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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 2011**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

5623611922

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Write your Centre number, candidate number and name on all the work you hand in.
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Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A
Answer **Question 1**.

Section B
Answer any **two** questions.

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

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

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Section A

Answer this question.

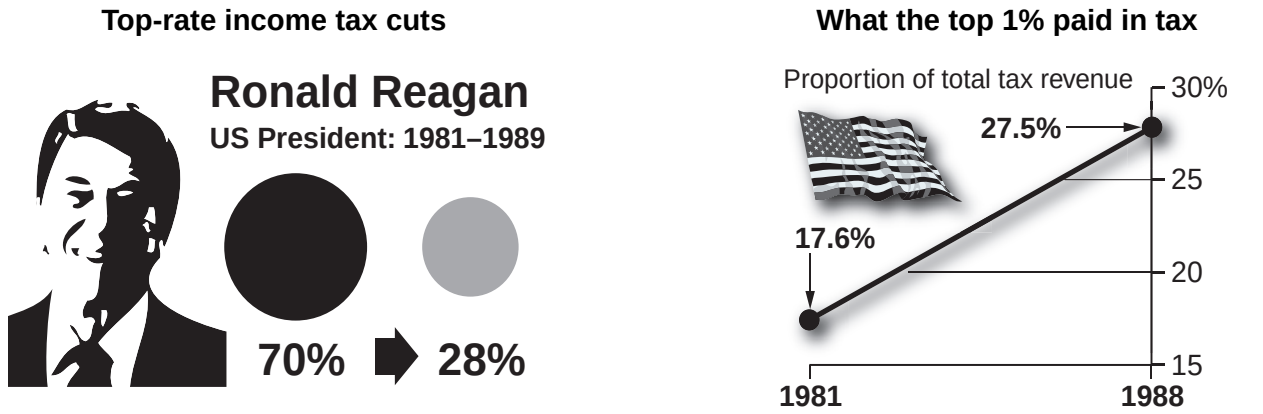
1 **High taxes do not help in a recession**

In 2009, there was an economic recession in many countries. One aspect of the recession was that unemployment rose. Governments paid large subsidies to a number of industries to try to stop the rise in unemployment. This increased the governments' debt and affected its other expenditure.

In an attempt to recover part of the extra expenditure, some governments had a policy of increased income tax rates on people who had high salaries.

However, critics of this policy argue that higher tax rates do not work. They say that the proportion of revenue received from top taxpayers falls and does not rise as taxes increase and the higher taxes cause damaging effects on the economy. It is better they say to decrease taxes. The decrease in taxes brings the government more revenue, not less revenue. Their opinion is supported by evidence from the past as is seen in the effect on tax receipts of changing tax rates in the US as shown in Fig. 1.

FIG. 1 CUTTING TAXES RAISES REVENUE



(Source: The Times, May 7 2009 p. 28.)

It is suggested that this opposite policy of reducing tax rates is better. Lower tax rates actually boost both the economy and tax revenues. For example, Russia, Latvia and Estonia reduced their highest tax rate and replaced a complicated system of taxes with a single income tax rate of 10%. They enjoyed a huge economic boost as a result.

Another aspect of the recession was that businesses found it difficult to borrow money from the commercial banks. In order to try and make borrowing easier and help businesses, some central banks lowered their interest rates. The central banks also bought government bonds in an attempt to increase the supply of money in the economy.

(a) Explain what is meant by a recession. [3]

(b) The article states that 'higher tax rates do not work'.

(i) What does the article mean by this statement? [3]

(ii) Is there enough evidence in the article to justify this statement? [6]

(c) Discuss why the actions of the central banks mentioned in the article might have been expected to ease the recession. [8]

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Section B

Answer **two** questions.

2 Discuss whether economic efficiency can be improved if governments are involved in the regulation and provision of goods and services when there is market failure. [25]

3 **(a)** Analyse, with the aid of a diagram, whether there is a link between diminishing marginal returns and economies of scale. [12]

(b) Discuss whether the objectives of a firm in a perfectly competitive market are likely to be different from the objectives of a firm in an imperfect market structure. [13]

4 Do you agree that the wage of labour is determined by the market like any other price? [25]

5 **(a)** Explain what is meant by GDP and describe the alternative methods by which it is calculated. [12]

(b) 'GDP figures tell us many things except that which makes life worthwhile. They tell us nothing about education, health and quality of life. They are, therefore, of little value.' Discuss the extent to which you agree with this argument. [13]

6 **(a)** Explain how the impact of the Keynesian multiplier process will change if a free-market closed economy becomes a mixed economy with foreign trade. [12]

(b) Analyse how a change to the equilibrium level of income resulting from the multiplier process might lead to unemployment or inflation. [13]

7 The main way a developing country could become a developed country is for government policy to concentrate on the protection of domestic industry and investment in infrastructure. Do you agree that this is the best policy? [25]

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Question 1 © adapted from Eamonn Butler; *It's GCSE economics: high taxes don't work*; The Times; 7 May 2009.

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ECONOMICS **9708/42**

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2 hours 15 minutes

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Section A

Answer this question.

1 Emerging economies and the way out of a recession

During the recession of 2009 several economists forecast that some emerging (fast developing) economies would perform better than the developed economies. One indicator of this, they said, was the strength of the exchange rate of the currency of some emerging economies against the US dollar. For example, between November 2008 and July 2009, the Brazilian currency rose 11.4% against the dollar and the Indonesian currency rose 10.2%. Another indicator was the forecast growth rate in GDP as shown in Table 1.

Table 1: Forecast growth rate in GDP for selected countries

Forecast Growth Rate in GDP		
	2009 %	2010 %
US	–2.7	+1.4
UK	–3.5	+0.3
Germany	–4.3	+0.3
Japan	–6.5	+0.4
Hong Kong	–5.9	–0.3
China	+6.0	+7.0
Singapore	–7.5	+1.9
Brazil	–1.5	+2.7
Columbia	–1.0	+1.5
India	+5.0	+6.4
Indonesia	–1.3	+0.6

Emerging economies are often dependent on exports to achieve an increase in GDP. Some economists suggested that it would be better for their economic growth if these countries were to concentrate on domestic demand rather than exports.

China, in particular, they said could lead the world out of the recession if it relied increasingly on domestic demand. Indeed, the Chinese government encouraged a shift from export-led industries to programmes aimed at improving the Chinese infrastructure in order to create jobs and thus increase consumption of Chinese goods. Banks were encouraged to make borrowing easier in order to create more credit for consumers and businesses. The government started a massive fiscal stimulus and increased its forecast of GDP to a growth rate of 8.3% in 2009 and 10.9% for 2010 (previous forecast figures were 6.0% and 7.0% as in Table 1).

However, other economists do not accept that there should be an emphasis on domestic demand. They argue that trading links are the strongest evidence of the emerging economies' ability to grow. They state 'no emerging market that adopted an export-led growth model has subsequently needed to break away from it – including China'. China's exports as a percentage of GDP are 32% compared with only 13% for the US. Smaller Asian countries are even more dependent on exports; Singapore's ratio of exports to GDP is 234%, Hong Kong's is 169%. It will be difficult for economies such as these to increase domestic demand and reduce their dependence on export-led growth.

(*Source: Financial Times:* June 12 2009. *Table source: Economist p105 April 18–24 2009)*

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(a) Explain what is meant by GDP. [3]

(b) The article says that banks were encouraged to make borrowing easier.
Explain what this might mean and why the government might have thought this was necessary. [3]

(c) Is there enough evidence in the article to support the view that there has been an improvement in the economic situation of emerging economies? [6]

(d) Identify the **two** policy approaches suggested by economists in the article and discuss whether there is a conflict between them. [8]

Section B

Answer **two** questions.

2 The use of cars causes market failure. To achieve an efficient use of resources it would be better if governments intervened to affect both the production and the use of cars.

Explain the meaning of the terms 'market failure' and 'the efficient use of resources' and analyse whether economic theory can be used to support this argument. [25]

3 **(a)** Discuss whether demand schedules and budget line diagrams are similar in the way they represent the effect of

(i) a rise in the price of a good

(ii) a rise in a consumer's income. [12]

(b) Analyse what is meant by the equi-marginal principle of consumer demand and whether it can be linked to the derivation of a market demand curve. [13]

4 **(a)** Discuss whether it is always advantageous for a firm to grow in size. [12]

(b) Explain the economic theory of profit maximisation for a firm and consider whether firms are likely to follow this theory in fixing their price and output. [13]

5 In imperfect competition, labour markets can lead to worker exploitation in terms of the wage rates they receive compared with wage rates in perfect competition. Discuss this opinion. [25]

6 **(a)** An increase in investment will raise national income but an increase in the desire by consumers to save will reduce national income.

Explain why this is the case. [12]

(b) To increase national income, interest rates should be lowered; indeed lowering interest rates is the only policy available to increase national income.

Discuss whether you support this opinion. [13]

7 **(a)** As an economy develops, the relative importance of different sectors of production changes. Explain, with examples, why the pattern of employment might change as an economy develops. [12]

(b) Discuss whether increases in economic growth are necessarily beneficial to an economy. [13]

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International Examinations

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