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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays (Supplement) **October/November 2012**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

3279883095

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Section A
Answer **Question 1**.

Section B
Answer any **two** questions.

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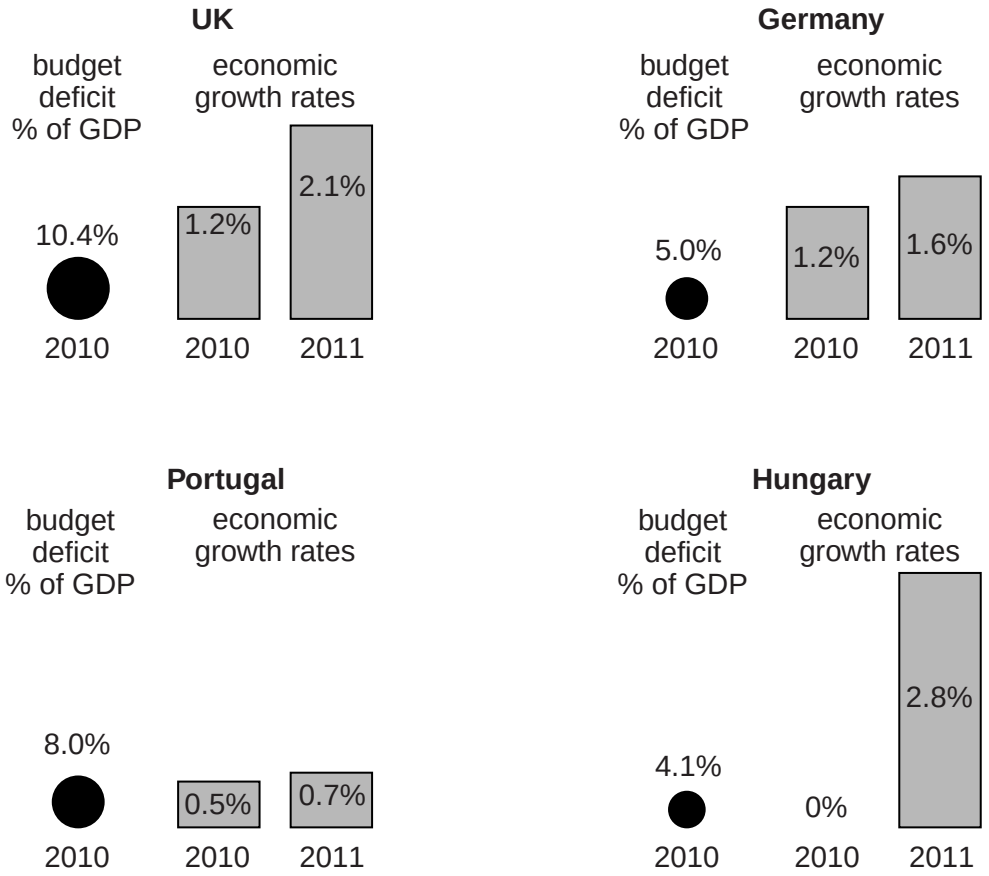
Section A

Answer this question.

1 **Budget deficits**

The recent world recession has resulted in an increased government budget deficit in many European countries. Fig. 1 shows budget deficits and economic growth rates for 2010 together with expected economic growth for 2011 for selected countries.

Fig. 1



Below are two opinions about budget deficits.

First opinion
Budget deficits should be reduced quickly by immediate reductions in public spending. An economy needs to grow and reductions in public spending encourage growth in the private sector. If the economy grows, wages will rise. Consumers feel safe to borrow and consume more. Investors will expect better returns if growth increases and they will also know that the deficit has been reduced by cuts in public spending and not by tax increases.

Second opinion
In 2009 there was a massive reduction in demand by the private sector in some countries. To offset the reduction in private spending, some governments believed they should increase public spending. This would cause a larger budget deficit and provide a stimulus to demand. Businesses need increased demand to invest and innovate. Increased demand causes a multiplier effect on national income. Demand is central to the debate about budget deficits.

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Below is a newspaper comment on these two opinions.

By 2010 the falling value of some countries' currencies stimulated international demand for their tradable goods, resulting in manufacturing growth. Some argued that this growth in exports meant it was possible for the government to decrease its spending to reduce the budget deficit.

Others argued that this growth in exports would be insufficient and raised the question 'where would demand for the economy's output then come from?' They said it would not come from the public sector because the decrease in government spending would put people out of work, ruin small businesses and damage some larger ones. It would not come from the private sector because interest rates on borrowing in some countries had been at record low levels for some time but this had failed to stimulate demand. They believe it is better to wait until an economy grows and repay the deficit by reducing public spending gradually. *(Source: The Observer 13/06/10)*

(a) The data refers to a 'government ..... budget deficit'. Explain what this means. [2]

(b) Use Fig. 1 to consider whether there is a link between the size of the budget deficit and economic growth. [4]

(c) Explain how the falling value of some countries' currencies 'stimulated international demand for their tradable goods, resulting in manufacturing growth.' [4]

(d) Use the evidence given to discuss the similarities and differences in the two opinions and consider which you think is more appropriate to overcome a recession. [10]

Section B

Answer **two** questions.

2 **(a)** Explain how the law of diminishing marginal utility might be used to construct a consumer's demand curve for a product. [12]

(b) Analyse how budget lines may be used to illustrate what happens for both a normal good and an inferior good when the price of the good increases at the same time as a consumer's income increases. [13]

3 **(a)** Explain why a firm's short-run average cost curve is usually drawn as a U shape and explain the link between the short-run average cost curve and the long-run average cost curve of a firm. [12]

(b) It is said that perfectly competitive firms and monopolies aim to maximise profits. Discuss whether price, output and profit levels are, therefore, likely to be the same in perfectly competitive firms as in monopolies. [13]

4 The differences in wage rates paid in different occupations are caused entirely by the differences in the elasticity of supply of labour. The way, therefore, to overcome the differences in wage rates is to increase the training available to workers.

Discuss whether economic analysis supports this argument. [25]

5 **(a)** Explain what is meant by an inflationary gap. [12]

(b) Discuss the effectiveness of the policies a government might use to reduce an inflationary gap. [13]

6 Whether a country can be classified as developed depends on the value of its GDP and the higher the GDP the better it is for the country.

Assess this opinion. [25]

7 **(a)** Explain what is meant when it is said that there might be inefficiencies in the production of goods and in the allocation of resources. [12]

(b) Discuss whether the best way to overcome market failure is to control private enterprise by means of taxation. [13]

Copyright Acknowledgements:

Question 1 Figure 1: *The Guardian* 12/06/10 p. 34 and *The Observer* 13/06/10

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ECONOMICS **9708/42**

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Section A

Answer this question.

1 **Income from migrant workers**

The recent financial crisis has slowed down economic growth worldwide but the number of migrants seeking work in another country is still increasing. One reason for this is that the countries from which workers leave may have experienced a severe recession making workers willing to travel abroad to do unpopular jobs that others avoid. A further reason is that many migrants move to join other members of their family which helps explain why migration, once established, is hard to reverse.

Workers going abroad are particularly important for the Philippines, where 25% of the labour force work overseas. Doctors go abroad to work as nurses; teachers go to work as housemaids. In addition, local centres train workers to enable overseas work. For example, workers train to clean cabins on cruise ships in the hope that they will be able to earn four times the local wage for cleaning. The workers send money home (migrant remittances) to support their families. This money can provide food, clothing, housing, pay for educational expenses or for investment in small enterprises.

Migrant remittances could become even more important to a country because experts predict that aid and foreign direct investment in developing countries could be halved as a result of the 2009–2010 financial crisis.

There is a debate about the use of migrant labour. For employers, there is an advantage in employing cheap foreign labour in order to reduce costs. However, the consequence of using foreign labour is that domestic workers are being replaced. There is also little or no incentive for manufacturers to mechanise their production processes because it is cheaper to use labour than invest in capital-intensive machinery.

The flow of money from migrant workers has been rising by as much as 33% each year in some areas, but the rate of growth is beginning to slow down. In 2007, the World Bank predicted that, by 2009, the amount sent home by the world's 150 million international migrants could fall by about 1%. Mexico, the third biggest recipient of migrant remittances in the world, estimated in 2007 it would receive $23.8bn but that this would fall in 2008 by almost 8%.

In 2010, a different organisation produced the following table of migrant remittances.

Table 1: Money sent home by migrant workers to selected countries (US$ billion)

Country	**2006** US$ bn	**2007** US$ bn	**2008** US$ bn	**2009** US$ bn
India	26.9	27.0	45.0	55.0
China	22.5	25.7	40.5	n/a
Philippines	12.7	14.4	16.4	17.3
Mexico	25.6	26.1	25.1	21.2
Bangladesh	5.5	6.6	9.0	10.7

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(a) What might be concluded about the Philippines' economy from the information given? [4]

(b) How far is the information in the fifth paragraph of the article supported by the evidence in Table 1? [4]

(c) Assess whether it is beneficial for the receiving country to use migrant labour. [5]

(d) Discuss the overall effect of the outflow of workers on the economy of their home country. [7]

Section B

Answer **two** questions.

2 A study found that demand for tickets for exhibitions at a major art gallery had unitary price elasticity.

(a) Explain how the concept of diminishing marginal utility may be used to construct a demand curve for the product and whether that analysis still applies in the case of demand for tickets for the exhibitions. [12]

(b) Discuss whether the law of diminishing returns contradicts the concept of economies of scale. [13]

3 **(a)** Explain what is meant by an oligopoly market and why prices might fluctuate less in an oligopoly market than in a perfectly competitive market. [12]

(b) Discuss whether a firm in monopolistic competition is more likely to act in the public interest than a firm that is a monopoly. [13]

4 Some workers producing non-essential luxury goods or services are paid very highly. The wage rate is not related to the economic value of a good or service but more to social factors or fashion. The economic theory of wages is, therefore, of little use in explaining wage differentials.

Assess this argument. [25]

5 It is said that the lack of investment funds for private companies from banks leads to temporary closures of factories which then become permanent and cause long-term unemployment. This loss of output will lead to a possible recession.

Analyse each part of this argument and discuss whether you agree with it. [25]

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6 **(a)** Explain how the age and employment structures of the population of a developing country are likely to differ from those of a developed country. [12]

(b) You are told that a country has problems relating to overcrowding, unemployment and pollution.

Discuss whether the existence of such problems necessarily means that the country must be a developing country. [13]

7 **(a)** For what purposes do people demand money? [10]

(b) Too much money causes inflation. Discuss the main macroeconomic aims of the government and consider whether it should give priority to the limitation of inflation in achieving economic well-being. [15]

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Section A

Answer this question.

1 **The virtual economy is set to make billions**

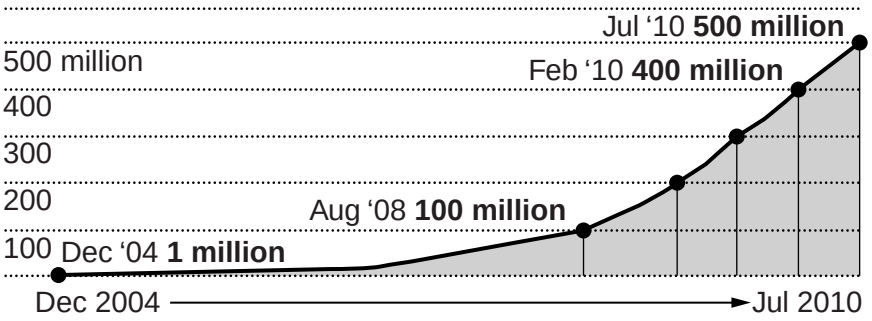
There has been a rapid growth in companies that sell 'virtual goods' on the Internet. The goods do not exist, they are only pictures on a screen used to play computer games. One game for example puts the consumer in the position of a farmer. Items for the farm, such as farm animals, crops and farm buildings, can be purchased. However, the farm buildings and the crops and animals are not real. They are only computer graphics on the consumer's home computer.

One firm has spent US$10m in the last ten years promoting these games. Its director said 'In the last two years we have seen the revenue of firms in this industry go from nothing to tens and hundreds of millions of dollars.'

The director of another firm said 'We have two different revenue sources. The first is the sale of the virtual goods for the games, the second is the revenue from other firms who wish to advertise within the game.'

Some items are acquired by consumers because they accumulate points by completing an activity within the game, such as harvesting a crop. Other items can be purchased to speed up the game. Part of the motive, said one consumer who spends about US$10 a month on virtual goods, is to impress your friends and let them see all the virtual goods you have won or bought. It has now become a popular thing to do. Central to the increased popularity of the games is the fact that the virtual goods can be purchased through social networking sites such as Facebook and MySpace.

Fig. 1: Facebook's Membership



Proof of the attraction of this market is the fact that the social networking sites are negotiating with the virtual goods firms to get a percentage of the revenue every time a consumer purchases a virtual tractor or crop.

The promoters of the virtual goods say it enables consumers to buy products without the rush and crowds of shops. They are easy to buy and that is why people are prepared to buy products that do not exist.

The firms claim that tens of millions of people buy the virtual products. In December 2009 one of the firms sold part of its business to another firm for US$113 million, whilst another was valued at US$400 million.

The director of one virtual goods firm said 'the industry is one of the most exciting developments of 2009, it is in the early stages of growth but it is growing fast.'

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(a) Identify two reasons given why people purchase virtual goods. [2]

(b) **(i)** What indicators may be used to determine whether a firm is large or small? [4]

(ii) Is the evidence given enough for you to determine whether the firms that sell virtual goods are large or small? [4]

(c) The article says that customer numbers are increasing rapidly. What is likely to happen to the total fixed costs and total variable costs of the virtual goods company as this occurs? [4]

(d) From the evidence given, discuss whether it is wise for a firm to spend money advertising products that do not exist through sites such as Facebook on the internet. [6]

Section B

Answer **two** questions.

2 'The achievement of equilibrium in a market rests solely on the ability to measure marginal utility. This is not possible and, therefore, equilibrium in a market can never be achieved.' Discuss this argument. [25]

3 **(a)** With the help of diagrams, analyse how a firm can experience both diminishing returns and economies of scale. [12]

(b) 'Monopolies create a deadweight loss. They should always be discouraged.'

Discuss this opinion. [13]

4 The economic analysis of wage determination states that all wages rates in different occupations will in the long run become the same and equal to the average product of labour.

Discuss this statement. [25]

5 In 2010 a number of governments were concerned that they had large budget deficits. A group of economists recommended that the deficit should be reduced by public spending cuts rather than tax increases.

(a) Explain what is meant by a budget deficit and why a large deficit might be a source of concern. [12]

(b) Discuss the similarities and differences of using spending cuts or tax increases as a means of solving budget deficits. [13]

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6 **(a)** Explain the causes of unemployment and consider which cause is the most significant for a country with which you are familiar. [12]

(b) The main guide to the economic development of a country is the proportion of its working population engaged in the tertiary sector. Discuss whether this statement is true. [13]

7 The table below shows figures for GDP for two countries in 2000 and 2010.

Country	GDP 2000 $US billions	GDP 2010 $US billions
USA	9825	13271
India	469	929

Discuss whether the above figures are sufficient to conclude that the standard of living in the USA is higher than the standard of living in India. [25]

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