Cambridge International A Level

Cambridge International Examinations
Cambridge International Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays (Supplement) **October/November 2015**

2 hours 15 minutes

No Additional Materials are required.

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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.

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Section A

Answer this question.

1 **Economic growth and happiness**

Research in the United States has demonstrated that economic growth – and improved wages that usually accompany it – improves happiness and well-being. The richer we are, the happier we are. There is no maximum wealth level beyond which higher incomes cease to increase well-being.

The best way to promote happiness is, therefore, to maximise economic growth and ensure that as many as possible are able to enjoy higher incomes. Every tax change should be judged against how it will affect GDP. Increasing taxes on higher incomes will reduce disposable income and not increase well-being.

Recently, real wages have been falling. Faster growth is necessary to overcome this. Without faster growth, people will become poorer and, therefore, unhappier. Further, without growth, it will not be possible to keep spending more on essential services such as health care without cutting expenditure in other areas.

The results of the research are not good news for those who argue that what makes people happy is not what they earn in absolute terms, but what they earn compared with others. An opposing opinion suggests that it is wise to reduce differentials in earnings. For example, high earners, such as investment bankers, should be taxed more heavily.

The results are also not welcomed by those, including environmentalists, who say that it is stressful and unsustainable for economies to focus on increasing their GDP. There should be careful consideration of future economic development. The country should not develop certain resources in case they increase carbon emissions and result in allocative inefficiency.

An example of this is found in the UK. There is a proposal to build a new runway at London Airport. The new runway will enable the number of flights from the airport to be increased with an estimated net private benefit from the expansion which is said to be £5 billion over 70 years. Environmentalists say that the calculation ignores many costs, such as what will be the effect of extra road journeys to and from the airport each year; what will be the effect on house prices; and what will be the cost to the environment of increased emissions?

Increasing investment and the resulting increase in GDP do not always bring increased happiness and welfare.

Source: Adapted from London Evening Standard, 2012; Daily Telegraph, 2013

(a) Briefly explain how, according to the article, an increase in economic growth increases happiness. [4]

(b) With the help of a diagram, explain how an increase in indirect tax rates might affect a consumer's total utility. [4]

(c) Consider whether you support the opinion in the article that it is a good idea to increase taxes on the rich. [4]

(d) Discuss whether consumer welfare is always increased if economic growth increases. [8]

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Section B

Answer any **two** questions.

2 There was a period when many publicly owned enterprises were privatised. Investors said that privatisation would increase competition, encourage greater efficiency and raise profits.

(a) Explain what is meant by economic efficiency. [12]

(b) Discuss how the privatisation of an industry might affect economic efficiency. [13]

3 **(a)** Analyse the relationship between the cost curves of an individual firm and the supply curve of the industry. [12]

(b) In the long-run, average cost falls with increases in output and, therefore, larger firms are always to be preferred to smaller firms. Do you agree with this opinion? [13]

4 'The economic theory of wages has as its central idea the achievement of an equilibrium in a perfect market. It is difficult to find a perfect market and it is unrealistic to speak of an equilibrium when private enterprise is full of uncertainty.'

Discuss whether this statement means that in explaining wage determination the theory has nothing to offer. [25]

5 **(a)** Explain why the government's annual budget is an important instrument of economic policy. [12]

(b) Analyse whether there is a link between the reasons given by the liquidity preference theory as to why people demand money and the rate of interest. [13]

6 **(a)** Explain what are the main determinants of business investment. [12]

(b) 'If investment increases it will cause an increase in output. If output increases it will cause an increase in investment.'

Discuss whether both these statements can be true. [13]

7 'People in developed countries suffer from pollution and overcrowding. However, people in developing countries suffer from malnutrition and poverty.'

Discuss whether it is correct to distinguish between developed and developing countries in this way and consider how living standards can be compared between the two types of country. [25]

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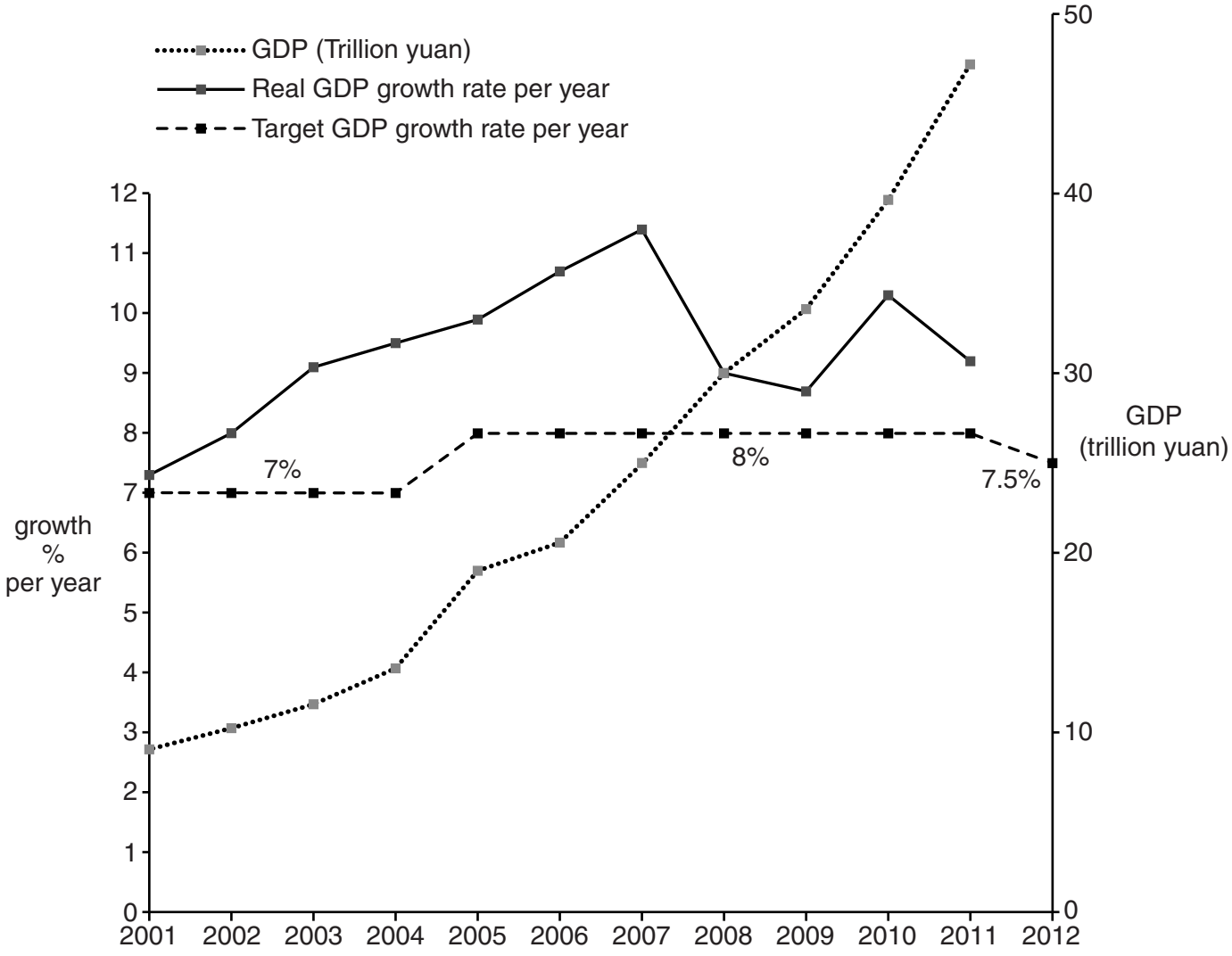
Section A

Answer this question.

1 **Economic growth in China**

In less than 30 years, China has seen a huge shift from being a mainly farming economy to a thriving manufacturing economy. Since 2007, economic growth has continued despite uncertain economic conditions and the global financial crisis. Some economists doubt China's ability to sustain such economic growth, which has been achieved at a cost to the environment.

Fig. 1: GDP growth for China since 2001



Source: Chinese Government work reports from 2001 to 2012, Su Jingbo/China Daily

As China's economy continues to grow, it has a new challenge: how will it deal with the shift of the population from being mainly rural to being mainly urban? In 2030, it is estimated that about 220 cities in China will have at least one million residents. This will increase the pressure on natural resources. Economic inefficiencies created by urban growth include air and water pollution, traffic congestion, poor housing and overcrowding.

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China's leaders have responded by reducing the target GDP growth rate. They have also concentrated on trying to improve the quality of China's economic growth and have focused on sustainable urban planning, low-carbon development, promoting improved public transit systems and improved water treatment.

National government policies can help correct market failures and set standards for environmental problems such as air pollution. They can establish partnerships between city authorities, businesses and the general public. Urban sustainability solutions do not just benefit the environment and people's quality of life; they are often highly profitable. Investment in rapid transit bus systems, for example, results in lower energy consumption and lower costs.

Source: The Daily Telegraph supplement, 2012

(a) Fig. 1 shows China's real GDP growth rate. Explain what this means. [3]

(b) How far does Fig. 1 support the suggestion in the extract that China's growth 'has continued despite uncertain economic conditions'? [4]

(c) The article refers to economic inefficiencies. Explain the distinction between an economically efficient situation and one which is inefficient. [5]

(d) Identify **two** market failures mentioned in the article and consider the methods that governments might use to help overcome these market failures. [8]

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Section B

Answer any **two** questions.

2 Consumers decide what they wish to buy and as a result direct the market. Producers develop new products, which they then promote by advertising, in order to maximise profits. Without producers there would be no products to buy.

(a) Explain how economic theory predicts what a rational consumer decides to buy. [12]

(b) Discuss whether the market is dominated more by producers or by consumers. [13]

3 **(a)** Explain the meaning of, and the relationship between, diminishing returns, total product and marginal cost. Use a diagram to illustrate your answer. [12]

(b) 'Firms undertake vertical and horizontal integration to grow in size. They achieve beneficial economies of scale through growth.'

Consider whether economies of scale are always caused by integration and whether, therefore, there is no place for small firms in a modern economy. [13]

4 **(a)** Explain the motives for the demand for money according to the Keynesian liquidity preference theory. [12]

(b) A worker is a weekly paid shop assistant. She is then promoted to a manager in a larger store on a higher monthly salary. At the same time interest rates fall.

Discuss how these changes would affect the worker's demand for money. [13]

5 The government of your country wants to know how the economy compares with other countries' economies.

Discuss which economic indicators it should obtain and how reliable they might be as a basis for such a comparison. [25]

6 Businesses say that high interest rates are not desirable because they prevent investment. Government ministers say that high interest rates are sometimes necessary because they encourage saving and control inflation.

Discuss these two opinions and decide whether they are always true. [25]

7 **(a)** Distinguish between supernormal profit and economic rent and consider the circumstances when each occurs. [12]

(b) Discuss whether you agree with the opinion that a trade union might be able to achieve higher wages for its members but only by causing some unemployment. [13]

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Section A

Answer this question.

1 **The economy as 'a machine'**

The economy has been spoken about as if it were a machine. Its businesses are 'the engines of job creation'; they change 'inputs into outputs' and 'generate profits'. In this approach, markets are assumed to be productively efficient, consumers rational, incentives are obvious and outcomes certain. This means that any regulation of the market is undesirable because it hinders the workings of the machine.

However, there is no evidence that markets are always efficient and there is no evidence of a prosperous economy that does not also have strong regulation and an active government. Recessions and economic downturns should have caused this 'machine' idea of an efficient economy to be discredited. Yet, this view still influences economic policy.

What is required is a theoretical framework for the economy that recognises that economies are not simple and predictable but complex; that understands that intended outcomes do not always happen. Consumers' decisions are not precise but approximate. The economy should be thought of as 'a garden', not 'a machine'. In this idea the economy cannot be completely efficient but if managed effectively it can work reasonably well.

Consider regulation. In the 'machine' idea, regulation is an unfortunate interruption of the process of income generation. The machine should be left to run on its own. Perfectly free markets are the ideal. Less regulation will automatically lead to more prosperity. In the 'garden' idea it is recognised that the economy requires regulation. The control of harmful activities and the encouragement of beneficial activities will enable the economy to become more efficient.

Consider spending. Government spending should not be thought of as a single action which uses money as an engine uses fuel. Rather, it is part of a continuous process that circulates money through spending. Also, some of this spending helps to develop the economy because it will be spent on education, health and roads, although not all spending is equally useful.

It has been argued that the most prosperous economies are those that tax and spend the most. Less spending cannot revive a weak economy, but more spending can. Employment is not created by profits. It is a consequence of a circular process that starts with consumer demand and spending. The customer is the true job creator and resources are allocated according to their preferences.

Source: Adapted from the RSA Journal, Winter 2012

(a) The article says that markets are assumed to be productively efficient. What is meant by productive efficiency? [3]

(b) Summarise the **two** main ideas about the working of the economy in the article. [4]

(c) Analyse how more spending can 'revive a weak economy'. [6]

(d) Discuss whether the last sentence of the article conflicts with the earlier statements about the need for a government. [7]

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Section B

Answer any **two** questions.

2 Economic theory often uses the concept of the margin.

(a) Explain how the concept of the margin is used in consumer theory to derive a market demand curve. [12]

(b) Discuss whether the use of the concept of the margin is important for a firm in deciding its business objective. [13]

3 **(a)** Analyse, with the help of a diagram, the possible shape of the long-run average cost curve of a firm and explain whether it is likely to be the same for small and large firms. [12]

(b) Two airlines were recently accused of colluding to exploit the consumer. An investigation was established to see if this had happened.

Discuss why collusion can occur in one market structure but not in another market structure. [13]

4 Briefly consider the causes of unemployment and then use the economic theory of the determination of wage rates to discuss whether an increase in wage rates may substantially increase long term unemployment in some industries but not in others. [25]

5 In 2012, many smaller specialised city centre retailers struggled against competition from large supermarkets and online retailers. They were also badly affected by government fiscal policy.

(a) Explain how small retailers could be badly affected by government fiscal policy. [12]

(b) Economic theory suggests that competition is good. The statement from 2012 seems to imply that it is not. Discuss this difference of opinions and consider which you support. [13]

6 In a number of countries interest rates have remained low for a long time. Some people have been unhappy with the low rates but others have been pleased. However, high interest rates also cause different reactions.

(a) Explain why different groups of people may differ in their reaction to the level of interest rates. [12]

(b) Discuss whether a low interest rate can help a government achieve its macroeconomic aims. [13]

7 Economic development and the exploitation of resources can result in structural change and unemployment in some industries, increased environmental damage, overexploitation of fish stocks, increased inequalities in the distribution of income and pressure on resources causing inflation.

Explain what is meant by a developing economy and discuss whether it would be wise to conclude from the above opinion that developing countries should, therefore, not seek to become developed. [25]

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