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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

ECONOMICS **9708/04**

Paper 4 Data Response and Essay (Supplement)

May/June 2004

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.
Write your Centre number, candidate number and name on all the work you hand in.
Write in dark blue or black pen on both sides of the paper.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Answer Question 1 and any **two** questions from Section B.
At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

You may answer with reference to your own economy or other economies that you have studied where relevant to the question.

This document consists of **3** printed pages and **1** blank page.

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Section A

Answer this question.

1 The following is adapted from an article which appeared in a newspaper in August 2002.

Lower earnings in the US could endanger economic recovery.

Although the recession has ended, the wage rates of more than 100 million workers in the US below management level have remained unchanged for over a year, and this is endangering consumer spending. The effect on spending is particularly noticeable because there has been a loss of overtime hours, which has decreased earnings. In addition, 1.7 million jobs have been lost in the past year and the unemployment rate is now 5.9%.

Employers faced with falling profits have cut their costs. They have stopped paying for health insurance for their employees. These charges are now deducted from their employees' earnings, which further reduces consumer spending. Some workers have tried to resist downward pressure on their earnings. 2700 workers in a food company were on strike for six weeks. At the end of the strike the company did agree to pay for the health insurance rather than pass the cost onto the workers. However, in a weak economy with unemployment rising, the bargaining power of other wage earners has diminished.

On the other hand, not everyone fears that consumer spending is likely to fall. According to the US Government's Commerce Department, a broader measure of personal income, which includes items such as social security benefits and unemployment benefits as well as wages, has shown an increase. Some argue that this increase is enough to generate a recovery in the economy. But if a broader picture is to be taken then any income earned from the stock market should also be included, as this is a huge source of income in the economy. Since the late 1990s this source has shrunk considerably.

It is, therefore, uncertain whether all these changes balance each other out or whether there will be a sufficient increase in consumer spending to generate a recovery. It also partly depends on how the workers view the changes in their earnings and how long they think the current situation will last.

(a) US workers experienced a fall in disposable income. Identify **three** reasons from the article why this occurred. [3]

(b) **(i)** Why was the cost of health insurance passed onto the employees by some employers? [2]

(ii) Why might the food company have agreed to continue paying for their employees' health insurance? [3]

(c) Discuss the reasons for the disagreement about the likely changes in consumer spending. [6]

(d) Analyse how lower earnings could endanger economic recovery. [6]

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Section B

Answer any **two** questions.

2 **(a)** Explain what is meant by the income and substitution effects of a price change and discuss why these might be different for different types of goods. [12]

(b) Discuss whether marginal utility theory is a realistic piece of economic analysis in explaining consumer demand. [13]

3 Discuss the similarities and differences between a firm's behaviour in perfect competition and oligopoly. [25]

4 In 2002 in the UK public sector fire-fighters threatened to go on strike because they stated that their earnings were very low compared with other workers. In the same year Robbie Williams, a singer from the UK, signed the largest ever recording deal in the music industry, worth millions of pounds.

Discuss whether the economic theory of wages can explain how workers in a vital industry such as the fire-fighting service can have lower pay than workers in a less vital industry such as entertainment. [25]

5 In many cities the level of traffic congestion is causing increased concern.

(a) Discuss whether the existence of traffic congestion in cities might be considered as evidence of market failure. [12]

(b) Analyse what might be done when market failure does exist. [13]

6 'The rise in interest rates might not have the desired effect of curbing the existing inflation' reported a newspaper in 2002.

(a) Explain what effect a rise in interest rates might have on the level of total expenditure. [12]

(b) Discuss what policies apart from interest rate changes a government might use to control inflation. [13]

7 **(a)** Explain what indicators suggest that an economy is developing rather than developed. [12]

(b) In Johannesburg in 2002 there was an international conference, the World Summit on Sustainable Development, to discuss the use of the world's resources and the best ways governments can help to promote environmentally friendly development.

Analyse how the policies adopted by a developed economy may affect the standard of living in a developing economy. [13]

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Question 1 *International Herald Tribune: Business Section August 12th 2002*.

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