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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essay (Supplement) **May/June 2010**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

2581843635

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Section B
Answer any **two** questions.

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Section A

Answer this question.

1 **Interest rates, inflation and growth**

Between 1 July and 1 October 2007, the GDP of the US rose at an annual equivalent rate of 4.0%. This was faster than the forecast rate of 3.1%. The rise was caused by an increase in consumer spending and by rising exports.

By November 2007, however, there were increased signs of a housing market slump, a rise in oil prices and a fall in the value of the US dollar. These changes presented the Federal Reserve (the US central bank) with a problem about interest rates.

The Federal Reserve had already cut interest rates in October 2007 and it reduced the interest rate again in November in order to help defend the US economy against the worsening housing market.

Further interest rate cuts were thought unlikely, as there was anxiety over the rising price of oil, which by November 2007 had reached a record level. The Federal Reserve said 'recent increases in energy and commodity prices may result in further inflation'.

A difficult balance: conflicting policy objectives

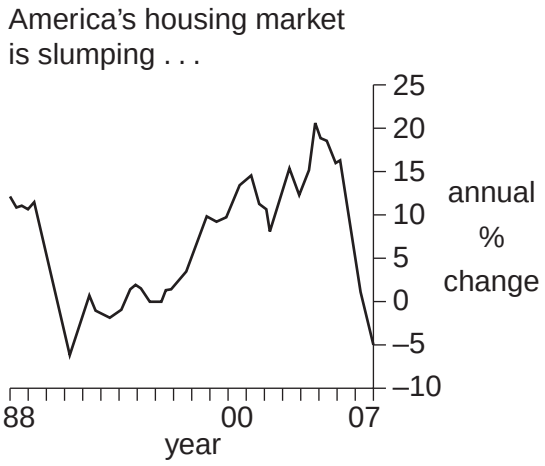


Fig. 1: House price index

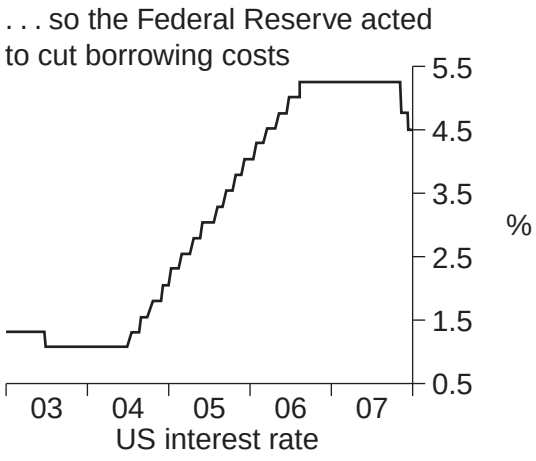


Fig. 2: US interest rate

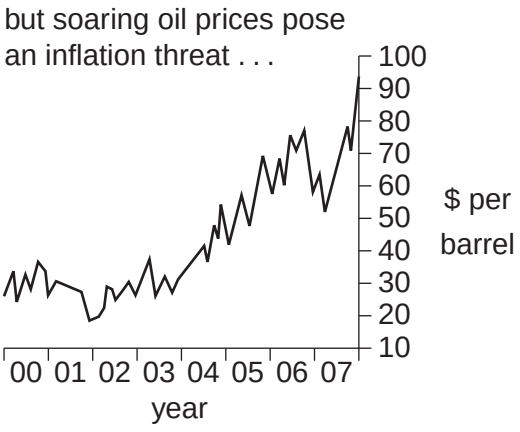


Fig. 3: US crude oil price

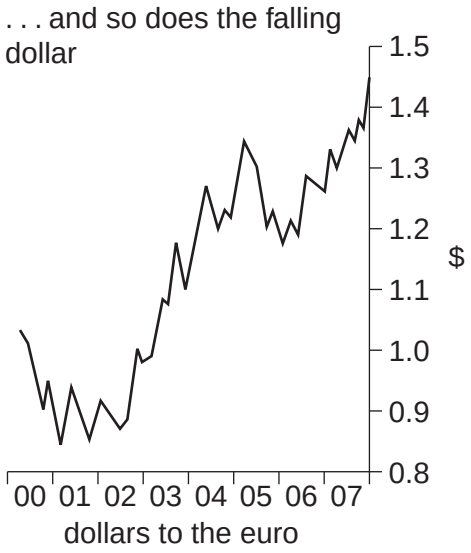


Fig. 4: Dollars to the Euro

(a) Name **two** components of aggregate demand **not** mentioned in the first paragraph of the extract. [2]

(b) Calculate the percentage increase in the GDP of the US between 1 July and 1 October 2007. [2]

(c) Why does Fig. 4 refer to a 'falling dollar' when the trend of the line is upward? [2]

(d) Discuss the likely effectiveness of a reduction in interest rates as a solution to a housing market slump. [6]

(e) To what extent does the data support the view that the US economy was facing 'conflicting policy objectives'? [8]

Section B

Answer **two** questions from this section.

2 **(a)** Explain what is meant by an efficient market equilibrium. [12]

(b) Discuss how the market mechanism might fail in the allocation of resources. [13]

3 In 2007 the cost of a single ticket on London trains bought at the time of travel was £4. The same ticket bought in advance was £2.50 if used up to 19.00 hrs and £2 after 19.00 hrs. Children could travel free at any time, and those over 60 could travel free after 09.00 hrs.

(a) Explain what is meant by price discrimination and analyse what evidence there is of price discrimination in the above statement. [12]

(b) Discuss how the output and pricing policy adopted by a firm might differ depending on the market structure in which it operates. [13]

4 'The level of wage rates is not satisfactorily explained by economic theory because that theory concentrates on perfect competition while most labour markets are imperfect.'

Discuss whether this claim is true. [25]

5 For some years governments of developed countries have been promoting Fair Trade, which means paying a fair price for primary products bought from African developing countries. Now the governments in developed countries, anxious to conserve resources, are complaining that the transport of products around the world increases pollution and should be limited. They support instead the purchase of goods produced at home. These are often more expensive to produce. African farmers may be left with products that their local people do not eat.

(a) Explain what might determine whether a country is classified as developed or developing. [12]

(b) Discuss whether the old and the new approaches to trade of the developed countries would help achieve the conservation of resources. [13]

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6 **(a)** A firm undertakes a major investment. Analyse why in a closed economy without a government the increase in national income from this investment might be higher than in an open mixed economy. [12]

(b) Discuss the policies that a government might use to influence the level of investment in an economy. [13]

7 Economic analysis adequately explains how a rational consumer determines a pattern of consumption from a given income in a perfect market with no advertising. It does not explain the more common case of what happens if income changes or if there is advertising. The theory is, therefore, of little merit.

Do you agree with these assertions? [25]

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ECONOMICS **9708/42**

Paper 4 Data Response and Essay (Supplement) **May/June 2010**

2 hours 15 minutes

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Section A

Answer this question.

1 **Income, Spending and Prices in the US**

Table 1 Some economic indicators for the US economy

	personal income	consumer spending	consumer prices
Nov 2008	fell 0.4%	fell 0.8%	fell 2.1%
Dec 2008	fell 0.2%	fell 1.0%	fell 1.0%
Jan 2009	rose 0.2%	rose 1.0%	rose 0.3%
Feb 2009	fell 0.2%	rose 0.2%	rose 0.4%

Consumer spending in the US fell by 0.8% in November 2008 and by a further 1% in December. December 2008 was the sixth consecutive month in which consumers cut back on their spending. Between October and December 2008 spending fell by a record 8.9%. Consumers were in a mood to increase their savings but not to go out and spend. Generally, that's a good thing, but not when everyone does it at the same time. By January 2009, the savings rate in the US had reached the highest it had been for 14 years. This increase in savings was caused by low consumer confidence and the fear of higher unemployment.

Declining consumer spending is a particularly troubling sign for the US economy, because spending accounts for more than two-thirds of GDP. GDP fell by 3.9% between October and December 2008, the sharpest decline in 26 years.

This decline in spending resulted in

- a proposed $888 billion stimulus plan from the government, including about $278 billion in tax cuts,
- companies reducing their workforce to cut costs because of falling revenue,
- the expectation that business investment, which accounts for about one-tenth of US GDP, would decline during 2009.

(a) What evidence is there in the data that the economic situation in the US improved after December 2008? [3]

(b) How far is there any consistent link in the data between

(i) changes in personal income and consumer spending and

(ii) changes in overall prices and consumer spending? [5]

(c) Explain why a fall in spending might be expected to lead to a fall in business investment. [4]

(d) Do you agree that a rise in savings is generally 'a good thing, but not when everyone does it at the same time' (line 5)? [8]

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Section B

Answer **two** questions.

2 In 2007 the UK Competition Commission indicated that failure in the market mechanism would result in both winners and losers.

(a) Explain why producers are usually the winners and consumers are usually the losers when the market fails. [12]

(b) Discuss what the government might do when there are losers because the market mechanism has failed. [13]

3 In March 2009, the government of France agreed to pay 250 million Euros to the car manufacturer Renault, which employed 63 000 workers, on condition that it would not reduce the number of French jobs or factories. General Motors, a US car manufacturer which employed 600 000 workers, said that it needed $2 million in government aid to avoid bankruptcy.

(a) Describe the characteristics and likely pricing policy of the market structure in which a car manufacturer is likely to operate. [12]

(b) Discuss whether economic theory supports the idea that governments should encourage all large organisations. [13]

4 **(a)** Analyse whether an increase in the wage rate always leads to an increase in the number of hours worked by an individual. [10]

(b) A government stated that pay increases in the coming year should be kept to a minimum. Discuss whether the main determinants of wage rates are factors such as trade unions and the government rather than market forces. [15]

5 Economic theory emphasises the idea of an equilibrium position. Discuss whether the idea of an equilibrium is a useful and practical way of explaining the behaviour of a consumer. [25]

6 **(a)** Explain the causes of unemployment. [12]

(b) Explain what is meant by liquidity preference and discuss how it might be affected by an increase in unemployment. [13]

7 'Developing countries have a low standard of living, yet many have much wealth in natural resources which multi-national companies would like to exploit.'

Discuss which is the better way of increasing the standard of living: to allow multi-national companies to exploit all the natural resources, or for the government to increase expenditure on education and health. [25]

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