Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays **May/June 2016**

2 hours 15 minutes

No Additional Materials are required.

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READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

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.

The number of marks is given in brackets [ ] at the end of each question or part question.

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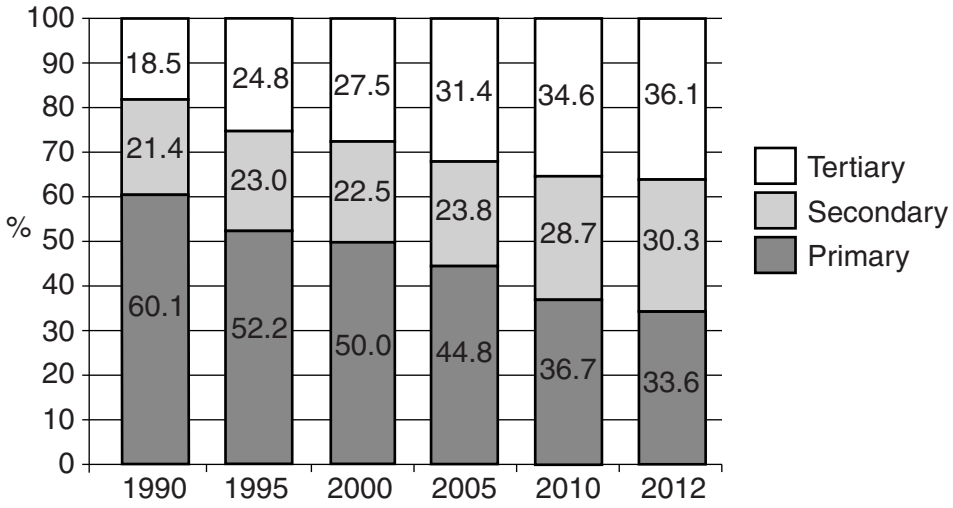
Section A

Answer this question.

1 Changes in the Chinese economy

China is an emerging economy. The proportions of workers employed by sector between 1990 and 2012 are shown in Fig. 1.

Fig. 1: Working population in China by sector 1990–2012



Iron ore is used for steel making. By 2013, China was the largest iron ore importer in the world. The main suppliers were Australia, Brazil, India and South Africa. China also needed other raw materials such as aluminium and copper. As a proportion of GDP, China bought four to ten times more of these than other countries and was responsible for much of the global increase in their demand during the two decades before 2013.

The iron and steel industry in China was stimulated by strong domestic demand, particularly from the construction, manufacturing and automotive industries, all of which had expanded production.

But during 2013 the outlook for China's economy was less bright. There was a sharper than expected fall in export growth in China, while imports actually fell. Growth in industrial output was also slower and this, together with increased output from new iron ore mines in Australia, seemed likely to cause a reduction in iron ore prices. It was thought that the potential change in industrial output in China, the world's second-largest economy, would worsen the outlook not only for mining companies but also for other producers worldwide.

Statistics for the annual rate of inflation in China indicated that in 2013 prices of key products such as iron ore fell, causing the rate of inflation to fall and creating the prospect of price deflation. An economist said 'falling prices are bad for the economy.' Some economists feared that the future growth of building and urbanisation would be at a significantly slower rate. The result, it was thought, would be that any economic growth would be more likely to be caused by consumption and not by investment.

This change to consumption from investment would mean that the demand for raw material inputs would fall significantly, as previous demand was a consequence of China's growth through an investment approach. Of course, items such as cars, washing machines and computers all require a substantial amount of raw materials, so the demand for some inputs would still increase.

Sources: China Labour Bulletin, accessed 29 April 2014, and *Daily Telegraph, 10 June 2013*

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(a) Identify the trends in working population in China and consider whether they are what might be expected in an emerging economy. [5]

(b) The article states that 'falling prices are bad for the economy'. Analyse whether falling prices necessarily harm an economy. [5]

(c) Does the article give enough evidence to lead you to conclude that the changes in the Chinese economy would be bad for countries that trade with China? [4]

(d) Using the article and your own knowledge, discuss what difference an investment approach to growth and a consumption approach to growth might make to an emerging economy such as China. [6]

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Section B

Answer any **two** questions.

2 'In a complex modern economy there is no possibility of a perfect market system. A concentration of market power always results and does not serve the public interest.'

Do you agree with this opinion? [25]

3 **(a)** Given the prices of two goods, how does economic theory analyse what is meant by 'consumer equilibrium'? [12]

(b) Suppose the price of one of the goods falls. Use indifference curve analysis to discuss whether consumers would always buy more of the good when its price falls. [13]

4 'Wage rate inequalities are inevitable and can be justified.'

Discuss whether this statement can be supported by economic theory. [25]

5 **(a)** Explain what is meant by diminishing returns and economies of scale, and consider whether diminishing returns can occur only in perfect competition and economies of scale in imperfect competition. [12]

(b) 'The theory of the firm that assumes perfect knowledge and the aim of profit maximisation can be found only in perfect competition. In monopoly those assumptions do not apply.'

Consider whether you agree with this statement. [13]

6 **(a)** Explain what is meant by the equilibrium level of national income, and consider whether it is possible to have such an equilibrium and unemployment at the same time. [12]

(b) At a time of an election a government makes a promise that, if re-elected, it would aim to increase the growth rate of the national income.

Discuss whether an increase in the growth rate is necessarily beneficial. [13]

7 Discuss which issues are at the heart of the debate about the quality of life in a country and what indicators might be used to assess them. [25]

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ECONOMICS **9708/42**

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Section A

Answer this question.

1 Housing and Economic Growth in the UK

In 2013 a press article reported that 'there has been a marked improvement in the housing market'. Potential buyers of housing had been encouraged because the central bank had fixed interest rates at an all-time low and also by a government scheme designed to give help to people wishing to buy property. The scheme meant that buyers did not have to find such a large deposit.

This caused a positive outcome for the construction industry, with investment and employment rising. However, it pushed up property prices.

In 2013 the average price of a house was seven times the average wage. A study recommended that the central bank should take steps to prevent house prices rising by more than 5% a year and should limit the amount people could borrow relative to their incomes. There should be regional variations to this limit, as property prices do not increase at the same rate in every region.

However, a deputy governor of the central bank said that limiting price rises would not solve the cause of the problem, which was the lack of new property development. He found it surprising that the study chose to focus exclusively on the demand side when the underlying problem was one of supply.

An economist said that the most effective intervention a government can make in the housing market is to relax the planning system and make it easier and cheaper to build more homes. Increased supply, leading to lower prices, would encourage demand. Others said that 'although there is talk of a large rise in the price of houses, it is not uniform throughout the country and trying to influence the basic laws of supply and demand is not the right way of tackling the problem.'

The buying of housing gives rise to increased consumer spending and some argue that this helps the economy. Although policies by the government and the central bank had increased consumer demand and spending, such expenditure is quite different from the export-led growth model preferred by the government. Analysts suggested that the demand and supply conditions causing the current situation cannot last forever. When they end, the effect on the housing market (which by then will have many people with very high debts) will be very bad for the economy. This can be seen in countries such as Spain and the Netherlands, where property values are in decline.

Source: *The Times*, 14 September 2013

(a) Identify **two** government policies in the article that could encourage an increase in aggregate demand. [2]

(b) The article states that there has been a 'marked improvement in the housing market'.

Using the article and your own knowledge, explain how an economy might benefit from an 'improvement in the housing market'. [5]

(c) Using the evidence in the article, assess whether it contradicts the view that an increase in house prices is an improvement for an economy. [6]

(d) The article contrasts a model of an increase in growth through consumer spending with a model of an increase in growth through exports.

Choose **two** macroeconomic aims of a government and discuss how the two growth models might have different effects on those aims. [7]

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Section B

Answer any **two** questions.

2 'Government economic policy is based on the idea that people cannot be trusted to choose what is good for them but instead sometimes choose things that are harmful to themselves or detrimental to the environment (or both). Therefore a free market cannot allocate resources efficiently.'

Do you support this argument? [25]

3 With the help of diagrams, use indifference analysis to:

(a) explain what is meant in economic theory by consumer equilibrium and how it is related to a consumer's demand curve. [12]

(b) discuss how this equilibrium might be affected by a government fiscal policy that raises taxes on goods. [13]

4 **(a)** 'In perfect competition in the short run, wage rates in some occupations will be higher than in others.'

Explain the economic analysis underlying this. [12]

(b) Do you agree that in an imperfect labour market any activity by trades unions designed to increase wage rates would inevitably lead to unemployment in that market? [13]

5 The traditional theory of the firm assumes a single objective for the firm, namely the maximisation of profit.

(a) Explain whether a firm with this objective necessarily always makes a profit. [12]

(b) Discuss how the objective in the traditional theory may be varied in different market structures. [13]

6 Imagine you have been asked to produce a report about the quality of life in your country. Discuss what would be important to include in your report and what economic indicators you would use in order to reach a conclusion. [25]

7 **(a)** Explain how the age and employment structure of a population in a developing country may differ from those of a developed country. [12]

(b) Consider whether a developing country is likely to experience different types of unemployment compared with a developed country. [13]

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ECONOMICS **9708/43**

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Section A

Answer this question.

1 Airport Expansion

In 2014, a proposal by Heathrow Airport Authority (HAA) in London recommended building an extra runway at Heathrow, one of the world's busiest airports. HAA acknowledged that it was an initial proposal that needed more detailed work.

They claimed that, if built, the runway would deliver greater economic benefits and be a better option for economic growth for the UK than any other proposal for new airport capacity. HAA was not able to quantify the benefits with any precision but said they would range from £50 billion to £156 billion (US$84 billion to US$262 billion) with a 'central estimate' of over £100 billion (US$168 billion). The majority would benefit the wider economy by creating jobs, encouraging trade, boosting spending and improving public finances. The proposal would allow the airport to be connected to more emerging markets and enable 40 new destinations to be served directly, including some in India and China. Cargo volumes would double and UK competitiveness would increase.

HAA added that more efficient vehicles, an increased proportion of passengers travelling by public transport and new aircraft technology would mean that the extra flights would not exceed the European Union pollution limits.

In order to build the new runway, major motorways would need to be altered. Many homes would have to be demolished but the airport said they would pay the owners 25% above the property's market value. When it was built, car drivers wishing to take passengers to the airport would have to pay a congestion charge.

Those opposing the new runway said that thousands of people would be forced out of their homes and communities would be destroyed and, while waiting for a decision to be made, they would be unable to sell their homes. 240 000 people would suffer from airport noise.

HAA said the runway would cost £15.6 billion (US$26.2 billion) to build, with the government paying £1.2 billion (US$2.1 billion) towards the motorway alterations.

There were alternative proposals. The first was to build a completely new airport to the east of Heathrow. The second was to add another runway to an existing airport, Gatwick, to the south of Heathrow.

HAA argued that a completely new airport would take much longer to build and be more expensive than an extra runway and would mean higher fares for passengers.

The owners of Gatwick Airport insisted that the new runway at Heathrow was not in the best interest of passengers and that Gatwick would be better able to offer lower fares and connect to emerging markets with longer-range aircraft. They said that their plans were cheaper – £7.8 billion (US$13.1 billion) – and could be built quicker than the Heathrow option, with less disruption to motorways. Noise from another runway at Gatwick would also affect fewer people – 14 000, not 240 000.

Sources: Heathrow Airport website, accessed 24 May 2014, and *Evening Standard*, 13 May 2014

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(a) HAA said 'the new runway would benefit the wider economy'. Explain why its claim might be justified. [4]

(b) Explain why dropping off passengers could be classified as an externality and suggest one method of addressing this externality. [4]

(c) Airport infrastructure is privately owned and makes money for its owners. Consider why in this case the government would pay £1.2 billion towards the cost of motorway alterations. [5]

(d) Consider whether the information in the proposal by the HAA was mainly factual evidence or opinion and comment on whether you would support the proposal. [7]

Section B

Answer any **two** questions.

2 **(a)** Economists write about indifference analysis when studying consumer choice. Does this theory of consumer behaviour mean that a consumer is always indifferent when choosing between two products? [12]

(b) Discuss whether the use of a demand curve and budget lines are similar in the way they represent what will happen if the price of a good falls. [13]

3 In 2014 an American multinational pharmaceutical drug developer and supplier made a bid to take over a Swedish-British multinational drug company, but the board of that company refused to accept the bid for its shares.

(a) Consider whether increasing a company's scale of production will always reduce its costs. [12]

(b) Analyse what is meant by a contestable market and consider whether companies that supply drugs are likely to be in a contestable market. [13]

4 Some workers are paid a basic rate and then paid additional commission based on the number of products sold. In 2014, a European court ruled that a worker's holiday pay should be based on total pay including commissions and not just on the basic rate.

(a) Explain, according to economic analysis, the shape of a worker's supply curve and suggest how this court judgement might affect the number of hours worked. [12]

(b) Discuss whether a trades union can always increase the wage rate of its members without affecting the level of employment. [13]

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5 It was reported that India's policymakers seem to be fighting a losing battle with inflation. Some economists linked the persistent rise in prices to the pace of economic growth.

(a) Consider whether economic growth will always cause inflation. [12]

(b) Assess how appropriate it is to use economic growth as an indicator of how a country's standard of living compares with other countries. [13]

6 Equilibrium is a key concept in the study of economics. Explain what an equilibrium level of national income means and discuss the relative merits of policies a government might use to cause the equilibrium level to change in an open economy. [25]

7 Private sector developers have discovered potentially profitable supplies of gas and proposed a new method of extracting it that involves drilling in some areas of natural beauty. They say it is important that a country's resources are used efficiently.

Consider whether they might mean the same as economists when they talk about the efficient use of resources and whether it is possible in practice for private organisations to achieve such economic efficiency. [25]

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