paper proved to be quite challenging. The mean score was 20.2 compared with 22.6 in January 2007. Nevertheless, the paper differentiated fairly well with a standard deviation of 6.1.

Question 1: The 2012 Olympics

(a) (i) With reference to Figure 1, explain two private costs of the 2012 Olympics.

This question was not answered as well as might have been expected: all too often the definition was imprecise and some of the examples were external costs rather than private costs.

(a) (ii) With reference to the second paragraph in Extract 1, suggest two reasons why the original estimated costs of the 2012 Olympics were inaccurate.

Most answers included two relevant reasons by making appropriate use of the material provided. To achieve full marks it was necessary to include a specific reference to the data and to offer some explanation of why the original estimates were inaccurate.

(b) With reference to Extract 1, assess the possible external costs arising from the 2012 Olympics. Illustrate your answer with a diagram.

Most responses showed an understanding of external costs but some lost marks through a lack of precision in their definition of the term. Diagrams were usually drawn accurately but the labelling was not always correct and the free market and socially efficient levels of output were not included in a significant proportion of responses.

A common weakness was the absence of any evaluation despite the requirement to "assess" in the question. Only the best answers discussed the relative importance of the external costs identified or considered the extent that the costs might be outweighed by the benefits.

(c) (i) Explain the potential private and external benefits arising from the 2012 Olympics.

The main weakness in some responses was an absence of definitions with the result it was often unclear whether the examples given were private or external benefits. Those answers which provided precise definitions often illustrated with relevant examples. However, many answers did not provide any explanations to support their examples.

(c)(ii) Examine two reasons why it is difficult to make an accurate estimate of the potential benefits of hosting the 2012 Olympics.

Most candidates were able to identify one problem involved in estimating the potential benefits, namely, the issue of quantifying and placing a monetary value on the potential benefits. However, relatively few responses included another reason although the issue relating to the likely number of tourists was clearly identified in the extract. Further, there was little evidence of evaluation in most answers.

(d) Assess the possible effects on the distribution of income resulting from the 2012 Olympics.

The most convincing responses considered the effects on the geographical distribution of income or between different occupational groups. However, a common problem was that many responses confused changes in the level of income with changes in the distribution of income. Indeed, relatively few answers provided a direct answer to the question, finding it difficult to apply the concept of income distribution to the context of the 2012 Olympics.

Question 2: The National Health Service

(a) Explain what is meant by the statement "The original underlying purpose of the NHS was the public provision of health care by a state run monopoly".

Many candidates were able to explain this statement in terms of the state being the sole supplier of health care. However, a sizeable proportion of responses focused on the legal definition of monopoly in terms of a 25% market share which was irrelevant to the context.

(b) (i) Apart from external benefits, analyse three reasons for the provision of health care by the state.

The most popular reason identified was that of equity. However relatively few candidates were able to discuss three reasons for state intervention and instead wrote about general issues relating to the NHS or medical issues. It was disappointing that only a small proportion of responses considered issues such as information gaps, economies of scale; monopoly/oligopoly; and asymmetric information. Candidates need to be aware of possible sources of market failure in different markets.

(b) (ii) Assess the private and external benefits arising from the consumption of health care. Illustrate your answer with an appropriate diagram.

The distinction between private and external benefits was usually made clear and diagrams were usually correct. However, as with question 1(b), labelling was often incomplete and the distinction between the free market and socially efficient production levels were omitted. Examples were sometimes rather sparse and there was some confusion between the private and external benefits. Evaluation was only rarely included even among the most convincing answers. Only the best responses included a discussion of short and long run benefits; the problems of measuring the benefits; or the opportunity costs involved in providing health care.

(c) Assess two possible economic reasons for the increase in government expenditure on the NHS since 1997.

The best responses included a discussion of issues such as an ageing population, the expense of modern drugs and new medical technology. Some answers made good use of the data by considering the increase in staff in the NHS and the increase in salaries. However, it was disappointing that relatively few candidates demonstrated relevant knowledge of health service issues. Many of these answers focused on general points such as inflation or rises in the National Minimum Wage. Evaluative comments were relatively rare in answers to this question, but occasionally a candidate would consider the relative importance of the reasons suggested, or comment on the short and long run consequences of the reasons identified.

(d) (i) Suggest one reason why it is difficult to measure performance in the health service.

This proved to be a challenging question. Nevertheless, some responses were very impressive. These answers considered an issue such as the problem of placing a monetary value on good health or by considering the range of targets used to assess performance and the problems involved in this process.

(d) (ii) To what extent does the information provided suggest evidence of government failure?

A pleasing proportion of candidates included a correct definition of government failure in terms of government intervention leading to a net welfare loss. Weaker answers simply referred to intervention 'making the situation worse'. Many responses provided appropriate examples from the passage to support the view that government failure was evident. However, evaluation was less common although the best responses referred to the increasing number of treatments being done as day cases and the reduction in treatment costs.

Principal Examiner's Report 6353/01 January 2008

The mean (24.0) was considerably higher than January 2007 (21.1) and there was a slight increase in the standard deviation to 7.7 (7.3). The reason for the increase in both can largely be explained by adjustments to the mark scheme, allowing marks to be awarded in a way which would fan out the marks, particularly in the upwards direction, to avoid the existence of 'dead' or inaccessible marks. The aim of the Principal Examiner was to try to head towards an A grade as near as possible to 80% (32/40) and the final decision rose towards that at 30/40. This leads to a better UMS conversion for the raw marks.

In general, most candidates made a reasonable attempt at what appeared to be a fairly testing set of questions. There were very few very low-scoring papers from unsuitable candidates, but there were also very few very high scoring papers because many obviously able, candidates were unable to sustain their high performance across all sub-sections. For example, Question 1(b)(ii) (impact on current account of productivity changes) and Question 2(c)(ii) (evaluation of spare capacity on the MPC interest rate decision) were not well-answered by the vast majority of candidates.

Question 2 was marginally more popular (55:45), but less so with the overseas entries, and it appeared that domestically and abroad many whole centres chose Question 1. It is presumed that in centres where candidates were told to read the essay question before starting the chosen question then the majority would choose Question 1.

The general perception was that the paper was challenging, and there were several places in which the wording of the question was glossed over by candidates racing to reproduce what had occurred in mark schemes for quite similar-looking questions in the past. It was clearly less helpful this year that the bold command words to evaluate had been removed in the later stages of editing. In January 2007 where there was a clear improvement in evaluation noted in the Examiner's Report thanks to the use of bold, but the removal of the bold this year meant that many did not observe the evaluation triggers.

Question 1

(a)(i)

Generally well done, with most candidates having a good grasp of the meaning of investment. Few gave a precise answer such as "*increase* in capital stock" (2/2 marks) and therefore more had to be written to find the marks. Many referred to capital goods or future productivity. Weaker answers were "spending on machines" or other rather too specific answers. There were many answers that tried to be too general however, and confused investment with saving, or included money market instruments.

It should be stressed to candidates that a short but precise answer is adequate for full marks.

(a)(ii)

Many scored full marks here, by using the data and describing it verbally. Occasionally a candidate would not use figures, but the usual reason for not getting the second mark was not giving a verbal explanation of the changes. Some estimates of investment were rather wild, and others had difficulty in deciding whether to compare start and finish points or to describe the changes throughout the whole year.

(a)(iii)

Generally very well done. Many earned 5/6 – two for the diagram; two for a transmission mechanism, and then one for the 4.6% data point. There are easy ways to increase marks, for example in mentioning the AS shift, or the multiplier.

It is evident that in whole centres candidates are showing the AS effects of a change in investment without mention of AD, which seems to be a fundamental oversight. Candidates should be encouraged to use the AD=C+I+G+(X-M) formula.

(b)(i)

Very few answers offered "**more** output from the same inputs" and although there was a mark available for the definition of productivity there was a soft marking of the subsequent analysis to allow for the sense of *increase.* Apart from economic growth arguments, which usually sprang from the notion of production rather than productivity, other "effects" in the mark scheme were seen rarely and it was not clear here that students understood the concept of measuring economic performance. It is important that candidates spell out the analytical process. For example, it is not necessarily true that growth or employment will rise when productivity rises; it may of course be that spare capacity increases (AS shift to the right).

(b)(ii)

There was a general failure to link the changes in productivity to the current account. Usually, those that did not start by explaining what was happening to productivity growth in Extract 2 went on to say very little of relevance and got 1/6 or 0/6. Very few got 6/6. Evaluation, as may have been expected, was virtually non-existent. Many simply addressed **causes** of low productivity rather than consequences, or indeed often discussed high productivity having missed the thrust of the data, although they could still pick up three of the four analysis marks if their explanation was clear.

(b)(iii)

The question afforded even the less confident candidates the opportunity to get some marks, and generally they took it. A high value of the currency was almost always used. The second point was varied: a relative inflation rate argument was popular, as was relative growth rates. Many of the other points on the mark scheme were rarely used. Many scored just 4/6 as the changes were not shown to be linked to the current account.

(c)

This essay question scored a higher mean than the equivalent part in Question 2. The best answers defined supply side policies and then drew a diagram straightaway to show the effects on the price level and real national output. Many could stroll through the policies with each being evaluated in turn. Only the very strong answers explained the resulting effects on the current account in each case. Many did not make a CAD reference at all and so were capped at 4/6. It does seem surprising that so many chose this question without having a basic understanding about the Balance of Payments.

Evaluation was standard – time lags; cost of policies; other policies are better; and sometimes the failure of supply side policies but it was encouraging to see some slight variation in the evaluation, e.g. privatisation has very little effect since most industries that would clearly benefit from being privatised have been, or that cutting the national minimum wage would have severe side effects on income equality. As usual some candidates did not evaluate.

Question 2

(a)(i)

As is often seen on 6353, there was seen the blurring of levels and changes in price levels. For example, that “the CPI is a measure of inflation”. For the weights reference some explanation of consumer spending patterns was required e.g. a proportion or importance reference. Many however were woolly:

Inflation in the UK is measured by attaching weights to goods. When a good is purchased its ‘weight’ value is calculated and the total weight for that good across the UK is found. These weights are then added and the inflation rate is decided upon by the MPC, whose job it is to control inflation. This method is called the CPI method (0 marks)

(a)(ii)

This was a surprisingly good discriminator question. A substantial number misread inflation as interest, or missed the request for just one reason and would go on to give two or even three shallow attempts. Another common weak response was "higher prices mean C falls and AD falls". Also 'A rise in inflation above 3% would increase the cost of goods, i.e. prices would go up. This could cause a detrimental effect on lower income families as they would not be able to afford basic necessities'. Many wanted to observe that the rise in inflation might affect the MPC's decision on interest rates, or indeed money market interest rates independent of the MPC, but they were rarely explicit about the interest rate, and went straight to the assumption that mortgage payments would increase. Ceteris paribus the real interest payment would decrease, so this was not allowed without the interest rate reference. Another example of this was "the rise in inflation would cause the monthly repayments on mortgages to go up" 0/3. Another common but weak answer stressed that the problem was serious but without giving any economic analysis: "A rise of inflation above 3% means the economy will be overheating and would cause it to collapse. This is a cause for concern".

The points expected in the mark scheme and implied in the text about those such as on fixed incomes was surprisingly rare, as was the requirement to send a letter to the chancellor. The more popular ones were the effect on international competitiveness; the erosion of the real value of saving/wealth; and the wage/price spiral.

(b)(i)

Many found this question easy to access, not least in that it have some microeconomic analysis which seems to be more accessible to the beginner Economist. Some of the weaker answers would go down the AD route and not even mention house prices, and some thought that the overall size of the mortgage would change, usually in an upwards direction! This ongoing confusion about the role of interest rates and mortgages does not seem to be diminishing, and a surprisingly large number thought that house prices would increase, confusing the cost of borrowing with the cost of housing perhaps.

(b)(ii)

This question was generally well done, and the better answers could include a look at AS as well as the transmissions mechanisms affecting AD. It was the "further analysis" that distinguished between the students. It is advised that whenever there is an AD shift that the multiplier is mentioned, and when there is a change that might shift both AD and AS then both should be explored, as there is no negative marking if one of the shifts is invalid.

(c)(i)

Most coped well here, although many wrote far more than was required. Brief but precise answers are generously rewarded. There was some reference to voluntary unemployment and frictional unemployment, which is arguably not *spare*. Many referred to the PPF and some referred to the backward L-shaped AS curve, which were perfectly acceptable. Analysis using the output gap was rare, but with its presence on the forthcoming Unit 2 specification an answer to a similar question might be expected to draw on this analysis.

(c)(ii)

This question relating spare capacity to the role of the MPC was probably the hardest question on the paper, and in future a phrase such as ‘bearing in mind the main responsibility of the MPC…’. Many saw the role of the MPC as an arm of the government, and that unemployment would be one of its concerns. For the few that saw the thrust of the question they then did not evaluate! Often answers would wax lyrically about the MPC without making any inflation reference at all. Very few drew from the data that there was slow wage growth. The key is to focus on the ability to allow lower interest rates in that the inflationary pressures are weakened, but then to evaluate this in that capacity constraint is just one of many inflationary pressures.

(d)

Although this was arguably one of the most difficult essay questions for some years, in that the case for not changing interest rates was hard to illustrate diagrammatically and semantically; it was clear that candidates had much to say about the ill-effects of rising interest rates and this tended to be the style of answers that were offered. Over half the candidates included a relevant diagram, while some described the impact of the rise in interest rates in words. There were few well-structured answers, but most candidates scored half marks or more—Most gave the aim of the MPC, often in passing. It does seem surprising that some chose this question without having an understanding about the MPC.

Many answers simply did not answer the question, and despite offering some creditable analysis the answers were not addressing whether rates should have been left on hold. Many candidates had difficulty in handling the evidence logically. Often candidates did not use the data and wrote out a set piece on the effects of changing interest rates. Few candidates gave a strong case for holding the rates, most preferring to focus on the problems caused by the rise in the rate and/or justifying the increase. As a result the evaluation marks almost always exceeded the “arguments” marks. It was so rare to find a candidate who would start a paragraph with “the MPC were right to keep rates on hold because…” and then go on to use some of the relevant data and explain why the data suggests that rates should not go up, with the explanation making links to inflation.

However the best candidates stood out quite clearly in their logical response to this question, so it was a good discriminator, allowing candidates to demonstrate their skills. It also turned out to be very topical in the light of the interest rate cut in December 2007, and those who referred to current economic developments were duly rewarded.

Principal Examiner's Report 6354 – January 2008

The examination paper was highly accessible and provided an effective means of differentiating between the qualities of candidate answers. The vast majority of candidates offered an explanation to all the supported multiple choice questions. Both data response questions proved popular with fifty-four percent of candidates answering Question 12 (The US Motor Vehicle Market) and forty-six percent attempting Question 11 (Price Fixing in the Air Travel Industry). It was pleasing to see many candidates use effective diagrammatic analysis in Q11e (price discrimination) and Q12c (a loss making firm).

The mean score for January 2008 (46.3) was lower than for January 2007 (47.8). The standard deviation for January 2008 (10.9) was slightly higher than for January 2007 (10.7).

Section A: Supported Multiple Choice Questions

These questions continued to be an effective differentiator to candidate responses and the full range of marks were awarded. A substantial number of candidates were very well prepared and demonstrated an excellent understanding of both the specification and the techniques involved in answering the questions. Many achieved scores over 30/40, providing excellent definitions, economic analysis and relevant application.

The key to success involves defining key concepts and applying appropriate economic theory and analysis. The use of diagrams when relevant is a good strategy for demonstrating a clear understanding of the issues at hand. Q1, Q3, Q6, Q7, Q8 and Q10 offered some scope for diagrammatic analysis.

As in previous years, candidates found some questions easier to answer than others. The three supported multiple choice questions which recorded the highest marks were Q5 (Advertising expenditure and contestability), Q1 (Perfect competition in the wheat market) and Q2 (Falling concentration in the newspaper industry).

The three supported multiple choice questions which recorded the lowest scores were Q3 (Falling marginal and average revenues), Q6 (Increasing variable costs in the dry-cleaning business) and Q7 (Break-up of Great Universal Stores).

As in previous examination series some candidates ran out of time. It is crucial for candidates to practice past papers under exam conditions to enhance their time allocation skills.

One interesting point to note is that in some centres many candidates attempted to gain marks by knocking-out incorrect options. Up to 2 marks are available for successfully knocking-out two incorrect options. However, mixed success was achieved here. It requires candidates to explicitly state the option key which is being knocked out and then to offer an appropriate explanation. Examples of how to successfully knock-out incorrect options are provided for each supported multiple choice question in this series. One can see that a certain skill is required and that it may be quite challenging.

Question 1 (B): Perfect Competition

Mean 3.27 out of 4 marks

This question was successfully answered by the majority of candidates who selected the correct option and outlined three or more characteristics of perfect competition; the most popular characteristics were free entry and exit to the industry, a homogenous product, price takers, perfect market knowledge and that supernormal profits are competed away in the long run leaving only normal profits. An outline of any three characteristics would lead to full marks as long as some application to wheat farming was made, for example, wheat might be considered a homogenous product.

Some responses also included a correct diagram of a perfectly competitive firm in short-run or long-run equilibrium position and this offered another means for achieving marks. A minority of candidates selected incorrect option ‘C’ (telephone services) but then proceeded to provide a sound explanation of perfect competition.

Some candidates successfully knocked-out one or more incorrect options, for example: *‘Option D is incorrect since banking services is in an oligopolistic market where a few large firms dominate the industry’.* This is a good example of how to knock-out an incorrect option.

Question 2 (E): Concentration in Newspaper Industry

Mean 3.23 out of 4 marks

This was another question answered well by the majority of candidates. Most responses started with an explanation of a concentration ratio (the combined market share of the largest n’ firms) and then proceeded to calculate the 3-firm concentration ratios for 1998 and 2006 (78.55% and 76.19% respectively). This was sufficient to achieve maximum marks.

Some candidates successfully knocked-out an incorrect option, for example:

‘Option B is incorrect since the daily circulation of quality newspapers decreased by 64,000’.

Question 3 (C): Average and Marginal Revenue

Mean 2.04 out of 4 marks

The examiners found it surprising that many candidates struggled to select the correct option. Often candidates achieved just one explanation mark for defining either marginal revenue or / and average revenue. A significant minority of candidates selected option 'B' suggesting that marginal revenue is falling at the same time as average revenue is rising. Although this option is incorrect, candidates often secured one mark by outlining that the gradient of the total revenue curve is falling (that is, marginal revenue is falling).

The most effective answers tended to offer diagrammatic analysis depicting both falling average revenue and marginal revenue curves as total output increased. Some responses pointed out that marginal revenue eventually falls to zero as total revenue reaches its maximum value on the graph. This was another good example of how the answer could be developed to achieve explanation marks.

Some candidates successfully used the knock-out technique, for example: '*Option A is incorrect since constant average revenue and marginal revenue would mean that total revenue is an upward sloping straight line from the origin*'.

Question 4 (D): Privatisation of the design and servicing division of British Nuclear Fuels Limited

Mean 2.70 out of 4 marks

Privatisation is not the most popular part of the Unit 4 specification but it was pleasing to read some excellent answers. It came as a surprise that most candidates selected the correct option and then achieved an explanation mark for defining privatisation, for example, 'the sale of state assets to the private sector' or 'the transfer of government industries to private sector companies'.

Further marks could be gained by explaining one or two 'benefits' of privatisation. Many ideas were accepted here. The most effective answers tended to make use of the data in the question, for example, the £3 billion revenue gained by the government which could be used to repay part of the national debt or for spending on the National Health Service. Other popular benefits included a discussion of potential increases in efficiency and lower prices for consumers through more effective management.

The successful use of the knock-out technique was evident in some responses, for example: '*It is not option B since x-inefficiency or managerial slack leads to higher costs of production and a worse service for consumers. The government does not want to achieve x-inefficiency but rather it wishes to reduce it*'.

Question 5 (C): Proctor & Gamble's advertising expenditure

Mean 3.28 out of 4 marks

The highest marks were recorded on this question and it reveals that many candidates have a good understanding of contestability and an ability to use the data in the table. Very few candidates selected an incorrect key.

The best answers defined contestability (a market with low entry and exit barriers, and thus, low sunk costs) and then identified advertising expenditure as a sunk cost. This was followed by reference to the bar chart depicting an increase in Proctor & Gamble's advertising expenditure on beauty products, from £71.3 million in 2001 to £134.3 million in 2006 – so reducing contestability.

Some astute candidates mentioned that advertising expenditure helps to create brand loyalty making it harder for firms to enter the market and gain customers. In a similar vein, candidates explained that new entrants would have to increase their advertising expenditure if they intended to compete with Proctor & Gamble.

The knock-out technique appeared in some answers, for example: *'Option B is incorrect since hit and run competition is a feature of a contestable market – where firms can easily enter a market to gain supernormal profits and then easily exit once these have been competed away'.*

In a similar light, '*Option B is wrong since advertising expenditure actually reduces the possibility of hit and run competition as it represents a sunk cost which cannot be reclaimed on exit'.*

Question 6 (A): Increased costs for a dry cleaning business

Mean 2.2 out of 4 marks

Although a challenging question it differentiated well between the quality of candidate responses and a high standard deviation was recorded here. Examiners were impressed by the large number of responses that successfully annotated the diagram in the question. Indeed, some candidates achieved full marks solely by diagrammatic analysis, for example, shifting the marginal cost and average cost curves upwards and then correctly identifying the higher equilibrium price and lower equilibrium output. This was followed by pointing out the original and new area of supernormal profits on the diagram.

It was still possible to achieve full marks without using the diagram but this required discussion of dry cleaning materials as a variable cost, impacting on marginal cost as well as average cost (as opposed to a fixed cost which only impacts on the latter).

A significant number of candidates selected the incorrect option B and only shifted the average costs curve upwards. This was awarded with one explanation mark, as the accompanying area of profits was incorrect.

A popular knock-out selection was option C, for example: *'Option C is incorrect since a fall in output, price and profit is more likely to be caused by a decrease in demand rather than an increase in costs. The increase in dry cleaning material costs puts pressure on the firm to pass on some these extra costs to customers in the form of higher prices'.*

Question 7 (A): Separation of GUS into Argos and Experian

Mean 2.24 out of 4 marks

Most candidates selected the correct key but often the explanation was limited. Nevertheless, some responses were credited with full marks by pointing out that increasing long run average costs are known as diseconomies of scale, illustrating it by diagram and then offering an example, such as poor management co-ordination within the company.

Some answers focused on the benefits for GUS by separating into two companies and specialising in the areas where resources are most suited. By splitting up, diseconomies are reduced, making each company more efficient. This was another valid approach.

A popular means of knocking-out an incorrect was the following: *'Option E is incorrect since a firm experiencing decreasing long-run average costs has little reason to split up into two companies. The split could even lead to a loss of economies of scale and worsen the position of both companies'.*

Question 8 (B): Minicab taxi firms operating in monopolistic competition

Mean 2.81 out of 4 marks

This was a traditional question applied to the context of minicab taxi firms. Most candidates had no problem selecting the correct key and explaining that the taxi firm is not operating at the output of productive efficiency ($MC \neq AC$) or the lowest average cost position. This was awarded with one explanation mark. By showing this on a diagram of a firm in long-run equilibrium under monopolistic competition, a second mark was awarded.

Unfortunately, very few candidates attempted an application of product differentiation to taxi firms, for example, by type of vehicle, opening hours, location and reliability. However, a third explanation mark could be gained by explaining that supernormal profits are competed away in the long run due to low entry and exit barriers.

The question was slightly more challenging since no marks were awarded for simply identifying a characteristic of a monopolistically competitive firm. Instead three characteristics were offered in the stem of the question and thus some explanation of each was expected.

However, knock-out marks offered an alternative route, for example: *'Options A and C are incorrect since a homogenous product is a characteristic of a firm in perfect competition, not monopolistic competition'.* This explanation is worth one mark, despite referring to two options since the reason offered is the same in both cases.

Question 9 (D): Abolition of price controls in telecom industry

Mean 2.67 out of 4 marks

Price capping has been a frequently tested topic on past multiple choice question papers and so most candidates were able to select the correct key. Furthermore, many proceeded to gain explanation marks by explaining the price capping formula (RPI-X or RPI+K) and the role of the industry regulator in terms of promoting competition and / or simulating conditions of competition to protect the public interest.

The best responses tended to explain the benefits of increased competition in the industry, namely, competitive prices and improved services and then linked this to new entrants such as Virgin mobile. This justified the removal of price controls as a competitive market now exists.

An example of an effective knock-out is: *'Option A is incorrect since the price capping formula is based on 'X' representing predicted efficiency gains for firms and not mortgage interest payments associated with the underlying rate of inflation'*.

Question 10 (B): Retail store cards and allocative efficiency

Mean 2.42 out of 4 marks

Most candidates selected the correct key but struggled to gain full explanation marks. This required an outline of allocative efficiency (in terms of the output position where price equals marginal cost) and that excessive charges on store cards reveal this has not been met. Indeed, the high interest rate charges mean that price exceeds marginal cost. Some candidates showed this by diagram, where the profit maximising price exceeds the allocative efficient price. This explanation was worth up to two explanation marks.

A third mark could be gained by explanation of the role of the Competition Commission in terms of protecting the consumer / public interest. In this case, it required measures to limit interest rate charges so that lower profits are made and consumers receive a better deal.

Suitable knock-out answers often focused on option 'D' for example: *'D' is incorrect since the intervention of the Competition Commission is to force retailers to reduce interest rate charges on their store cards. This would directly reduce profitability as a lower interest rate means a lower price for credit'.*

Section B: Data Response Questions

Both data response questions were popular choices with candidates. Fifty-four per cent opted to answer Q12 and forty-six per cent selected Q11. The mean score for Q12 (20.29) was marginally higher than for Q11 (19.55). In each data response, many candidates struggled to handle economic efficiency and inefficiency (Q11c and Q12d).

Question 11 Price Fixing in the Air Travel Industry

Q11 (a)

Explain the functions and powers of the Office of Fair Trading in the regulation of UK firms.

Mean 3.88 from 6 marks

The best answers tended to distinguish between the functions and powers of the Office of Fair Trading (OFT).

The most popular ‘functions’ included reference to investigating allegations of anti-competitive practices and the abuse of monopoly power. Sometimes examples were provided, such as investigating price fixing, or restricting rival firms access to raw materials or market outlets. Some candidates demonstrated an awareness of the current investigation into the supermarket sector.

Another valid ‘function’ mentioned in some answers is the referral of cases on to the Competition Commission for further investigation.

The most popular ‘powers’ included reference to the extract where guilty firms can be fined (up to 10 per cent of annual global turnover) and Directors face prosecution through the criminal courts.

How to Improve

Ensure the answer is relevant: unfortunately some candidates confused the role of the OFT with that of an industry regulator such as Ofcom, spending a lot of time explaining the intricacies of price capping.

Ensure candidates explain both the functions and powers of the OFT. All too often candidates did not differentiate between the two.

Q11 (b) (i)

To what extent does the information provided indicate that airlines have entered into price-fixing agreements?

Mean 3.21 from 6 marks

The most effective answers made use of the information provided, for example, identifying that British Airways and Virgin Atlantic's air fares were identical for seven of the ten destinations and that fuel surcharges were increased at the same time and by the same amount. Similarly, candidates were able to call upon the extract where Noel Josephides reported suspicions of price fixing. An awareness of the oligopolistic nature of the industry and accompanying possibility of collusion was often reserved for the stronger responses.

How to improve

Ensure that some evaluation is offered. This might take the form of discussing why price fixing may not have occurred, for example, the firms may have responded to rising oil prices or that fierce price competition could lead to identical air fares on selected routes.

On the other hand, some well read candidates referred to the fact that British Airways has pleaded guilty and been fined since the article was written. This warranted marks and demonstrated the importance for candidates to keep up to date with current affairs.

Q11 (b) (ii)

Apart from price fixing, explain one collusive practice that firms in an industry might undertake.

Mean 1.45 from 3 marks

There were some excellent answers, with different types of collusion offered, for example, allocation of market shares, information sharing, exclusivity deals between manufacturers and retailers, and agreements to limit advertising expenditure. The most popular responses referred to output agreements such as those used by the Organisation of Petroleum Exporting Countries. Here, candidates often explained how each member country is allocated an output quota on the basis of its known oil reserves, the intention being to restrict market supply and raise price and profits.

Some candidates referred to tacit collusion. This was accepted as long as the focus was on non-pricing forms of tacit collusion. However, the notion of a price leader in an industry with other firms following (without making any contact) was credited.

How to improve

Ensure the choice of collusive practice is valid. Some candidates suggested limit pricing and predatory pricing as types of collusive practices. These were regarded as inappropriate selections and consequently, no marks awarded.

Q11 (c)

Assess the likely impact of collusive practices on economic efficiency and consumer welfare.

Mean 4.03 from 10 marks

Many candidates struggled to consider the impact of collusion on both economic efficiency and consumer welfare. A lot of responses hardly extended beyond discussion of the meaning of economic efficiency and consumer welfare.

However, there were some excellent answers, for example:

'Collusive practices are likely to reduce economic efficiency in an industry since it leads to a reduction in competition. Firms may agree to fix a high price and so guarantee high profits. There is little incentive to keep production costs down and so x-inefficiency may creep into the business; similarly, firms may not be too concerned with improving customer service or product quality if they have guaranteed sales and so leading to allocative inefficiency. Price is likely to be set well above marginal cost in order to exploit the profits.

Consumer welfare is likely to be harmed since firms charge higher prices in collusion than in competition – leading to a reduction in consumer surplus. This appears to be the case with transatlantic air fares which are very high compared to other flights. Moreover, if the collusive practices involve erecting entry barriers, there is a lack of consumer choice. As competition is limited, then over a long period of time the industry may lack investment and innovation, further undermining product development'.

In order to achieve full marks, some evaluation was required. It was very pleasing to read the large number of answers that referred to the idea of firms re-investing profits into the business, and so improving product quality and development. They suggested that collusion could possible improve consumer welfare.

Further variants of this theme included reference to stability within an industry, so guaranteeing supplies, product quality and certainty. Other responses suggested that price fixing could actually lead to fierce competition through non-price means such as a focus on product differentiation and improved customer services in air travel. Sometimes reference was made to exclusive check-in procedures, VIP lounges and luxury travel services offered from home to airport.

Some candidates offered application to different markets such as sportswear, independent school fees, vitamins and glass manufacture. These were valid responses.

How to improve

Ensure that both economic efficiency and consumer welfare issues are addressed. An overlap exists between them but a deliberate attempt at investigating each is required.

Explain the meaning of each term – as marks are usually available for this and it helps to focus the answer.

Offer evaluative comments.

Q11 (d)

Examine the likely effectiveness of one measure the competition authorities might undertake to increase the contestability of the air travel market between London Heathrow and the United States.

Mean 2.04 from 6 marks

Overall, many candidates struggled with this question. Yet marks were available for explaining the obvious way to increase contestability in the transatlantic air travel market, namely, ending the agreement on flight slots being controlled by a few airline companies.

Marks were also awarded for demonstrating an understanding of contestability and its application to the transatlantic market. For example, by offering flight slots to more airlines and restricting those held by the major carriers, market entry should become easier. It might even be possible to increase the number of flight slots if more night flights were permitted.

As usual, there were some excellent answers which included evaluation. These responses investigated other possible barriers to the transatlantic route in terms of obtaining suitable aircraft and pilots, getting a civil aviation licence and arranging suitable destinations in the US.

How to improve

State the obvious and use the data in the extract. The British and American governments could permit more companies to fly transatlantic routes through an open skies policy.

Explain the key term in the question, that is, contestability.

Q11 (e)

With reference to Figure 2, evaluate the use of price discrimination as a means of raising the profitability of an airline company. Illustrate your answer with diagrammatic analysis.

Mean 4.94 from 9 marks

Many answers offered sound diagrammatic analysis and application. Clearly, price discrimination is a popular topic in the specification. It has been tested on previous papers and most students were up to the task.

The two sector model proved popular with candidates along with relevant explanation of the conditions necessary for price discrimination to be successful. These included reference to market power, market separation and different price elasticities of demand between the market segments.

The main drawback appeared to be a lack of time for candidates to do justice to the model.

How to improve

Ensure diagrams are correctly drawn and labelled; a higher price should be evident in the market where demand is inelastic. Use the data in Figure 2 to explore how price elasticity of demand may vary over time and how consumer surplus may be captured.

Question 12 The US Motor Vehicle Market

Q12 (a)

With reference to Figure 1, describe the changing market shares of US and Japanese motor vehicle manufacturing firms from 1998 to 2006.

Mean 1.97 from 3 marks

The vast majority of candidates identified the trends of falling US motor vehicle and rising Japanese motor vehicle market shares. The best answers calculated the overall trends. For example, the US market share fell from 70.0% to 54.8% and Japanese market share rose from 15.0% to 32.2% between 1998 and 2006.

How to improve

Use the data when prompted by the question.

Q12 (b)

Discuss one reason why many motor vehicle manufacturing firms have become multinational companies.

Mean 2.50 from 5 marks

Many answers were not convincing since they focused on economies of scale as the main reason why a firm might seek multinational status. Often these responses just concentrated on economies of scale from production of motor vehicles in one country which are then exported to other countries. However, the examiners regarded a multinational company as a firm with production facilities in more than one country. Consequently, it was necessary to link economies of scale to production in different countries.

The best responses tended to consider the benefits a firm might achieve from lower production costs, for example, lower wage costs, higher productivity and cheaper raw materials. New motor vehicle plants in Europe have tended to locate in relatively low wage economies such as Hungary and the Czech Republic.

Another valid approach was to consider the benefits of increased motor vehicle sales by accessing markets that have import controls. A way to overcome tariffs is to locate production facilities within the country and so be classified as a domestic firm.

How to improve

Avoid common pitfalls by thinking through a reason for becoming a multinational company.

Q12 (c)

Using diagrammatic analysis, explain how 'rising costs and falling demand' have caused a large US motor vehicle manufacturing company such as GM to make a loss (Extract 1, lines 3 and 4).

Mean 3.20 from 6 marks

The diagrams offered by candidates were often messy but reflected the requirement to demonstrate shifts in both cost and revenue curves. Examiners were careful to look at key points in the diagram, for example, an upward shift in the average cost curve and a downward shift in the average revenue and marginal revenue curves. The end result required a loss to be shown. Up to four marks were available and a great number of candidates achieved this. It was also totally acceptable to show two separate diagrams to deal with each shift in the curves.

How to improve

Somewhat ironically, many candidates did not identify the reason for the increase in costs (high wage costs and healthcare costs for employees) or the decrease in revenue (Consumers switching to more fuel efficient models produced by Japanese motor vehicle companies) and so failed to achieve two ‘easy’ marks. It is good practice to briefly explain diagrams, especially shifts in curves.

Q12 (d)

Examine the significance of one type of economic inefficiency that is likely to affect US car manufacturers.

Mean 2.31 from 6 marks

Overall, many candidates appeared to struggle with questions on efficiency and inefficiency. Yet it was easy to achieve one mark by simply identifying a type of inefficiency. A further three marks was available for explaining and applying the inefficiency to US car manufacturers. The information provided gave support here, for example, Figure 2 shows assembly hours per vehicle are higher for US firms than Japanese firms, implying productive inefficiency. Similarly, the extract points out that US cars cost on average $2000 - $2500 more than their Japanese counterparts.

Another two marks was available for an evaluative comment, for example, Figure 2 shows that US motor manufacturers were reducing assembly hours per vehicle at a faster rate than Japanese firms. In other words, the US firms were reducing their inefficiency.

How to improve

Refer to the data as a source for explanation, application and evaluation.

Q12 (e)

Evaluate two strategies a US car manufacturer such as Ford might use to reduce its losses.

Mean 5.13 from 10 marks

This was generally well answered, with many candidates opting for advertising to increase revenue and redundancies to reduce labour costs. Often the strategies were well explained and some attempt made at evaluating them.

Another popular strategy was discussion of product quality improvements and innovation. This was highly relevant, bearing in mind the need for US firms to change the type of vehicles produced.

How to improve

Be careful over choice of strategies. Some candidates referred to pricing policies, such as sales maximisation, limit pricing and even predatory pricing! Generally, these were seen as unsuitable in the context of companies already making huge losses.

Q12 (f)

Discuss the entry barriers that Chinese firms may face in selling cars in the US motor vehicle market.

Mean 5.18 from 10 marks

This was a very popular question and there were many excellent answers. Examiners were looking for up to three entry barriers - well explained, to award up to six marks. A whole range of valid obstacles were offered, for example, high start-up costs, advertising and strong brand loyalty, the difficulty of establishing a nationwide network of dealerships, import controls, environmental regulations and limit pricing.

The best answers offered two or more evaluation points and so secured maximum marks.

How to improve

The main limitation appeared to be one of time allocation. It is better for candidates to concentrate on analysing and evaluating just two or three entry barriers rather than go for a general sweep of points. This is all the more important bearing the time pressures associated with this paper.

GCE Economics Grade Boundaries

6351	Max Mark	A	B	C	D	E
Raw	40	31	27	24	21	18
UMS	90	72	63	54	45	36
6352	**Max Mark**	**A**	**B**	**C**	**D**	**E**
Raw	40	24	21	18	15	13
UMS	90	72	63	54	45	36
6353	**Max Mark**	**A**	**B**	**C**	**D**	**E**
Raw	40	30	26	22	19	16
UMS	120	96	84	72	60	48
6354	**Max Mark**	**A**	**B**	**C**	**D**	**E**
Raw	80	54	47	41	35	29
UMS	90	72	63	54	45	36

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