Cambridge International AS & A Level

Cambridge Assessment International Education
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays **October/November 2019**

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 Growth and the uncertain economic system

Competition and a market economy support industrialisation and create higher living standards. The collapse of the world financial markets in 2008 was a failure of such a system and the ideas that underpinned it, not of individual policymakers. There was a misunderstanding of how the world economy worked.

Many of the problems that concern governments – poverty, rising inequality, crumbling infrastructure – would be eased by rates of growth that before the financial crisis seemed quite normal. But the rate of economic growth has declined across the developed world. Some blame this on a slowing of innovation and productivity. Others say that the struggle to revive the world economy is a result of the disequilibrium that led to the crisis.

Before the crisis, consumer spending was at unsustainably high levels in the United States (US), the United Kingdom and some other countries in Europe. It was at unsustainably low levels in Germany and China. The imbalance between countries increased – with resulting large trade deficits or surpluses. These imbalances were not irrational, they were the result of people struggling to behave rationally in a world of uncertainty and competition – all part of the market economy.

Bad investments were made in housing in the US and some European countries, in construction in China and in the export sector in Germany. The most obvious symptom of the disequilibrium was the extraordinarily low interest rates. Central banks were trapped into a policy of low interest rates because of a belief that the solution to weak demand was further monetary stimulus. They were in a 'prisoner's dilemma': if any central bank raised interest rates, they would have risked a slowing of growth in their own country and given others an advantage.

So, with interest rates close to zero and fiscal policy constrained by high government debt the objective of economic policy in a growing number of countries was to lower the exchange rate.

The experience of stubbornly weak growth around the world since the crisis has led to a new pessimism about the ability of market economies to generate prosperity. By 2015 world recovery was slower than expected. Whatever can be said about the recovery since the 2008 crisis, it has been neither strong nor sustainable. There has been a continuing shortfall of demand and output from pre-crisis levels. Lost output and employment have revealed the true cost of the crisis and shaken confidence in our understanding of how economies behave. Many countries now see that they have taken monetary policy as far as it can go.

Source: Sunday Telegraph, 28 February 2016

(a) What is economic growth and does it necessarily remove poverty and inequality? [4]

(b) In the circumstances described in the article why might a country decide that lowering its exchange rate would help its economy? [5]

(c) What evidence is there in the article that monetary policy had failed to improve the economies after the crisis? [5]

(d) Explain what is meant by a 'prisoner's dilemma' and analyse why the term was applied in the article to a market economy. [6]

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Section B

Answer **two** questions from this section.

2 'Competition is an essential element of an efficient market economy. If there is a monopoly then there is no competition. Monopolies exist in all economies and, therefore, all economies must be inefficient.'

Discuss this opinion. [25]

3 **(a)** Explain what is meant by a consumer's equilibrium and how it is related to the demand for a product. [12]

(b) Indifference curve analysis refers to income and substitution effects. Explain what these effects are and discuss whether they might be the major influence for a manufacturer intending to change the price of a product. [13]

4 **(a)** What relation is there, if any, between the law of diminishing returns and internal and external economies of scale? [12]

(b) 'It is a general rule that firms maximise profits. They do so where the average revenue from the sale of a product is equal to its marginal cost of production.'

Do you agree with this statement? [13]

5 **(a)** Explain why economists use a Lorenz curve and a Gini co-efficient and comment on likely government policy implications if a country's Gini co-efficient increased from 0.34 to 0.68. [12]

(b) With the help of a diagram analyse what is likely to happen to a worker's transfer earnings and economic rent if a perfectly competitive labour market is replaced by a monopsony. [13]

6 'The Human Development Index (HDI) is a more useful indicator of changes in living standards than changes in Gross Domestic Product (GDP) but it still does not provide an entirely accurate assessment of whether living standards have improved over a given time period.'

Critically evaluate this statement. [25]

7 **(a)** Discuss the effects of an expansionary monetary policy on the demand for money. [12]

(b) How far do you agree with the view that an expansionary fiscal policy will reduce the level of unemployment in the short run but it will cause inflation to accelerate and unemployment to rise in the long run? [13]

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Section A

Answer this question.

1 **The Economic Outlook for Japan**

In 2017, the forecast of the Bank of Japan (the country's central bank) was that Japan's economy was likely to enjoy moderate growth. Domestic demand was likely to increase due to spending in both the corporate and household sectors. Expansionary monetary policy and fiscal spending by the government had produced a large-scale stimulus.

As part of the Japanese government's economic strategy, progress was expected in overcoming deflation through quantitative easing. Supply-side measures included regulatory and institutional reforms; increased labour participation by women and the elderly, and support for firms in their efforts to improve productivity.

The Bank of Japan stated that business investment was likely to continue to increase, supported by expansionary monetary policy, heightened growth expectations, and increases in demand related to the Olympic Games to be held in Japan in 2020. Private consumption was expected to continue to increase as employee incomes continued to improve. Public investment was projected to increase during 2017, due mainly to government measures and was expected to remain at a relatively high level after 2017.

Meanwhile, other advanced economies were expected to continue to grow steadily and a recovery in emerging economies was expected as a result of their own policy measures and the growth in the advanced economies. Japan's exports were expected to rise as a result of an improvement in the economies of its trading partners and the depreciation of Japan's currency, the yen.

There was also an upward revision of GDP following a change in the calculation of GDP statistics. The projected financial conditions suggested that real interest rates were likely to remain very low.

Source: Bank of Japan, Outlook for Economic Activity and Prices, January 2017

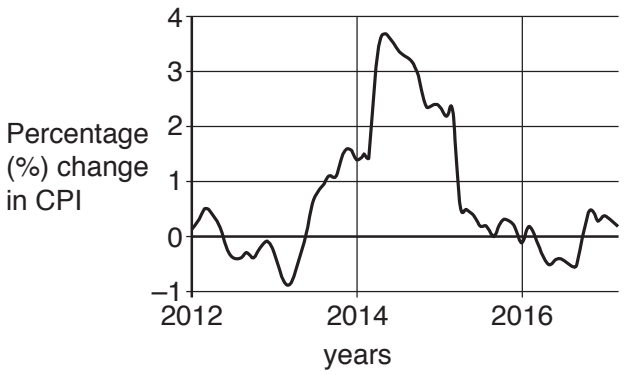


Fig. 1.1: Japan's inflation rate, 2012–2016

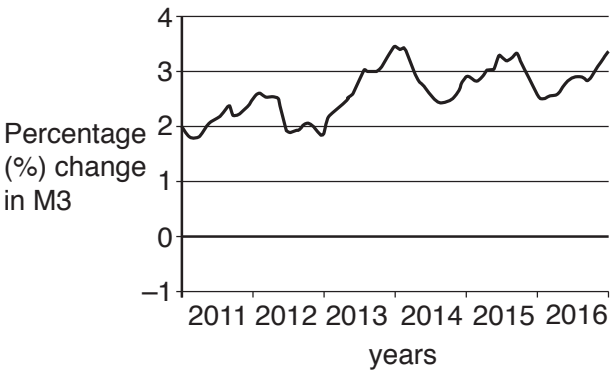


Fig. 1.2: Changes in Japan's money supply (M3), 2011–2016

Source: Trading Economics, 2017 and Bank of Japan Annual Review, 2017

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(a) Identify **two** positive influences on Japan's economic growth. [2]

(b) To what extent do Fig. 1.1 and Fig. 1.2 support Friedman's view that 'inflation is always and everywhere a monetary phenomenon'? [5]

(c) Explain the likely impact of quantitative easing on the Japanese economy. [6]

(d) Discuss the possible effects on the Japanese economy of the changes in supply-side policy and international economic events described in the article. [7]

Section B

Answer **two** questions.

2 'Free markets make the most efficient use of resources and are the foundation of a successful economy.' To what extent do you agree with this? [25]

3 **(a)** Explain what is meant by a normal good and comment on the link between total utility, marginal utility and a consumer's demand curve for that good. [12]

(b) Discuss how a government's policies toward income and wealth distribution can affect a consumer's demand. [13]

4 **(a)** Explain how a firm maximises its profit in perfect competition. [12]

(b) Discuss whether profit maximisation is the best strategy in the long run for firms in different market structures. [13]

5 **(a)** Explain the relevance of economic rent and transfer earnings when comparing the wages of skilled workers and unskilled workers. [12]

(b) Discuss whether workers always benefit when their trade union achieves an increase in wages. [13]

6 Evaluate how the relative size of injections into and leakages from the circular flow of income can affect the ability of a government to achieve its macroeconomic aims. [25]

7 Discuss whether countries at different stages of development should use different methods of measuring living standards. [25]

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Section A

Answer this question.

1 Production, living standards and market failure

Today, the average person lives better than they did fifty years ago. Two reasons are given for this. The first is capital accumulation, the idea that if people save more, production increases. Secondly, we are better at managing resources; we have learned to get more outputs from given inputs. Table 1.1 shows the changes in GDP by continent.

Table 1.1: Average annual real GDP growth rates (%) by continent

	1962-71	1972–81	1982–91	1992–2001	2002–11	Average annual rate (1962–2014)
Africa	4.5	3.6	2.6	3.1	5.5	3.9
Americas	4.8	3.9	2.5	3.4	2.3	3.3
Asia Pacific	7.9	4.9	5.1	4.9	6.3	5.8
Europe	5.1	2.8	2.4	1.4	2.2	2.7

Education and learning have played a central role in these increases in GDP.

However, there have been fundamental changes in the labour market. It used to be that people often had the same job for years. Now job turnover is high and employers are less willing to invest in formal education. There needs to be systematic intervention by the government. Markets alone will not do a good job of creating a learning society.

It was government support that enabled the decoding of the human genome. But a US company realised that if it could patent a test for a certain gene, it could profit. It succeeded in getting patents for a test on two breast cancer genes. It exercised its monopoly power. When Yale University discovered a better test for the genes the company said they could not use it. But the company's tests were inferior and people suffered through misdiagnosis. Private returns have nothing to do with social returns.

The values that have allowed western capitalism to thrive – individualism, competition, consumption – now threaten its future.

Values that were considered less important need now to be cultivated to promote social efficiency: sustainability, community, co-operation and reflection. In the market, this can only be achieved by government intervention to adjust economic disincentives and incentives to take account of external costs and benefits. The lessons of the prisoners' dilemma might be relevant.

Economic disincentives include taxes on carbon emissions to limit negative externalities. Economic incentives that include subsidies and pollution permits can be used to encourage the development of sustainable technologies and practices.

Source: RSA Journal, Issue 3, 2014

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(a) The article says that an increase in saving would increase production. Would an economist necessarily agree with this statement? [5]

(b) Explain what is meant by market failure and consider whether there are examples of market failure in the article. [5]

(c) Suggest why the article says that the lessons of the prisoners' dilemma might be relevant. [4]

(d) Discuss, with the help of the information, whether the article is correct in asserting that the 'average person lives better than they did fifty years ago'. [6]

Section B

Answer **two** questions from this section.

2 **(a)** Explain the meaning of and whether there is a link

(i) between Pareto optimality and equality;

(ii) between free markets and equity. [12]

(b) Consider the methods a government can use to increase efficiency in resource allocation. [13]

3 **(a)** Critically discuss the explanation in economic theory of how a rational consumer exercises choice and how it links to a demand curve. [12]

(b) Analyse how a consumer's equilibrium might change if the government increased a sales tax (goods and services tax) on a normal good, an inferior good and a Giffen good. [13]

4 **(a)** Contrast the features of a perfect competitive market with those of an oligopoly and compare the aims of the firms in each of these market structures. [12]

(b) Discuss what you would expect to happen to the output of the industry and the level of profit if perfect competition were replaced by a monopoly. [13]

5 Analyse and discuss whether the economic theory of wages can explain why there are inequalities in wage rates in a country. [25]

6 **(a)** Explain the speculative motive for the demand for money and consider its significance in relation to monetary policy. [12]

(b) Discuss the view that monetary policy can be used effectively to control demand-pull inflation but not to control cost-push inflation. [13]

7 'There have been many attempts to measure changes in living standards both within and between countries. Although some have been more useful than others, none of these alternative measures has produced a sufficiently accurate, reliable indicator of changes in living standards.'

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

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