Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays **May/June 2020**

2 hours 15 minutes

2616564398

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **two** questions.
- Follow the instructions on the front cover of the answer booklet. If you need additional answer paper, ask the invigilator for a continuation booklet.
- You may use a calculator.
- You may answer with reference to any economy you have studied where relevant to the question.

INFORMATION

- The total mark for this paper is 70.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages. Blank pages are indicated.

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Section A

Answer this question.

1 **In pursuit of well-being**

It has been said that the mark of success of a government is raising the quality of life or the well-being of the people in the country. This is sometimes measured by the Human Development Index (HDI). Table 1.1 shows the rank order of selected countries by the HDI and compares it with the rank by Gross Domestic Product (GDP) of that country.

In order to understand how people make decisions, governments in the United States (US), the United Kingdom (UK) and Australia established Behavioural Insights Teams. They came to be known as the Nudge Units as they used nudge theories from behavioural economics.

It was hoped that this approach would help to achieve an increase in well-being as well as in economic growth and GDP. Nudge policies were used, with some success, to get people back to work, encourage them to pay their taxes on time and give them good reasons to save for future pensions or to study for improved qualifications.

They were not, however, sufficient to eliminate government budget deficits which remained at a high level. There was an ever-rising demand for public services but this was not matched by an equal rise in tax revenues so the deficit increased.

Eliminating the government budget deficit continued to be a problem. One method of dealing with the problem was to increase taxation. However, tax rates were already high and even higher tax rates would not result in the increase in revenue that was needed. An alternative option was to increase government borrowing. There might be a strong case to support economic growth, but increasing the deficit in order to achieve this could risk causing another financial crisis.

A third option was to reduce government expenditure on public services. This could be achieved without causing a reduction in the quality of the service and a reduction in well-being if increases in productivity took place. Without continued increases in productivity, however, further cuts in spending could have serious long-term detrimental effects, especially in health provision and education.

Table 1.1 Rank of selected countries by HDI and GDP in 2017

	Rank	HDI		Rank	GDP (millions US$)	
Norway	1	0.89		29	391 959	
Australia	3	0.86		13	1 359 723	
Germany	5	0.85		4	3 423 287	
UK	13	0.83		5	2 496 757	
Thailand	70	0.58		26	432 898	
Botswana	103	0.43		115	15 564	
Pakistan	117	0.38		43	251 487	
Eswatini	121	0.36		157	3 938	

Sources: RSA Issue 1, 2017

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(a) What is meant by *nudge theory*? [2]

(b) Consider whether the information provides any evidence that nudge theory could increase an economy's GDP. [6]

(c) Distinguish between demand-side and supply-side policies and identify and explain **one** demand-side policy and **one** supply-side policy from the information. [6]

(d) The information is entitled 'In pursuit of well-being'. Discuss whether the information supports the idea that GDP is a good measure of well-being. [6]

Section B

Answer **two** questions.

2 Discuss whether competitive markets in the private sector are the best way to achieve an efficient allocation of resources. [25]

3 **(a)** Explain what is meant by a 'consumer's equilibrium position' in indifference curve theory and how it can be used to form a demand curve. [12]

(b) One of the world's first filmed singing commercials advertised a soft drink. It stated that, for the same price, consumers would get twice as much of that drink than that of its major rival. This made it cheaper and was similar to a price reduction. Its rival responded by an advertising campaign stating that its own drink was superior to the first firm's inferior product.

Discuss whether it is possible to use diagrams from indifference curve theory to illustrate how a consumer might react to these two advertising campaigns. [13]

4 'A firm is fully aware of market conditions and its best rational interest would be achieved by pursuing the clearly defined objective of maximising profits.'

Consider whether this statement has any merit in different market structures. [25]

5 After negotiation, the workers in an industry obtained from employers higher wage rates. The employers' spokesperson said 'the cost of the deal would have to be met through improved productivity or by reductions in other costs'.

Analyse whether this deal can be incorporated into the economic theory of wages and consider the possible outcome for employment of such a deal. [25]

6 **(a)** Explain what economists mean by an inflationary gap and discuss why this is considered to be an economic problem. Use a diagram(s) to support your answer. [12]

(b) How far would you agree that the use of monetary policy is the most effective way to solve the problem of an inflationary gap? [13]

7 **(a)** 'Developing countries have low levels of productivity and a high dependency ratio.'

Explain the meaning of these **two** characteristics and consider whether they are linked. [12]

(b) Assess the view that foreign direct investment remains the key to economic growth in developing countries. [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 The impact of economic concentration

By locating closely together manufacturers can often gain economic benefits. The makers of industrial machines save on transport and communication costs when they are close to the firms that supply their raw materials and components. A group of similar manufacturers attracts a large number of workers with similar skills. Educational and training facilities in the area will develop courses and research skills that support the local industry. Similar benefits also occur in service industries, for example with the concentration of information technology in Silicon Valley and finance in New York, Hong Kong and London, where groups of accountants, merchant bankers and specialist lawyers in mergers and acquisitions all exist in close proximity.

The scope for concentration depends on the size of the market. The recent trend towards globalisation has increased the size of the available market. This has allowed some internet retailing firms to overcome competition from other countries. But the overall impact has been the delivery of a wide range of goods and services at low prices that have benefited consumers everywhere. This suggests that globalisation has not been a 'zero-sum' game.

But concentration has not always been beneficial. Silicon Valley has significant traffic congestion and many local people are priced out of the housing market. Seven of the ten most polluted cities in China are in Hebei Province, a centre for the iron and steel industry. This concentration has caused large amounts of air, water and land pollution. The competing demand for a limited number of workers has also led to wage increases.

Geographical concentration of an industry can lead to problems when demand for the product changes. This has been evident in the United States (US) where the city of Detroit has experienced unemployment rates as high as 25% (see Fig. 1.1) and a fall in its population by over 60% because of the decline in Detroit's motor industry caused by vehicle imports and the movement of production to US states where trade unions are not as strong.

Source: The Economist, 21 October 2017

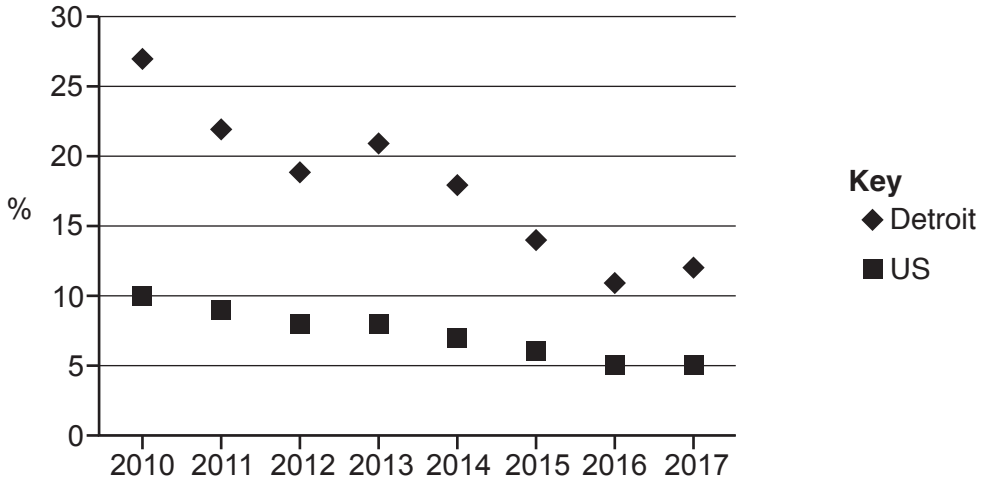


Fig. 1.1: Unemployment rates in the US and Detroit, 2010–2017

Source: US Bureau of Labor Statistics, accessed 12 May 2018

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(a) Explain the meaning of *zero-sum* in game theory. [2]

(b) Use the information to explain how external economies of scale develop. Show, with the aid of a diagram, how this would affect a firm's average costs. [5]

(c) There is a fall in demand for the product of a geographically concentrated industry. Analyse the economic implications of this for the area where the industry is located. [6]

(d) Consider how the negative externalities from concentrated industrial production can be reduced. [7]

Section B

Answer **two** questions.

2 **(a)** Use indifference curve analysis to explain the derivation of an individual demand curve for a normal good. [12]

(b) Discuss, using indifference curve analysis, whether the demand for a good always increases when its price falls. [13]

3 **(a)** Explain how the fixed and variable costs of a perfectly competitive firm affect its survival in the short and long run. [12]

(b) Explain what is meant by the principal-agent problem and consider its importance in relation to the objectives for a firm. [13]

4 'Government intervention in the microeconomy always improves efficiency.'

Discuss the validity of this claim. [25]

5 In January 2018 tax reductions were introduced in the US, and the Federal Reserve Bank (the US central bank) announced it would raise interest rates later in the year.

Discuss how these policies may cause conflicts for a government in trying to achieve its macroeconomic aims. [25]

6 **(a)** Compare the characteristics of developed and developing countries. [12]

(b) Discuss whether gross domestic product (GDP) is the best measure of a country's standard of living. [13]

7 **(a)** Explain the Keynesian theory of the determination of the rate of interest. [12]

(b) Discuss the impact on the economy of the introduction of quantitative easing (QE) by the central bank. [13]

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