Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays **October/November 2016**

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.

You may answer with reference to your own economy or other economies that you have studied where relevant to the question.

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Section A

Answer this question.

1 Unemployment and Government Policy

When considering alternative government policies in time of recession, it is worth remembering that in the 1930s US recession it was feared that what Keynes called 'equilibrium at less than full employment' might become permanent.

Moreover, technological unemployment could also remain a permanent feature of the labour market, especially among the less skilled and the elderly.

In 2013 there was another recession in the US. Unemployment stood at 6.7% of the workforce rather than above 20% as it had been in the 1930s. However, the economic recession was far from over in 2014. The US economy was 8% smaller than had been forecast for it. This led to a repeat of the question of whether stagnation is inevitable and whether unemployment would be a permanent feature.

The policies of the US government to solve the recession of 2013–14 included raising the minimum wage to US$10.10 an hour, increasing benefits to the unemployed and increasing the money supply. There was, however, little enthusiasm from some economists for more government action in the form of government spending. They did not support a programme of creating public sector jobs to combat unemployment, saying it was bureaucratic. Even if the right investment could be decided, they feared the new jobs would demand skills that the unemployed simply did not have.

However, not everybody agreed. Others gave the example that in 2009, 39 states used US$1.3 billion to create more than 260 000 jobs by subsidising private employers. Many of these jobs went to people who were difficult to employ, including those who had been unemployed for a long time. When the programme ended in 2010, 37% of the workers covered by the subsidy kept their jobs. Those who favoured such public expenditure said that the private sector, if left to its own devices, would not have hired such workers.

Supporters of public expenditure also said there were great benefits from government investment in public works in a time of recession; in previous recessions, roads, bridges and public buildings were built. And, if such investments took place again, it was argued, they would not be very expensive. The cost of government borrowing was below the rate of inflation and the investment would help reduce the nation's debt.

To them it seemed foolish for the US central bank to stimulate the economy by encouraging increased lending with low interest rates: that would be similar to the credit expansion that had led to a financial crisis a few years before. They thought it would be better to rely on fiscal policy.

Source: *New York Herald Tribune*, 30 January 2014

(a) Briefly explain the difference between monetary policy and fiscal policy, and identify an example of each policy from the article. [4]

(b) Explain what is meant by 'technological unemployment' and suggest why it could be permanent among the less skilled and elderly. [3]

(c) The article refers to 'equilibrium at less than full employment'. Explain with the help of an aggregate demand and aggregate supply diagram how an economy can be in equilibrium at less than full employment. [5]

(d) Contrast the opposing views in the article about the policies a government should adopt in a time of recession and consider what evidence is given to support each policy. [8]

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Section B

Answer any **two** questions.

2 Adam Smith's eighteenth century idea of an 'invisible hand' where the free market allocates resources effectively and efficiently is false because the 'invisible hand' cannot work in a complex modern economy.

Do you agree with this argument? [25]

3 **(a)** Explain the meaning of an indifference curve and show to what extent indifference curves can be used to determine a consumer's demand curve for a product. [12]

(b) Consider whether indifference curves can be used to analyse the effects of a fall in the price of a good on the demand for both a normal good and a Giffen good. [13]

4 In 2014, the average monthly salary in South Africa for an executive business manager in the private sector was 60 000 rand; for a public sector nurse, 13 700 rand; for a cleaner, 3 600 rand. These differences in wage rates can be entirely explained by the economic theory of the labour market.

Discuss whether you agree with this conclusion. [25]

5 **(a)** Explain how an equilibrium position is determined for a firm and for an industry in perfect competition in the short run and in the long run. [12]

(b) Outline the conditions that make price discrimination in a monopoly market possible and discuss whether such discrimination is ever beneficial. [13]

6 **(a)** Explain **three** major government macroeconomic policy aims and describe why there may be a conflict in trying to achieve them at the same time. [12]

(b) Governments are sometimes concerned with microeconomic issues, for example, planning applications for large projects such as airports which have environmental implications. Discuss how a government's decision on a microeconomic issue might have macroeconomic implications. [13]

7 **(a)** Explain what is most in need of development in a developing economy. [12]

(b) Discuss how easy it is to compare the standard of living between developing and developed countries. [13]

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ECONOMICS **9708/42**

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Section A

Answer this question.

1 Risks of reduced US monetary stimulus

The US Central Bank (the Federal Reserve) announced in January 2014 that it would reduce its quantitative easing (QE) by cutting its monthly bond purchases by another $10 billion. It said that it was optimistic that 'the economy is about to start growing faster and there is underlying strength in the wider global economy'. It had set interest rates near to zero.

This policy of the Federal Reserve contributed to a global shift in investments. Turkey, for example, which depends heavily on foreign investment, tried to bolster its currency by raising its interest rate to attract funds, but this did not work.

The Federal Reserve, however, was thought to be unlikely to adjust its own policy in response to the problems in other countries unless it saw evidence that the problems were affecting the US domestic economy. Indeed the problems in countries such as Turkey may have made it easier for the Federal Reserve to reduce its expenditure on bonds. Investors seeking to limit their risks were bidding up the price of US bonds, counteracting the effects of the Federal Reserve's gradual reduction in the volume of its own purchases.

The prospect of a future rise in US interest rates caused worrying declines in investment in emerging markets. China's Deputy Finance Minister argued that the US has a responsibility beyond its own domestic economic concerns, saying 'We hope that as the issuing country of the largest reserve currency in the world the US should be mindful of the wider effects of its macroeconomic policies'.

The Deputy Finance Minister added that balance of payments problems in the developing world are partly due to lack of domestic economic reform there. This was supported by a British official who said that emerging economies had been helped by cheap money from the advanced countries but this disguised the need to follow through on fundamental reforms in some countries. Currencies of countries such as India, Indonesia, Turkey and Brazil have been under particular pressure because of their current account deficits.

A US official said that strong US growth is good for the global economy and responded to criticism of the Federal Reserve's handling of QE: 'I think that what has been demonstrated is that we've pursued a pro-growth policy that we believe is ultimately good for the global economy. Because when the US economy is growing, it helps to provide momentum more broadly'.

Source: International New York Times, 30 January 2014

(a) Explain what is meant by monetary policy and give **two** examples of monetary policy from the article. [3]

(b) What is meant by 'the economy is about to start growing faster'? Explain how a stronger global economy could help to achieve this. [4]

(c) Consider how far the reason suggested in the extract could explain the pressure on the currencies of India, Indonesia, Turkey and Brazil. [6]

(d) Suggest what effect the Federal Reserve's decision to reduce its bond buying by $10 billion a month could have on the US economy. [7]

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Section B

Answer any **two** questions.

2 It has been said that the aim in the allocation of resources should be to achieve the greatest happiness for the greatest number of people.

Discuss whether economics has anything to say about the best way to maximise welfare from the use of resources. [25]

3 **(a)** A number of consumers are deciding whether to buy a product. How far does economic theory explain the determination of the market demand curve for that product? [12]

(b) Discuss whether that theory is still valid if the producer decides to advertise the product, and consider the effects of the advertising on the demand curve for the product. [13]

4 Explain what is meant by the 'equilibrium of a perfectly competitive firm' and consider the view that equilibrium is always achieved in perfect competition but never in a monopoly market. [25]

5 **(a)** Explain the causes of unemployment and consider what type of unemployment is the most serious for the country in which you live. [12]

(b) Discuss whether government macroeconomic aims of full employment, economic growth and price stability are likely to conflict with each other. [13]

6 **(a)** Some occupations that do not have pleasant working conditions, such as rubbish collection, receive low pay, while those with pleasant conditions, such as senior managers, receive high pay.

How far does economic analysis explain this situation? [12]

(b) Discuss what influence a trades union and a government can have in determining wage rates. [13]

7 **(a)** Conventional estimates of national income indicated that average income per head between 2009 and 2013 was US$98 780 in Norway and US$36 900 in New Zealand. Consider whether this means that the standard of living in Norway is nearly three times as high as in New Zealand. [12]

(b) Norway and New Zealand are classified as developed countries. Make a judgement on what are the important distinguishing differences between a developed country and a developing country. [13]

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Section A

Answer this question.

1 Interest rates and economic growth

In January 2014 Turkey's central bank agreed to a large increase in its main interest rate from 4.5% to 10% in order to try and strengthen Turkey's currency, the lira. Financial markets did not react much to the increase.

The morning after the interest rate increase in Turkey there was an initial rise in the lira but by the afternoon demand for the lira had fallen. The interest rate rise was an attempt by the Turkish central bank to slow down inflation and increase the demand for the lira by offering a better return. However, higher interest rates threatened to hinder economic growth by raising the cost of borrowing. A spokesman from the Turkish Currency Exchange said that the Turkish economy was not strong enough and if the lira was weak it would have an impact on all aspects of daily life.

A similar policy was adopted by the South African central bank, which increased its main interest rate from 5% to 5.5%. This also failed to prevent a decline in the value of that country's currency, the rand. Some analysts said the increase in interest rates in South Africa was more to control inflation than to support the exchange rate.

Currency traders also sold their holdings of currencies of other emerging countries such as Russia and Argentina. The Russian currency, the rouble, fell 1% against the dollar in January 2014 to its lowest point since 2009. Currency traders were less inclined to deal with countries that they regarded as being poorly governed or had major public protests. These included Russia, Argentina, Ukraine and Thailand.

Some argued that the decline in developing countries' currencies could adversely affect developed economies such as the US, Europe and Japan because the developing countries would not have the same purchasing power and would buy fewer imports. European countries have a great dependency on exports to developing countries.

Meanwhile, policy makers in developing countries face a problem. They cannot raise interest rates without endangering economic growth and in any case raising interest rates, it appeared, did not convince currency traders that the high rates would be maintained in the long term. Instead currency traders preferred to put money back into the developed countries, which were seen to be less risky.

Source: International New York Times, 30 January 2014

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Table 1: Key economic indicators for selected countries, May 2014

	Interest rate %	Inflation rate %	GDP growth %
Argentina	14.9	10.9	1.4
Brazil	11.0	6.3	1.9
Germany	0.25	1.3	2.5
Russia	7.50	7.3	0.9
South Africa	5.5	6.1	2.0
Turkey	10.0	9.3	4.4
UK	0.5	1.8	3.1

Source: http://www.tradingeconomics.com/ accessed 21 May 2014

(a) Explain what is meant when it is said that Turkey and South Africa hoped that an increase in interest rates might 'strengthen' their country's currency. [2]

(b) Distinguish between monetary policy and fiscal policy and give **two** examples of fiscal policy. [4]

(c) Discuss how far the information in Table 1 can be used to support the statements in the extract about the links between high interest rates, inflation and economic growth. [6]

(d) How far does the experience of the countries mentioned in the extract support the view that higher interest rates benefit macroeconomic performance? [8]

Section B

Answer any **two** questions.

2 'The price mechanism is the most effective and certain method for ensuring an efficient allocation of resources to achieve maximum welfare.'

Comment on this opinion. [25]

3 The use of indifference curves to establish a consumer's equilibrium is purely a theoretical tool. They show the relation between two goods; they do not show prices or income and, therefore, cannot be used to determine a demand curve.

How far do you agree with this statement? [25]

4 **(a)** Assess the differences and the similarities in characteristics, pricing and output between perfect competition and monopolistic competition. [12]

(b) Consider whether it is true that prices are always higher and output always lower under monopoly conditions than they are under perfectly competitive conditions. [13]

5 **(a)** With the help of a diagram, explain how far the introduction of a minimum wage in an occupation might affect the division between a worker's transfer earnings and economic rent. [12]

(b) Discuss how far wage differentials are caused in the real world solely by differences in market demand and supply. [13]

6 **(a)** 'National income is the only determinant of the demand for money.'

Do you agree with this statement? [12]

(b) Assess how alternative macroeconomic policies might affect the demand for money. [13]

7 **(a)** Consider whether the main distinguishing feature of a developing economy is a low level of income per person. [12]

(b) Are the problems that arise in estimating changes over time in national incomes significantly different depending on whether the countries are developing or developed? [13]

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