Cambridge International AS & A Level

Cambridge Assessment International Education
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays **May/June 2019**

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 **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 **Loyalty and consumer behaviour**

Consumer loyalty can be thought of either in relation to card schemes which offer discounts based on the amount spent with a specific retailer, emotional loyalty where customers are loyal to a particular brand, or as a monopoly loyalty where there is no alternative to the retailer or brand.

Retailers recognise that price has an importance in consumers' choice. Many supermarkets use loyalty cards to attract customers with promotions and price reductions available only to those who have a card.

By using cards, supermarkets seek a marketing advantage and attempt to build barriers between retailers. Research indicates, however, that although 70% of United Kingdom (UK) consumers hold some kind of loyalty card, only about 10% are loyal to one particular card.

Concerns have been raised that, when consumers are collecting points towards a particular goal, the loyalty card schemes may act as a constraint on free competition and prevent switching between brands. It is also thought that the costs of the scheme might be funded through higher prices. Further, the incentives and marketing discounts used by the scheme are often thought to be confusing and make it more difficult for the consumer to compare prices. There are risks for retailers too. It requires substantial investment to run such a scheme – one supermarket put the cost at US$60m a year.

But how do loyalty card schemes fit into the context of the way in which consumers make choices? The relative importance of factors that influence consumers when choosing from which shop to buy groceries are one-stop shopping (43%), good service (22%), price (18%), the availability of a coffee shop (12%) and help with packing (6%). Loyalty cards come below these.

Companies who have invested in card schemes use them as a means to gather data on customers. When the loyalty card is used the retailer can see what the customer prefers to buy and can direct future offers to their wants in specific promotions both on-line and in the mail. Loyalty schemes are thus sometimes less about loyalty and more about understanding customers' wants.

The economic model of consumer behaviour using indifference curves assumes that consumers conduct research and buy products and services in a rational way. However, many purchases are based on habit and consumer research is imprecise. When the consumer has a low involvement in research or a low emotional attachment to the product, there will be little loyalty.

Source: RSA Journal 1, 2001, page 83

(a) What evidence is there in the article to suggest that loyalty cards make markets imperfectly competitive? [4]

(b) Analyse why a profit maximising retailer might be interested in the link between utility, consumers' loyalty and price elasticity of demand. [4]

(c) Consider whether there is conflicting evidence in the article about the effectiveness of loyalty cards which offer price discounts. [5]

(d) Discuss how the idea of rationality is used in the indifference curve theory of consumer behaviour. [7]

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Section B

Answer **two** questions from this section.

2 **(a)** Explain the meaning of and whether there is a link

(i) between externalities and public goods

(ii) between transfer payments and the poverty trap. [12]

(b) Consider whether the existence of externalities in production means that it is impossible to achieve an optimal allocation of resources. [13]

3 **(a)** Explain what is meant by 'the principal–agent problem' and analyse why it is likely to be found in some market structures and not others. [12]

(b) Explain what is meant by a contestable market and discuss whether a firm in a contestable market necessarily aims to maximise its profit. [13]

4 'A rise in wages and salaries will increase the costs of production, decrease profits, cause inflation and is detrimental.'

Discuss whether the economic theory of wage determination supports the view that an increase in the level of wage rates is detrimental for the firm and for the worker. [25]

5 **(a)** Distinguish between the internal value of money and the external value of money and consider whether there is a link between these two values. [12]

(b) 'Policies which attempt to control the internal value of money will automatically make it difficult to control the external value of money.'

Discuss the view that this statement is only partially correct. [13]

6 'The failure of the policy of quantitative easing (QE) to solve problems associated with an economic recession illustrates the weakness of monetary transmissions mechanisms in particular and monetary policy in general.'

Critically evaluate this statement. [25]

7 **(a)** Assess the impact of foreign direct investment (FDI) on developing economies. [12]

(b) It is often stated that the problem of 'a vicious cycle of poverty' exists in developing countries.

Explain what this means and discuss how this problem might be solved. [13]

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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 **India's grocery market**

Amar Singh explained why he sells 'exotic' produce, such as broccoli and iceberg lettuce, at his vegetable stall in Mumbai. "I have to keep the customer in my grasp," he said. Mr Singh has traded for 20 years, and is not worried by the supermarkets whose stores have recently opened nearby. "They are cheaper," he said, "but they cannot match me on quality."

In India, the 11 million small traders like Mr Singh are protected. India's complex rules have made it difficult for supermarkets from developed countries to enter the Indian grocery market. Also, India's domestic supermarkets account for only 2% of food and grocery sales and are struggling to make a profit. Revenues have not kept pace with rising rents. Reliance Fresh, one of India's big supermarket companies, has recently closed some shops around Mumbai. The companies had hoped that as India became richer, its consumers would abandon kiranas (small family-owned shops) and stalls such as Mr Singh's for modern supermarkets. This has not happened.

This may be because 70% of India's population are rural dwellers so a localised strategy is vital to accommodate the variation in languages and cultures. India's kiranas are often described as neighbourhood stores, embedded in their local communities. Many have been run by the same families for generations. They have a deep understanding of the local market and a good relationship with their customers, some of whom are loyal to the shop that their parents used. Today's kirana and stall owners make product recommendations, offer credit to help shoppers balance their budgets, and can even obtain products not normally stocked. They will also deliver shopping to customers free of charge – something that the supermarkets struggle to match.

Long-established kirana retailers often also benefit from prime store locations, leaving modern supermarkets struggling to find space in existing shopping areas. Instead, supermarkets are forced to look for new places to develop larger stores.

Fig. 1.1 shows the results of a survey of customers in the largest cities in India to find their preferred place to purchase groceries and vegetables.

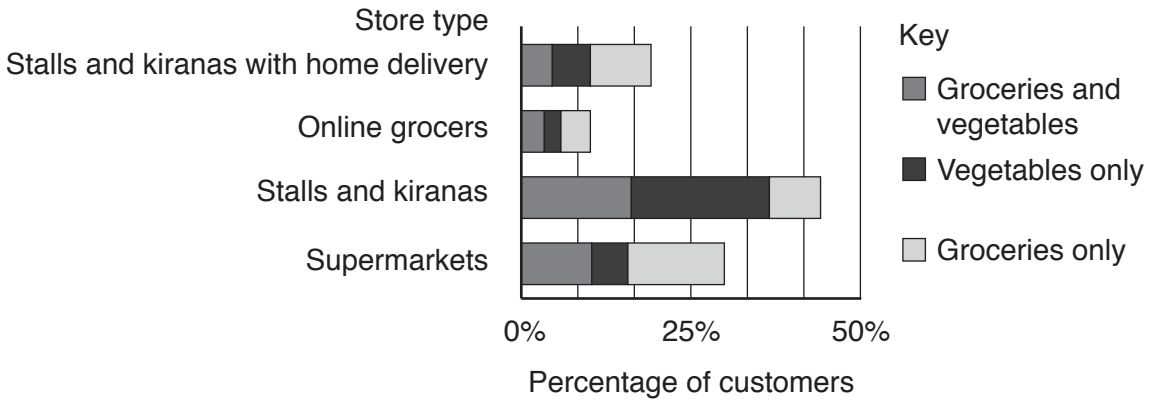


Fig. 1.1: Survey results

Sources: adapted from The Economist, October 2014, Laura May, academia.edu, April 2014 and Market Express India, September 2016

(a) Identify **two** ways in which kiranas compete for customers. [2]

(b) What can be concluded about the groceries and vegetables trade in India from Fig. 1.1? [5]

(c) Use economic analysis to suggest the market structure in which kiranas operate and explain how equilibrium is reached by a firm in such a market. [6]

(d) Discuss how it might be possible for supermarkets in India to compete with the stalls and kiranas. [7]

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Section B

Answer **two** questions.

2 Explain what is meant by 'market failure' and consider how far government intervention can reduce market failure. [25]

3 A recent newspaper article commented on the fact that a pharmaceutical company charged customers in the United States (US) US$800 per treatment whilst it charged customers in Egypt US$80 for the same treatment.

(a) Explain why the company might follow this policy and what conditions are necessary to allow the policy to be successful. [12]

(b) Discuss whether oligopolistic industries always operate against the interests of consumers. [13]

4 **(a)** Analyse how an individual consumer's demand curve for a product is derived and consider how this may be linked to its market demand. [12]

(b) Use indifference curve analysis to distinguish between the effect of an increase in income on a consumer's demand for a normal good and an inferior good. [13]

5 Cyclical and structural unemployment are the most common types of unemployment.

Explain the causes of these types of unemployment and assess the effectiveness of government policies to reduce them. [25]

6 **(a)** The US Federal Reserve (the country's central bank) has pursued a policy of quantitative easing (QE) for several years.

Explain how quantitative easing affects the level of economic activity in a country. [12]

(b) Discuss how far **(i)** an increase in wages and **(ii)** a loss of business confidence might affect the rate of interest. [13]

7 **(a)** Explain what is meant by actual economic growth and potential economic growth. [12]

(b) 'Health, education and savings are the most important factors in determining long-term development in developing countries.' Comment on this statement. [13]

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