Examiners' Report/
Principal Examiner Feedback

Summer 2013

International GCSE Economics (4EC0)

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General comments

In this report I am going to attempt to concentrate on those areas of the specification and their associated questions which, in this summer's paper, have given cause for concern. Particular areas of the specification which appeared to cause the most serious problems for students included:

- the importance of price elasticity of demand in the pricing decisions of firms,
- regional policy,
- the relationship between inflation and prices,
- the relationship between interest rates and inflation,
- the relationship between inflation and balance of payments,
- exchange rates.

Specific comments

Question 1

(a)(i)(ii)(iii)(iv) Demand and supply is a topic fundamental to Economics. Questions which refer to shifts in the demand and supply curves should have posed few problems but there were still some who thought that crude oil was obtained from agricultural sources e.g. palm oil. Demand factors were more easily identified than supply factors, the most popular responses referred to increased incomes and population and increased use of cars.

(bi)(ii)(iii) Infrastructure and opportunity cost are economic terms which were familiar to the majority of students. Apart from some confusion between subsidies and substitutes students could usually define a subsidy: *"an amount of money given by a government to a firm to reduce the costs of production".*

(ci)(cii)(ciii) Students showed a good understanding of price elasticity of demand, its definition and the factors determining it. However they had more difficulty applying their knowledge to its role in the price making decisions of firms. In the specification attention is drawn to the link between price elasticity of demand and total revenue. Some teachers are disadvantaging their students by choosing to ignore this relationship. A good response is given below.

"Knowledge of price elasticity of demand for products helps firm to generate higher total revenue. If firms know that their products have elastic demand, they will reduce the price of their products. The relative increase in quantity demanded is greater than the fall of the price. The total revenue will increase. On the other hand, if a firm's products have inelastic demand, they should increase the price because a rise in price is greater than a decrease in quantity demanded. So their total revenues will rise.

However, price decisions made by firms can also be influenced by other factors. For example in a price war, firms may decrease their prices to attract more consumers and gain market share irrespective of the elasticity of demand. Changing costs may lead to price changes so that firms maintain profit levels. This shows that price elasticity of demand is important but is just one of many factors a firm will look at when setting its price."

(di)(dii) No problem with defining a mixed economy. Unfortunately, even after years of emphasising in this report that teachers should use examples from their own economy, few students could give little more than a basic account of the characteristics of public and private sectors.

"Spain is a mixed economy. In recent years there has been a move towards a free market economy as many state owned firms have been privatised e.g. Iberia Airlines. Privatisation increases competition and efficiency and raises revenue for the government. There are still some state owned firms e.g. RENFE (railway network) and Correos (postal service). Their primary aim is not to make a profit, unlike the private sector firms, but to provide a public service.
Private sector firms include many foreign multinationals e.g. the fast food chain McDonalds and also domestic firms e.g. the large bank, Santander. These exist to make a profit for their shareholders.
Some parts of the economy are owned and run by both private and public sector firms e.g. schools and hospitals.
As the economy of Spain declines so the government will sell off more and more state owned firms and the economy will become more a free market economy but it will still be known as a mixed economy as the state will still provide public and merit goods."

Question 2

(ai)(aii)(aiii)(aiv)(av) Straightforward questions which created few problems for students.

(bi)(bii) Monopoly is so well taught that students seem to spend more time explaining why they may be considered a disadvantage for consumers rather than an advantage. The more able students also referred to the merits of natural monopolies and government intervention.

(ci)(cii)(ciii)(civ) A set of questions designed to give the weaker students confidence in their ability to complete the paper.

(di)(dii) Explanations of government incentives in the form of loans and grants produced positive results. The most popular other incentives identified by students included education and training of workers, improved infrastructure and tax holidays.

(diii) Despite the knowledge displayed in (di)(dii) students could not analyse why these government incentives should be used in regional policy nor the disadvantages of regional policy. Their lack of understanding is a cause for concern especially as so many did not even attempt this question. Regional policy does appear on the specification:

Section B: 3 Public and private sectors: Government regulation: To influence location of firms: solution to regional problems of unemployment, congestion, income inequality.

Students depend on teachers and textbooks to guide them. Current iGCSE textbooks include regional policy. Teachers need to ensure that they don't fail their students by ignoring this topic. An excellent response is given below.

"Regional policy can overcome problems such as unemployment and/or congestion in certain parts of a country. Relocating firms to areas where older industries have closed will help solve the unemployment problem in these areas. It might also help in reducing income inequalities in the country. If firms are encouraged out of congested areas this would leave those areas with cleaner, healthier environments for the people who live there.
However regional policy, like giving loans and grants to firms, has an opportunity cost. Instead of spending it on education and healthcare or infrastructure for the whole country it is spent on just one region. Another disadvantage is that firms may fail when government incentives are withdrawn so the area may not benefit in the long term.
Overall, regional policy can lead to increased employment, decreased pollution, greater economic growth for the whole country not just particular regions. The drawbacks depend on how much the policy costs the government, how the money is raised and how successful it is in solving the problems of the region. Sometimes policies like giving advice, granting planning permission and reducing red tape are just as effective and don't cost a lot."

Question 3

(ai)(aii) Whilst students could define inflation few could apply the data in Figure 3a to prices. Too many thought that between April 2011 and July 2011 prices in India fell. Whilst inflation was falling between these months it was still positive so prices were rising but at a slower rate.
(aiii) In order to score marks students needed to know the difference between a borrower and a lender - many did not!
"During inflation as prices rise the value of money falls and so does its purchasing power. This is a disadvantage for lenders as the money they receive back from borrowers has less purchasing power than when it was loaned to the borrowers. The lenders can buy fewer goods and services with the money when it is returned. On the other hand borrowers have the use of the goods and services bought at a lower price with the borrowed money and pay back less in real terms. So the borrowers gain and the lenders suffer.

Lenders usually add interest to loans. If the lenders set the rate of interest higher than the rate of inflation then the borrower won't benefit. The lender will be compensated by the interest payments on the loan and will be able to purchase the same amount or even more when the loan is repaid. In this case borrowers will suffer. If during inflation, borrowers' incomes don't rise then they may find it difficult to repay the loans. In this case both borrowers and lenders are losers."

(bi)(bii) Figure 3b showed the interest rate in 2011. It changed 6 times not 12!
Figure 3b also showed a rise in interest rates throughout 2011 whilst in Figure 3a inflation fell and then increased. Students required an understanding of the relationship between interest rates and inflation. Too many students simply listed the changes in interest rates and inflation throughout the year with no attempt to show any understanding of the relationship between the two.

"In January - March 2011 India was experiencing falling inflation 9.47% to 8.82%. The government probably thought that inflation was under control and kept interest rates at 6.5%. However it thought it necessary to increase interest rates in March to 6.75%. This might have been due to the fear of demand pull inflation. A rise in interest rates makes borrowing more expensive and should reduce demand. From March to December interest rates rose from 6.75% to 8.5% but the impact on inflation was varied. It peaked in September at 10.06% but fell to 9.2% in December. The government might have decided that interest rates alone could not control inflation or that it was due to increased costs (cost-push inflation) rather than excess demand in the economy. Unfortunately, for governments, changes in interest rates may be subject to time lags so the results are not seen immediately. The increases in interest rates over 2011 from 6.5% to 8.5% may be the reason why inflation fell from 10.06% its highest level in September to 9.20% in December but more data would be needed to confirm this."

(ci) Reducing unemployment and protection of the environment were the missing economic objectives.

(cii)(ciii)(civ)(cv) Students performed well on this set of questions relating to the current account of the balance of payments.

(cvi) Too many students were unprepared for this question and had little idea about the relationship between inflation and the balance of payments. Unfortunately some of those who did understand the relationship wasted precious time writing about the effect of inflation instead of <u>falling</u> inflation on the balance of payments.

"Reducing inflation will make the price of exports appear lower to buyers. The demand for exports will increase. At the same time imports will appear more expensive than domestic goods and services so the demand for imports will fall. Therefore reducing inflation could increase exports and reduce imports, as a result the balance of payments improves. However, it is not always the case. If inflation is still higher than in other countries then exports may still be relatively more expensive and imports cheaper. If imports have no domestic substitutes then they will still be bought by domestic consumers. If the government wants to improve the balance of payments then controlling and reducing inflation is important but the government may also need to use some protectionist measures e.g. tariffs."

Question 4

(ai)(aii) Few problems were encountered.

(aiii) Teachers need to acknowledge that students become easily confused with the terms appreciation and depreciation and must address this problem in their teaching of exchange rates.

(aiv) The topic of exchange rates has not been taught well in many centres. The basics need to be understood:

> July 2011 1GBP could be exchanged for 71.9INR
> December 2011 1GBP could be exchanged for 82.8INR
> The GBP has <u>appreciated</u>, it can buy more INR. The INR has depreciated.
> Indian goods are now cheaper to people in Great Britain (GB).
> More Indian goods are demanded by people in GB so Indian manufacturers sell more goods.
> This is an advantage for Indian manufacturers.

Further development of this question could have included reference to elasticity of demand and its effect on revenue, the possible rising cost of imported raw materials into India due to the change in the exchange rates. Far too many students thought, incorrectly, that when goods are exported to Great Britain (GB) the British importers pay the Indian manufacturers in GBP which the Indian manufacturers then change into INR and therefore gain because of a better exchange rate. These students did not understand that the importers of Indian goods into GB would pay the Indian manufacturers, by bank transfer, in INR.

(bi)(bii) Most students understood the data in Table 4a and used it to show that despite international debt being lower in the Central African Republic, it causes a greater problem than in China.

(biii) Few incorrect responses.

(biv) Some excellent responses to this question which reflects good teaching by centres.

"International borrowing can be used by the country to increase economic growth. This can be done by using the loans to improve infrastructure, develop a skilled labour force, improve existing industries and set up new firms. The standard of living in the country will improve as more people are employed and education improves. The government may also use the loan to improve the health service to achieve a healthy and productive workforce.
The main disadvantage is that the debt has to be repaid usually with interest. If the government hasn't spent the loan on increasing the country's productive capacity but has spent it on importing guns and tanks then it may find it difficult to repay the loans. It may be forced to borrow more to repay previous debts. The country would suffer as it falls deeply into debt. Sometimes developed countries agree to cancel the debts to developing countries but this is not always the case so borrowing might cause more problems than benefits."

(ci) Usually students could only identify one characteristic of a customs union: free trade without barriers e.g.no tariffs between members. The other main characteristic is the Common External Tariff applied to non members. The most popular <u>incorrect</u> responses stated that members of a customs union had to:

- pay huge amounts of money to be a member,
- had to be near each other,
- have NO trade with countries outside the union,
- have the same currency and free movement of labour.

(cii) Students who concentrated on the advantages and disadvantages of free trade were able to score up to 4 marks. Those who could adapt their responses for a customs union could achieve maximum marks.

"Joining a custom union makes imports cheaper to the country as barriers like tariffs and quotas are abolished. This leads to an increase in exports because countries in the union trade more with each other. Firms will have larger markets and so might expand and this could lead to lower unemployment.
However, joining a customs union can result in too many imports into the country, this could worsen the balance of payments. Moreover, domestic firms will face higher competition from other firms in the union. They might not be able to compete and have to be closed down leading to unemployment. This will worsen the balance of payments even more as there are now fewer exports.
On balance, joining a customs union has the main advantage of increasing trade between members but this may be outweighed by the decline of domestic firms if they are unable to adjust to competition. The loss of markets outside of the customs union should also be taken into consideration as countries outside the union have to face high customs duties and other barriers to trade and may retaliate and impose similar barriers to goods and services exported from the union."

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