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 2018**

2 hours 15 minutes

No Additional Materials are required.



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Section A
Answer **Question 1**.

Section B
Answer **two** questions.

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Section A

Answer this question.

1 **Sustainable electricity**

The UK government favoured the production of cheap, sustainable electricity and subsidised the large companies that operate wind farms. The wind farms cost a lot to build and maintain. However, as the wind is free, the companies pay nothing for fuel and can sell electricity at very low prices – when the wind is blowing. This destroys any incentive to build power stations that combine the use of wind and gas because when the wind blows the gas unit is switched off and the return on the investment in gas is zero or negative. This has meant that the gradual replacement of coal-fired power by more efficient gas-fired power is not progressing and, as a result, there is no significant cut in carbon dioxide emissions.

Prices charged for electricity not produced by wind farms have been rising because government support for the electricity industry has been directed to the wind farms. Expensive electricity production has driven industries abroad which has resulted in a loss of income and jobs. By 2020 it is estimated that small businesses will be paying 77% more per unit for electricity. The poor and the elderly have been hit hardest by high electricity bills. Some say that the support of wind farms has caused the destruction of landscapes.

Source: The Times, 9 November 2015

Sustainable agriculture

In Africa, industrial methods of agriculture deplete the soil, pollute water tables and fail to benefit small-scale farmers. Agro-ecological methods – aimed at producing food without damaging natural resources – are by contrast more sustainable for the farmers and more nutritious for consumers. Advocates say these methods are profitable for small-scale farmers and more productive with high yields and cheap inputs. They say 'we need to develop local markets, create local diversity and increase the capacity of local economies'. Using them could have a huge effect on the 70% of Africans that rely on agriculture for their livelihoods. This was endorsed by a conference in Mali in 2015. Even large commercial farms are starting to adopt the agro-ecological methods.

Currently, six companies supply 60% of the world's commercial seed market and 11 companies supply 98% of the world's pesticide market. Supporters of agro-ecological methods claim that these huge multinationals can easily capture markets through their combined financial and political power and can restrict farmers' choice of what inputs to buy and which markets to supply. Those representing small farmers say that these markets are not competitive.

Large corporations deny this accusation that they restrict markets and exploit small-scale farmers. They say farmers have to make a new choice each year so whenever input suppliers have a new product they need to offer something that is reliable so that the customers will come back and buy more.

Source: African Business, August/September 2015

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(a) Identify, from the article, **three** problems the UK faces in the production of electricity. [3]

(b) Explain what is meant by equity and consider whether, according to the article, the subsidising of wind-power electricity production is likely to be equitable. [6]

(c) The article says that the African agricultural markets are not competitive. Explain what is meant by a competitive market and comment on whether you agree with the judgement. [5]

(d) Discuss whether there is evidence in the article that might lead you to conclude that large businesses are detrimental to an economy. [6]

Section B

Answer **two** questions.

2 'A society that cares about efficiency needs to provide government funds for social sciences that work on the assumption that efficiency matters'. (*Royal Society of Arts Journal, Issue 4, 2013*)

Explain what is meant by economic efficiency. Consider whether you agree that the only way to achieve economic efficiency is through public sector intervention in the economy. [25]

3 **(a)** Explain what is meant by consumer equilibrium and consider whether the assumptions underlying consumer equilibrium are realistic. [12]

(b) Analyse the differences between a normal good, an inferior good and a Giffen good. Discuss whether knowledge of these differences is all that is required by a company considering changing the price of its product. [13]

4 **(a)** Explain the economic theory of wage determination in perfectly competitive labour markets. [12]

(b) In 2016, a union representing doctors organised strikes to oppose new contracts and rates of pay that were proposed by the government. Hospital appointments were cancelled. The government agreed to change some of the proposals.

Does this statement prove that in imperfect labour markets wages are determined solely by trade unions and not by economic principles? [13]

5 Recession in some economies has caused high unemployment. At the same time high levels of national debt and substantial budget deficits have been experienced.

This means that governments can no longer use Keynesian demand management policies to solve the problem of unemployment.

To what extent do you agree with this conclusion? [25]

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6 **(a)** Examine the effects on the demand for money in an economy, when the money supply is increasing and more individuals are using credit and debit cards instead of cash to purchase goods and services. [12]

(b) Quantitative easing will lead to lower interest rates and it will depreciate the value of the national currency. This will automatically lead to high levels of inflation.

To what extent do you agree with this view? [13]

7 **(a)** Distinguish between economic growth and economic development and consider whether they are linked. [12]

(b) It is difficult to calculate the value of GDP and it does not provide an accurate measure of the welfare or happiness of a country's citizens, therefore it should not be used as an indicator of the standard of living.

Discuss whether you agree with this statement. [13]

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ECONOMICS **9708/42**

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Section A

Answer this question.

1 What's to be done about rising inequality?

There is great inequality of income and wealth in the United States (US), that many believe is not equitable. It seems, even to some of those who benefit from this inequality, that something should be done to reduce it. What are the strongest reasons for trying to bring about greater equality of income and wealth?

One obvious reason for redistributing resources from the rich to the poor is simply that this is a way of making the poor better off. Many people in the world are poor, and the improvement in their lives that richer people could bring about by giving money is enormous by comparison with the small sacrifice that this would involve. Redistributing assets increases the well-being of the poor more than it decreases that of the rich.

A justification for reducing inequality through non-voluntary means, such as taxation, needs to explain why redistribution of this kind is not just arbitrary.

The possibility of making the poor better off is not the only reason for seeking to reduce the world's rising level of economic inequality. Many people in the US believe that high and rising levels of inequality are objectionable.

It is worth inquiring into why this might be so.

1. Economic inequality can give wealthier people an unacceptable degree of control over the lives of others, for example over where and how they can work, what they can buy and in general what their lives will be like.

2. Economic inequality can undermine the fairness of political institutions. If those who hold political offices depend on large private contributions for their election campaigns, they may be more responsive to the interests and demands of wealthy contributors, and those who are not rich will not be fairly represented.

3. Economic inequality undermines the fairness of the economic system itself by making it difficult, if not impossible, to create equality of opportunity. For example, it means that some children will enter the workforce much better prepared than others and people with few assets find it harder to access a loan to start a business or to pay for higher education.

Source: Reasons we should fix economic inequality, TM Scanlon, accessed 19 April 2016

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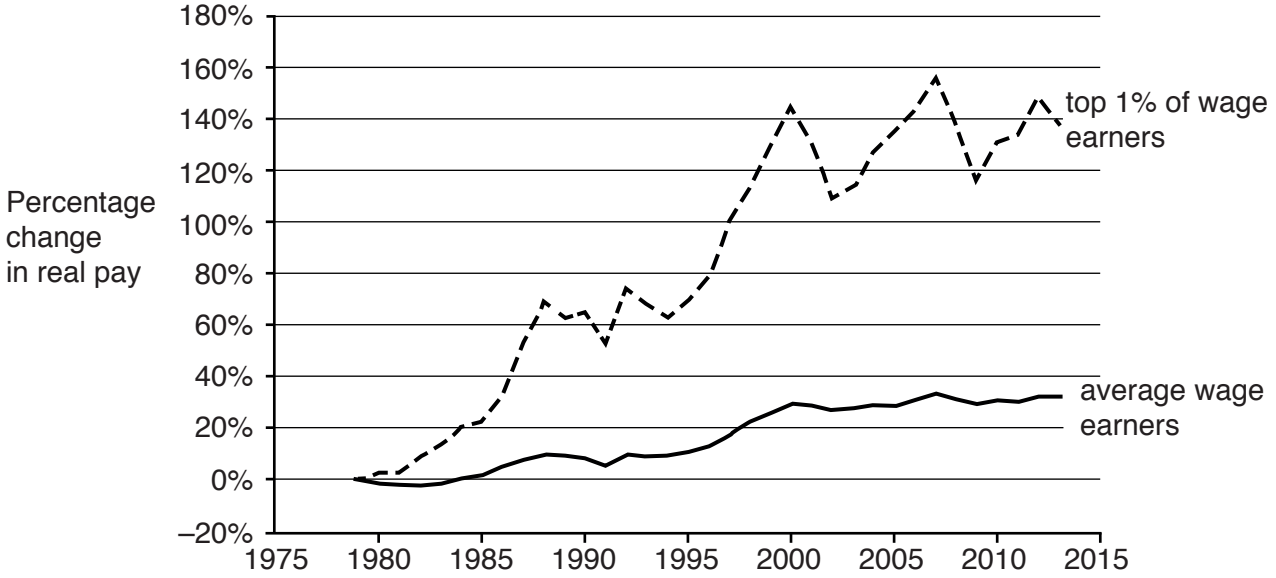


Fig. 1.1: Change in real annual pay in the US, 1979–2013

Source: Adapted from EPI analysis of data from Kopczuk, Saez and Song (2010) and Social Administration wage statistics. (Accessed 19 April 2016)

(a) The article says that many in the US believe that inequality is not equitable.

What is the difference between equality and equity? [2]

(b) Explain, using the article, **two** ways in which inequality is considered harmful. [4]

(c) Consider whether the changes in real annual pay shown in Fig. 1.1 support the idea of rising inequality in the US. [6]

(d) The article refers to a reduction of inequality through taxation. Discuss the effectiveness of fiscal policy in redistributing income. [8]

Section B

Answer **two** questions.

2 Discuss whether economic efficiency is always achievable in a market economy. [25]

3 **(a)** Analyse the factors which determine the price of a firm's product and its output in monopolistic competition. [12]

(b) Assess the effect on output and price if a monopoly firm maximises its sales revenue rather than its profit. Consider who will benefit the most from this change. [13]

4 Consider whether wages are only determined by the market forces of supply and demand. [25]

5 Robots are increasingly used in various areas of production.

(a) Explain the type of unemployment which may arise as a result of the increased use of robots. Consider the contribution this may make to total unemployment in an economy. [12]

(b) Discuss whether GDP is always a good measure of living standards. [13]

6 A country with an open economy has an increasing demand for its exports and a fall in the supply of labour.

(a) Explain the effects of these changes on the general price level and national output in that economy. [12]

(b) Consider the effectiveness of using only monetary policy in this situation. [13]

7 **(a)** Explain how developing countries differ from developed countries. [12]

(b) Assess the extent to which a multinational company's investment in a developing country leads to economic growth. [13]

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Section A

Answer this question.

1 The government and market failures

Countries are seeking innovation-led growth that is more inclusive and more sustainable than in the past. Modern capitalism is facing challenges of climate change, youth unemployment and rising inequality.

These challenges require rethinking the role of government and public policy. It requires a new justification of government intervention that goes beyond that of fixing market failures, to one of stimulating and facilitating change by creating markets which more fairly distribute both risk and rewards.

This is not just about spending public money on different activities; it requires new indicators through which to evaluate public investments.

Markets are 'blind' and the direction of change they provide often represents inefficient resource allocation from a society's point of view. Market failure theory (MFT) justifies government intervention in an economy in order to correct a situation of inefficient resource allocation. This involves taking measures such as devising market mechanisms to internalise external costs or the direct provision of public goods.

MFT has developed methods to evaluate government actions, usually through cost-benefit analysis (CBA) – which has limitations in its effectiveness. The CBA then informs an assessment of the 'principal-agent' structure that will force private agents to do what the government wants.

Critics of MFT say that it assumes that the government only fixes existing problems and this is not as useful as a policy that creates dynamic new markets or products. However, this can lead to accusations of 'crowding out' private sector businesses.

The argument against those criticisms rests on showing how government investments cause both a larger national output that can be shared between private and public sectors, and creates cost savings. However, this argument does not include the idea that the goal of public investment is about more than just increasing output. It should also be, as Keynes wrote, to 'do those things which at present are not done at all'.

In fact, new events that have transformed economies have also been influenced on both demand and supply sides by policymaking. The iPhone, Global Positioning Systems (GPS), touch-screen displays, solar power and wind farms, for example, were all publicly funded.

Source: RSA Journal, Issue 2, 2015

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(a) Explain what is meant by the 'principal-agent' problem and describe how it can be applied to governments and private sector businesses. [4]

(b) Outline what the article means when it mentions 'inefficient resource allocation'. [4]

(c) The article refers to 'internalising external costs'. Explain what economists mean by this and consider whether cost-benefit analysis can be used to achieve it. [6]

(d) Consider whether the article provides sufficient evidence to conclude that market failure theory (MFT) is inadequate as a government policy tool. [6]

Section B

Answer **two** questions.

2 A city bus company proposes to reduce passenger fares.

Explain whether consumers always buy more of a good at a lower price than a higher price. Consider what might be the effect on demand for bus journeys and the revenue of the bus company of the lower fares. [25]

3 **(a)** Two major hotel groups agreed to charge a lower rate for rooms booked through a booking agent than if guests asked for a room upon arrival at the hotel.

Explain how price discrimination can occur and how it can be profitable and consider whether the above situation is an example of price discrimination. [12]

(b) It has been said that where monopoly occurs rather than a competitive market, the public is the victim; prices are high and output is restricted.

With the help of a diagram, consider how far economic theory can be used to support this statement. [13]

4 Discuss how economic theory analyses wage rate determination. Consider if the theory can be used to explain the fact that the highest pay is often given for the work that is most agreeable while those occupations that are most unpleasant, such as rubbish collection, receive low pay. [25]

5 **(a)** Explain what is meant by the term 'natural rate of unemployment'. Consider which types of unemployment would cause this rate to rise. [12]

(b) Some economists argue that government intervention is the best way to reduce the natural rate of unemployment while others suggest that it would be better to allow market forces to reduce this type of unemployment.

Compare both approaches and assess which is likely to be the more effective. [13]

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6 **(a)** 'Central banks can control interest rates but they cannot control the money supply. Commercial banks can control the money supply but they cannot control interest rates.'

To what extent would you agree with this statement? [12]

(b) 'Monetary policy alone is unlikely to have any significant effect on real variables such as the level of output but it is the only effective way to control inflation'.

Critically evaluate this view. [13]

7 The Kuznets curve was based upon empirical evidence and it supports the hypothesis that as an economy develops, market forces first increase income inequality and then reduce it.

(a) Explain this hypothesis and consider whether it still applies to both developing and developed economies. [12]

(b) Significant income inequalities continue to exist in developed economies.

Evaluate the use of government policy to redistribute income in developed economies. [13]

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