Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/41**

Paper 4 A Level Data Response and Essays **October/November 2023**

2 hours

2955971686

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **one** question.
  - Section C: answer **one** question.
- Follow the instructions on the front cover of the answer booklet. If you need additional answer paper, ask the invigilator for a continuation booklet.
- You may use a calculator.
- You may answer with reference to any economy you have studied where relevant to the question.

INFORMATION

- The total mark for this paper is 60.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages.

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Section A

Answer all parts of Question 1.

1 **Economic decline in 2020**

In 2020, Japan suffered its third quarterly decline in gross domestic product (GDP) in a row. The size of its real GDP shrank to its lowest level since 2011 when the country was suffering from 20 years of deflation and economic stagnation. In 2020, the economy was not helped by a previous increase in sales tax, the COVID-19 pandemic and the trade war between the world's biggest economies, the United States (US) and China. They were Japan's two most significant trading partners; 19.9% of exports went to the US and 19% to China. Table 1.1 gives some economic indicators for Japan for selected years.

Table 1.1 Selected economic indicators for Japan, 2016–2019

	2016	2017	2018	2019
Central bank rate of interest (% per year)	0.1	0.1	0.1	0.1
Change in industrial production (% per year)	0.0	3.1	1.1	0.1
Change in retail sales (% per year)	0.6	1.9	1.7	0.1
National debt (% of GDP)	236	234	236	237
Economic growth (% change in GDP per year)	0.5	2.2	0.3	0.7

In 2020, the International Monetary Fund (IMF) warned that the global economy was facing its worst recession since the world depression in the 1930s. Japan's economy shrank by 7.8% between April and June of 2020, while the US economy contracted by 9.5% and China's by 3.2%.

Japan, which was the world's fourth largest exporter, incurred an overall trade deficit of US$15.2 billion for 2019, an increase of almost 50% on the trade deficit for 2018. In 2020, exports fell by a further 18.5% in the third quarter, mainly caused by a decline in Japan's motor vehicle exports. In that quarter, its main car producer, one of the world's biggest car companies, made its smallest quarterly profit in nine years as sales halved.

The government of Japan used expansionary fiscal and monetary policies to try to stimulate the economy. Low interest rates had been used by the central bank since 2016. In August 2020, economists said that despite this stimulus to encourage growth there was a chance economic activity may stagnate even further if major nations again adopted more restrictive measures, such as lockdowns, to combat any reoccurrence of the pandemic.

Source: 'Japan's economy slides into record decline under pandemic pressure', Martin Strydom, The Times, 18 August 2020

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(a) With reference to Table 1.1, what indicates that Japan's government had borrowed substantially? [2]

(b) Although Japan was the world's fourth largest exporter, it had suffered trade deficits.

Explain how this might have happened. [4]

(c) Consider whether the evidence provided shows that Japan's economic decline in 2020 was caused by the COVID-19 pandemic. [6]

(d) Low interest rates have been used by Japan's Central Bank since 2016.

Analyse how low interest rates might stimulate an economy and evaluate whether their use has been successful in stimulating Japan's economy since 2016. [8]

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Section B

Answer **one** question.

EITHER

2 The provision of health care by the public sector is inefficient and therefore all health care should be provided by firms operating in the private sector.

Evaluate this comment. [20]

OR

3 A government allows the merger of two large firms in the same industry.

With the help of a diagram, evaluate the view that this merger should not have been allowed. [20]

Section C

Answer **one** question.

EITHER

4 Assess the extent to which monetary policy can be used effectively to solve the problem of unemployment. [20]

OR

5 To what extent do you agree with the view that globalisation benefits high-income countries at the expense of low-income countries? [20]

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Surname	StemUp Model Solution
Answer booklet	Write the question number in the left-hand margin at the start of each answer.

Question number

Answers for paper 9708/41

1(a) Table 1.1 shows that Japan's national debt was between 234% and 237% of GDP from 2016 to 2019, so the debt was more than twice the size of Japan's annual GDP. Debt this large can only build up through many years of heavy government borrowing to finance budget deficits.

1(b) A trade deficit means the value of imports of goods is greater than the value of exports. Being a very large exporter does not stop this, because Japan also imports a lot, for example most of its oil, gas, food and raw materials. If import prices rise, or import demand is price inelastic, the import bill can grow faster than export revenue.

Second, export sales fell. Japan's two biggest markets were the US (19.9% of exports) and China (19%), and the US–China trade war reduced their demand and world trade volumes, so Japanese exports suffered. Motor vehicle exports fell sharply, for example its main car producer's sales halved, and industrial production growth slowed from 3.1% in 2017 to 0.1% in 2019. The deficit rose to US$15.2 billion in 2019, almost 50% higher than in 2018.

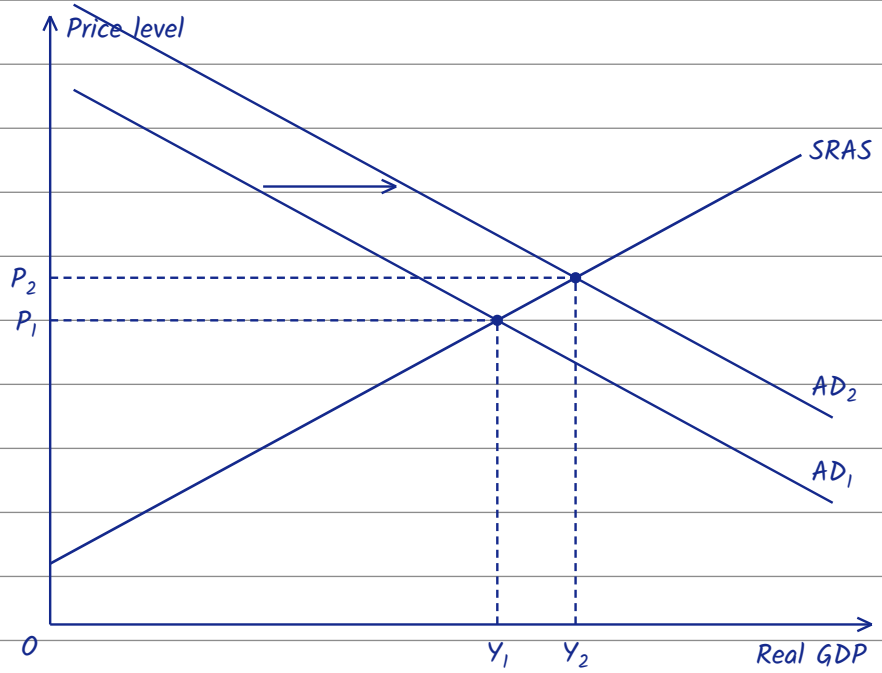
1(c) Some evidence supports the view. In 2020 the IMF warned of the worst global recession since the 1930s, and Japan's economy shrank by 7.8% between April and June 2020, while the US fell 9.5% and China 3.2%. Lockdowns cut domestic consumption, and exports fell by a further 18.5% in the third quarter of 2020 as car sales halved, so the pandemic clearly made the decline much worse.

However, the decline did not start with the pandemic. Japan had already suffered

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20 years of deflation and stagnation before 2011, and Table 1.1 shows weak growth before 2020: GDP growth fell from 2.2% in 2017 to 0.3% in 2018 and 0.7% in 2019, industrial production growth fell to 0.1% and retail sales growth to 0.1% in 2019. The rise in sales tax in 2019 helps explain the fall in retail sales, and the US–China trade war and the growing trade deficit were also hitting exports. So the evidence suggests COVID-19 was the trigger that turned slow growth into a deep decline in 2020, but it was not the only cause, since the economy was already weak because of longer-term factors.

1(d) Low interest rates reduce the cost of borrowing and the reward for saving. Households borrow more and save less, so consumption rises, especially of durables bought on credit, and mortgage payments fall, raising disposable income. Firms find more investment projects profitable, so investment rises. Lower rates also tend to depreciate the currency, making exports cheaper. Since AD = C + I + G + (X – M), AD shifts right from AD1 to AD2, and via the multiplier real output rises from Y1 to Y2, creating growth and jobs.



Evidence of success: the rate was 0.1% from 2016, and in 2017 growth rose to

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2.2%, industrial production growth to 3.1% and retail sales growth to 1.9%, the best year in the table.

However, after 2017 the policy seems to have failed. Growth fell to 0.3% in 2018 and 0.7% in 2019, industrial production growth fell to 0.1% and retail sales growth to 0.1%, even though the rate stayed at 0.1%. Consumers with low confidence and expectations of falling prices kept saving, and firms would not invest while exports fell. With the rate already near zero, it could not be cut further (a liquidity trap). Other factors, the sales tax rise, the US–China trade war, a national debt of 237% of GDP and then the pandemic, outweighed it.

Overall, low interest rates may have helped briefly in 2017 and stopped a worse decline, but they have not stimulated sustained growth in Japan, so monetary policy alone was not enough.

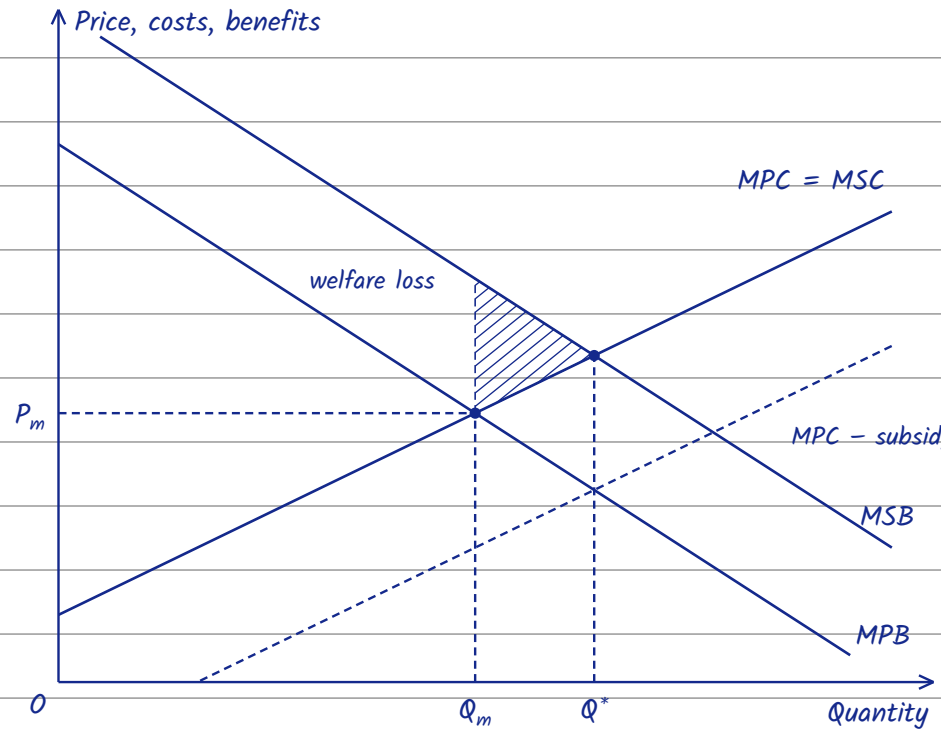
Section B

2 Health care can be provided by the public sector, owned and run by the government and usually free at the point of use, financed by taxes, or by private sector firms, owned by individuals or shareholders, which charge a price and usually aim to maximise profit. The comment claims public provision is inefficient, so all health care should be private.

Health care is a merit good: one that is under-consumed in a free market, because consumers have imperfect information and underestimate its private benefits, and because it creates positive externalities. A vaccinated or healthy person benefits third parties, since disease spreads less and workers are more productive. In the diagram, the free market produces where MPB = MPC at Qm, but the socially optimum output is Q^*, where MSB = MSC. Output is below the allocatively efficient level and the shaded triangle is the welfare loss. This is why governments provide health care free or subsidise it: a subsidy shifts supply to MPC – subsidy,

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raising consumption from Qm to Q^*.



There are reasons why public provision may be inefficient. Without the profit motive and competition there is little incentive to minimise costs, so X-inefficiency, bureaucracy and waste can occur, for example too many administrators. Because care is free at the point of use, demand exceeds supply, causing long waiting lists, and there is no price signal to allocate resources to where they are valued most. Government failure is also possible, as decisions may be political rather than based on need.

Private provision could improve efficiency. Firms seeking profit cut costs, remove unnecessary bureaucracy and innovate, so they are more likely to be productively efficient and to use scarce resources well. Competition between hospitals can improve quality and choice, and if some patients use private care, more public resources become available for others.

However, providing all health care privately is likely to make allocative efficiency worse. Private firms ignore the external benefits, so they would produce at Qm, not Q^*, and health care would be under-consumed. Profit-maximising firms charge a

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price above marginal cost and may have local monopoly power, raising the cost of care. Access would depend on ability to pay, so the poor, the elderly and the chronically ill may go without treatment, which is inequitable. Information failure also matters: patients cannot judge the treatment they need, so private providers may over-treat to raise revenue, and private insurance faces adverse selection and moral hazard, so high-risk people may be refused cover.

The argument also depends on the type of care. Routine services such as dental care, minor surgery or opticians may be provided efficiently by firms, but emergency care, public health and vaccination programmes have large externalities and are unlikely to be supplied at the right level by the market. Public sector inefficiency can also be reduced without privatisation, for example through internal markets, performance targets or contracting out services to private firms while care stays free.

In conclusion, the statement is too strong. Public provision may be productively inefficient, but full private provision would lead to under-consumption of a merit good, allocative inefficiency and inequity. The net benefits are greatest with a mixed system: public funding to ensure access at Q^*, with private firms and competition used where they lower costs, so not all health care should be provided by the private sector.

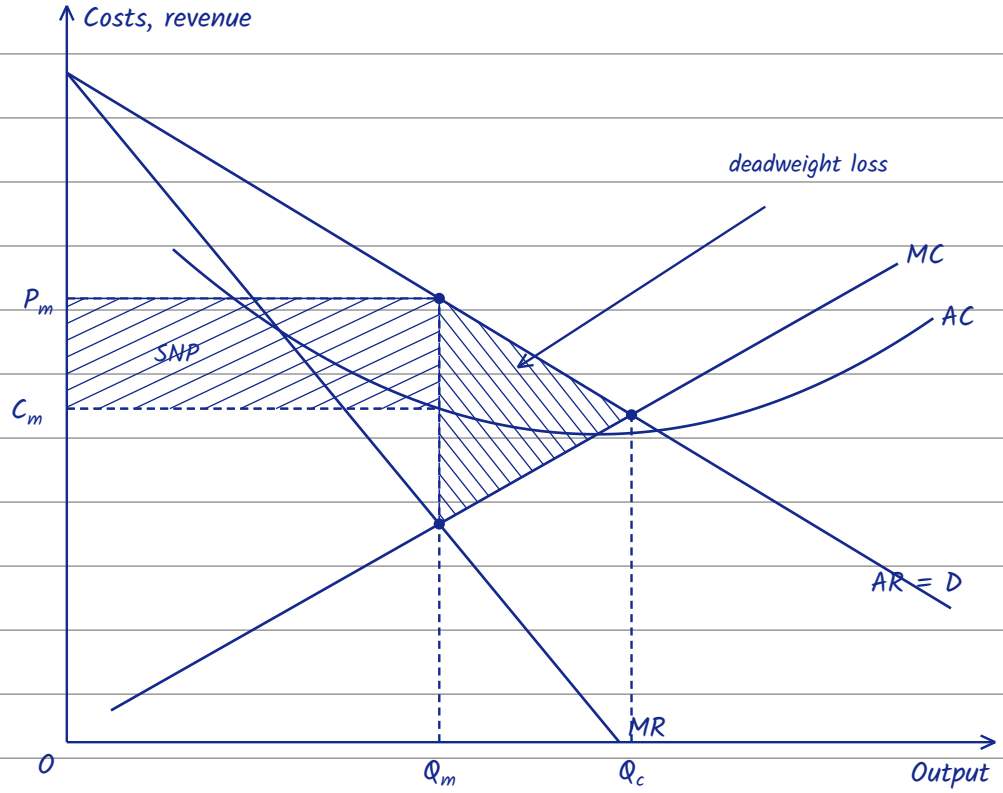
3

A merger is when two firms join to form one. Two large firms in the same industry at the same stage of production is horizontal integration. It increases market concentration and can create a monopoly or a dominant firm with a large market share and high barriers to entry.

The case against allowing it is shown in the diagram. Before the merger, a competitive industry would produce where price = MC at Qc. The merged firm faces the downward sloping industry demand curve (AR) and maximises profit where MR = MC, so it restricts output to Qm and raises the price to Pm. Because

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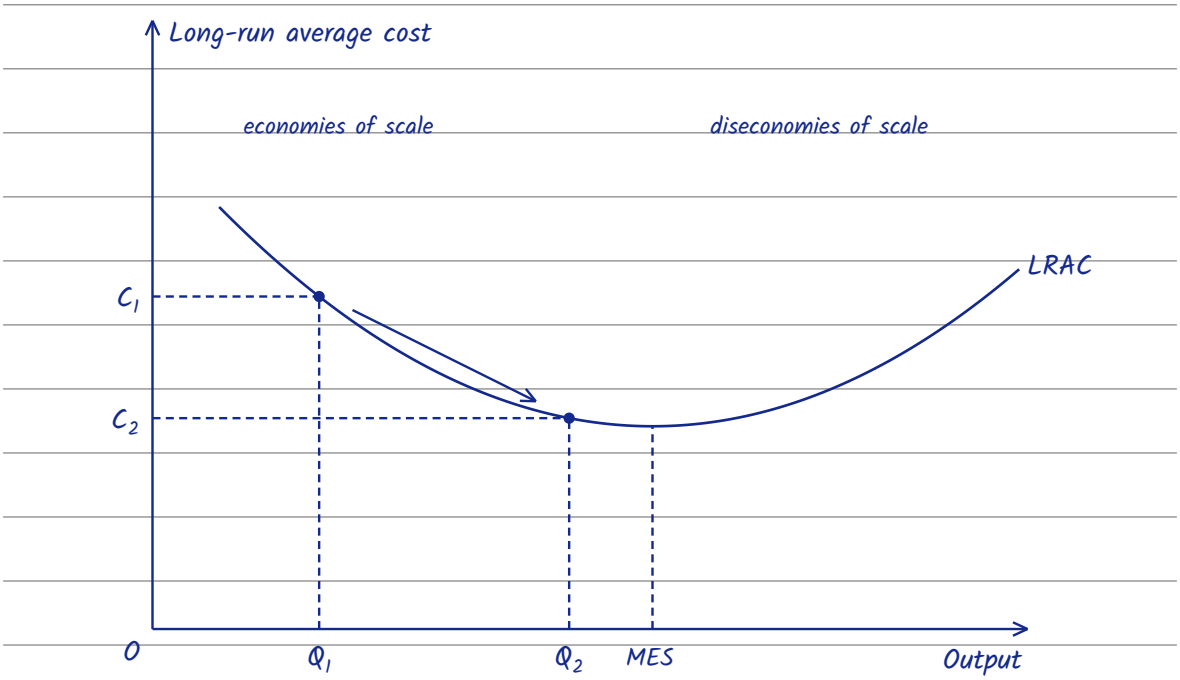
P > MC, the firm is allocatively inefficient, and the triangle between AR and MC from Qm to Qc is a deadweight welfare loss. Consumer surplus is transferred to the firm as supernormal profit (Pm – Cm) × Qm, which barriers to entry protect in the long run. Output is not at minimum AC, so it is also productively inefficient.



Other problems follow. Consumers have less choice. Without competitive pressure, the merged firm may become X-inefficient, letting costs rise. It may drive smaller rivals out with predatory pricing, and as a dominant buyer of labour it can act as a monopsonist, cutting jobs (for example closing duplicate sites) and paying lower wages. It may also gain monopoly power over suppliers.

On the other hand, the merger may bring benefits. The larger firm can gain economies of scale, for example technical, purchasing, financial and managerial economies, moving down the LRAC curve from C1 to C2. If costs fall enough, the merged firm's MC could be so much lower that it produces more at a lower price than the competitive firms did, so consumers gain.

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Supernormal profits can fund research and development, leading to dynamic efficiency: new products, better quality and lower costs in the long run. The merger may also be needed for the firms to survive and compete with large foreign firms in global markets, protecting jobs, and in industries with high fixed costs, such as telecoms or pharmaceuticals, only a few large firms can exploit economies of scale. A larger range of goods may even increase consumer choice.

Whether the merger should have been allowed depends on several factors: the combined market share and whether the market is contestable, since low barriers to entry would keep prices close to costs; the size of the cost savings and whether they are passed on to consumers; and whether foreign competition exists. The government can also allow it with conditions, such as price caps, selling off some brands or regulation by a competition authority, to reduce the risk of abuse.

In conclusion, the merger should not be allowed if it creates a dominant firm in a market with high barriers to entry and little evidence of cost savings, as higher prices and welfare loss are likely. However, if large economies of scale and dynamic gains are likely, the market remains contestable and regulation is in place, the benefits may outweigh the costs, so the government's decision to allow it can be

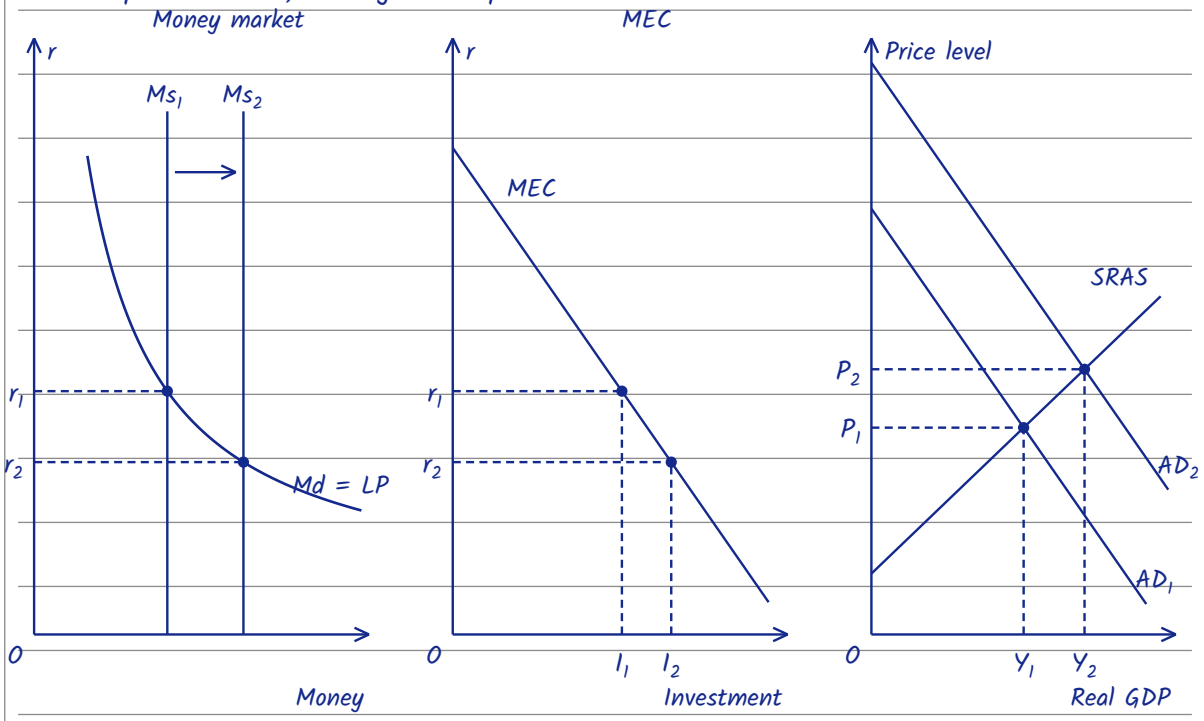
Question number

justified.

Section C

4 Unemployment is when people who are willing and able to work at the going wage rate cannot find a job. It wastes scarce resources, as the economy produces inside its PPF, and it lowers incomes and tax revenue, raises benefit spending and causes social problems. Monetary policy is the use of interest rates, the money supply and the exchange rate by the central bank to influence aggregate demand.

To reduce unemployment the central bank uses expansionary monetary policy. A cut in the interest rate from r1 to r2, or an increase in the money supply from Ms1 to Ms2 (for example through quantitative easing), lowers the cost of borrowing. Investment rises from I1 to I2 along the MEC curve, as more projects become profitable, and consumers borrow more and save less, so consumption rises. Lower rates also cause a depreciation of the currency, so exports become cheaper and imports dearer, raising net exports.



AD shifts right from AD1 to AD2 and real output rises from Y1 to Y2. Since the

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demand for labour is a derived demand, firms hire more workers, and the multiplier increases the effect, so cyclical (demand-deficient) unemployment falls.

However, the effectiveness of monetary policy depends on the cause of unemployment. It works on aggregate demand, so it is most effective for cyclical unemployment in a recession. It does little for structural unemployment, where workers lack the skills or are in the wrong location for the vacancies, or for frictional unemployment. These need supply-side policies such as training, education and better job information.

Its effectiveness also depends on how consumers and firms respond. In a deep recession, confidence is low, so firms may not invest even at very low interest rates because they expect low demand (investment is interest inelastic). Banks may not lend, and if interest rates are already close to zero they cannot be cut further, a liquidity trap, as Japan found with rates of 0.1%. There are also time lags of up to 18 months before a change in interest rates has its full effect.

Monetary policy may also conflict with other objectives. If the economy is close to full employment, the rise in AD mainly raises the price level, causing demand-pull inflation, and a depreciation raises import prices, causing cost-push inflation. Very low interest rates can cause asset bubbles such as a housing boom, and they hurt savers. Higher imports may worsen the current account.

Compared with fiscal policy, monetary policy can be changed quickly and is not affected by politics if the central bank is independent, but fiscal policy, such as government spending on infrastructure, injects spending directly and can be targeted at regions with high unemployment.

In conclusion, monetary policy can be effective in reducing cyclical unemployment when the economy has spare capacity and confidence is reasonable. However, it is far less effective for structural and frictional unemployment, in a liquidity trap, or when there are time lags and inflation risks. So it can only partly solve the problem, and works best combined with fiscal and supply-side policies.

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5

Globalisation is the increasing integration of the world's economies through free trade in goods and services, free movement of capital and labour, and the transfer of technology, helped by multinational companies (MNCs), the WTO and cheaper transport and communication. High-income countries have high GDP per head and productivity, while low-income countries usually have low GDP per head, low productivity, high dependency ratios and depend on producing and exporting primary goods.

High-income countries clearly benefit. Under comparative advantage, each country specialises in goods it can produce at a lower opportunity cost and trades, so world output and consumption rise. High-income countries gain access to cheap raw materials and cheap manufactured goods, which lowers costs and inflation and raises real incomes. Their MNCs gain new markets and economies of scale and can locate production where labour is cheap, so profits flow back to the home country.

There are reasons to think this is at the expense of low-income countries. Many specialise in primary products whose prices are volatile and whose terms of trade have tended to fall, so they must export more to buy the same imports. Income elasticity of demand for primary goods is low, so as the world gets richer, demand for their exports grows slowly. High-income countries protect their own farmers with subsidies and tariffs, which keeps low-income farmers out of their markets. MNCs may pay low wages, ignore safety and environmental standards, use transfer pricing to avoid tax and send profits home, and new local firms cannot compete with them. Skilled workers may emigrate (brain drain), and dependence on a few exports and on foreign capital can create trade imbalances and debt, which can lower living standards in the long run.

However, low-income countries can gain a lot. Foreign direct investment brings capital, jobs, training and new technology, which raises productivity and shifts the PPF outwards, so potential growth increases. Access to large markets allows local

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firms to grow and export, as shown by countries such as Vietnam and Bangladesh, where export-led growth has lifted millions out of poverty. Higher incomes raise tax revenue, which can be spent on merit goods such as health care and education. Remittances from workers abroad are also a major source of income. Consumers gain cheaper and more varied goods.

High-income countries also face costs: jobs in manufacturing move to low-wage countries, causing structural unemployment in old industrial regions, and wage inequality rises. So globalisation is not simply a gain for rich countries and a loss for poor ones.

The outcome depends on several factors: whether the low-income country can diversify away from primary products into manufacturing and services; the quality of its institutions and governance, so that the gains are not lost through corruption; investment in education and infrastructure so that technology can be absorbed; and whether trade rules are fair.

In conclusion, I only partly agree. High-income countries have gained more in absolute terms and some low-income countries, especially those dependent on primary exports, have lost out. However, globalisation has been mutually beneficial for low-income countries that use trade and FDI to industrialise, so it does not necessarily benefit high-income countries at the expense of low-income ones.

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ECONOMICS **9708/42**

Paper 4 A Level Data Response and Essays **October/November 2023**

2 hours

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You must answer on the enclosed answer booklet.

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INFORMATION

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Section A

Answer all parts of Question 1.

1 Traffic Control

In 2020 Lagos, Nigeria's largest city, banned the use of motorcycle taxis and tricycles from its most congested areas.

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Plans are in place to extend the system to 400km.

Sources: dailytrust.com, 7 February 2020 and The Daily Telegraph, *3 March 2020*

(a) Explain what is meant by equity and how the ban on motorcycle taxis and tricycles affects equity for commuters in Lagos. [3]

(b) Explain, with the help of a diagram, what is meant by a negative externality and identify **two** examples of negative externalities from the article. [6]

(c) From the evidence, consider whether the Singapore quota system or the ERP was more effective in solving the problem of traffic congestion. [6]

(d) Assess whether government's involvement in the provision of transport systems is because transport is a public good. [5]

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Section B

Answer **one** question.

2 Evaluate the use of indifference curve analysis to derive the demand curve for a normal good and the demand curve for an inferior good. [20]

OR

3 The model of perfect competition is the ideal form of market structure because it is the most efficient.

With the help of diagrams, evaluate this statement. [20]

Section C

Answer **one** question.

4 The presence of multinational corporations (MNCs) in a low-income country always promotes economic growth in that country.

Evaluate this statement. [20]

OR

5 Consider the relative merits of gross national income (GNI) and the multidimensional poverty index (MPI) as measures of the standard of living. [20]

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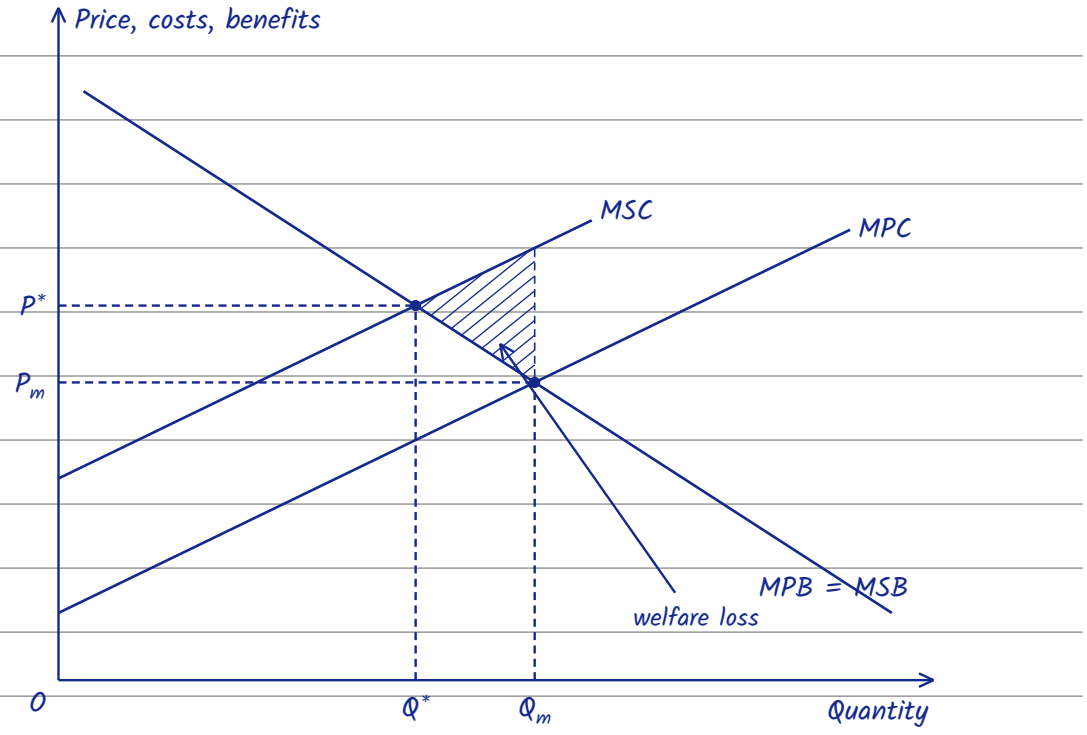
Surname	StemUp Model Solution
Answer booklet	Write the question number in the left-hand margin at the start of each answer.

Question number

Answers for paper 9708/42

1(a) Equity means fairness or justice: people in the same situation receive the same treatment. The ban is likely to reduce equity for commuters in Lagos, because poorer workers rely most on cheap motorcycle taxis and tricycles to get to work. They now pay more for other transport or must walk long distances in the heat, while richer commuters with cars are not affected in the same way.

1(b) A negative externality is a cost of a private transaction that falls on a third party who is not part of the transaction and is not compensated. As a result the marginal social cost (MSC = MPC + external cost) is above the marginal private cost.



In the diagram the free market produces where MPC = MPB at Qm, but the social

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	optimum is Q^*, where MSC = MSB. The good is over-consumed, as Qm > Q^*, and the shaded triangle is the welfare loss.
	Examples from the article: deaths and injuries from road accidents involving motorcycle taxis, and traffic congestion, which wastes other road users' time.
	Damage to the environment from pollution is another.
1(c)	The quota system limited the number of cars by making people bid for a licence to own one. This raised the price and cost of owning a car, which reduced car ownership. However, once people had paid so much for a car, they wanted to get value from it, so the quota encouraged owners to use their cars more, and congestion at busy times was not solved.
	The ERP (electronic road pricing) charges motorists directly each time they use a road. It is more flexible, as the charge changes with the time of day and the level of congestion on each road. This makes motorists consider the time of travel, their route and their method of transport, such as switching to public transport, so it targets congestion directly where and when it happens, making drivers pay something closer to the external cost.
	The evidence suggests the ERP was more effective, because it targets the use of roads rather than ownership of cars. However, its success depends on good public transport alternatives and the charge being set at the right level.
1(d)	A public good is non-excludable, as people who do not pay cannot be stopped from consuming it, and non-rival, as one person's consumption does not reduce the amount available to others. So the free market will not provide it because of the free rider problem.
	Transport is not a public good. Travellers on trains or buses must buy a ticket, so non-payers can be excluded, and trains and roads have a fixed capacity, so at busy times one more passenger or car reduces the space for others, so it is rival.

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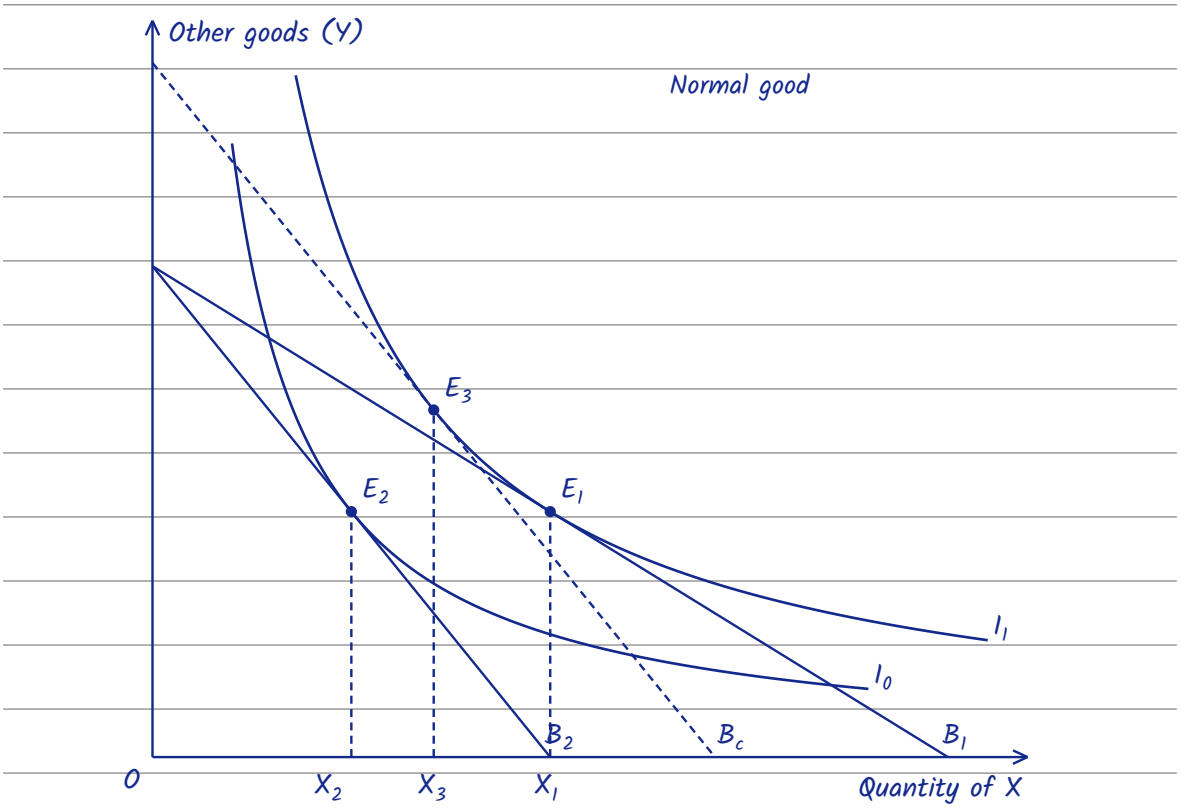
Therefore, government involvement is not because transport is a public good. Instead it is because public transport is a merit good with positive externalities, such as less congestion and pollution, and needs large infrastructure investment, like extending the rail system to 400km, which private firms may not finance.

Section B

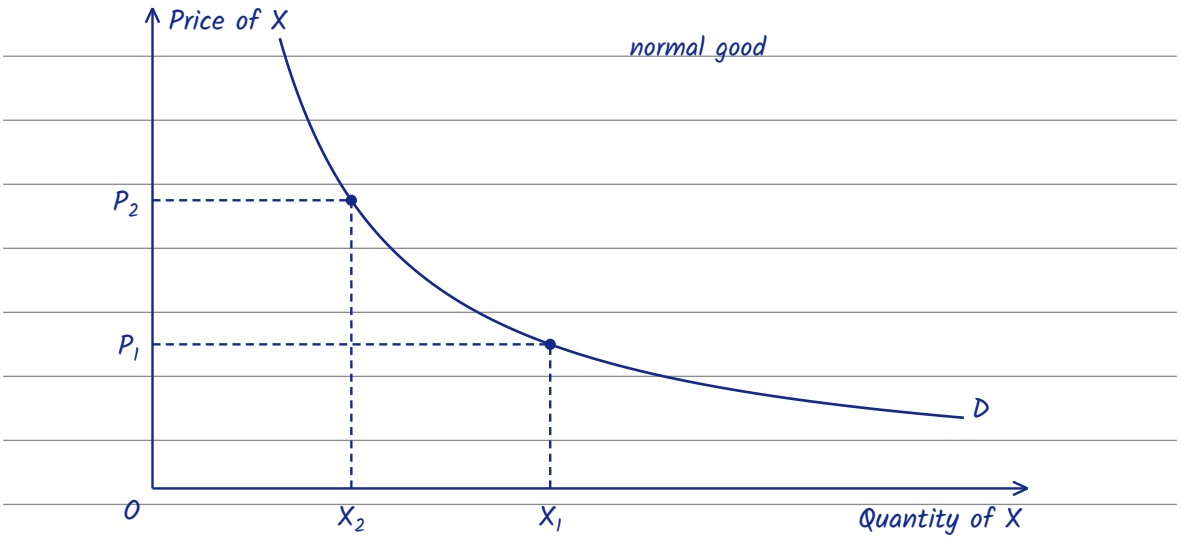
2 Indifference curve analysis explains consumer choice using two tools. An indifference curve (IC) joins combinations of two goods that give the consumer the same level of satisfaction. It is convex to the origin because of a diminishing marginal rate of substitution: the more of good X the consumer has, the less of Y they will give up for one more X. Higher ICs show higher satisfaction, giving an indifference map. The budget line shows all combinations of the two goods that can be bought with a given income at given prices; its slope is the price ratio. The model assumes rational consumers who prefer more to less, a two-good world, constant prices and income initially, transitivity and perfect knowledge. The consumer is in equilibrium where the budget line is tangent to the highest possible IC, maximising satisfaction.

Normal good: in the first diagram the price of X rises, so the budget line pivots inwards from B1 to B2 and the consumer moves from E1 on I1 to E2 on I0, cutting X from X1 to X2. This is split into two effects using a compensated budget line Bc, parallel to B2 and tangent to the original I1. The substitution effect, X1 to X3, is the move along I1 caused only by the change in relative prices; it is always negative, as X is now relatively dearer. The income effect, X3 to X2, is caused by the fall in real income. For a normal good less is bought when real income falls, so the income effect works in the same direction and reinforces the substitution effect.

Question number



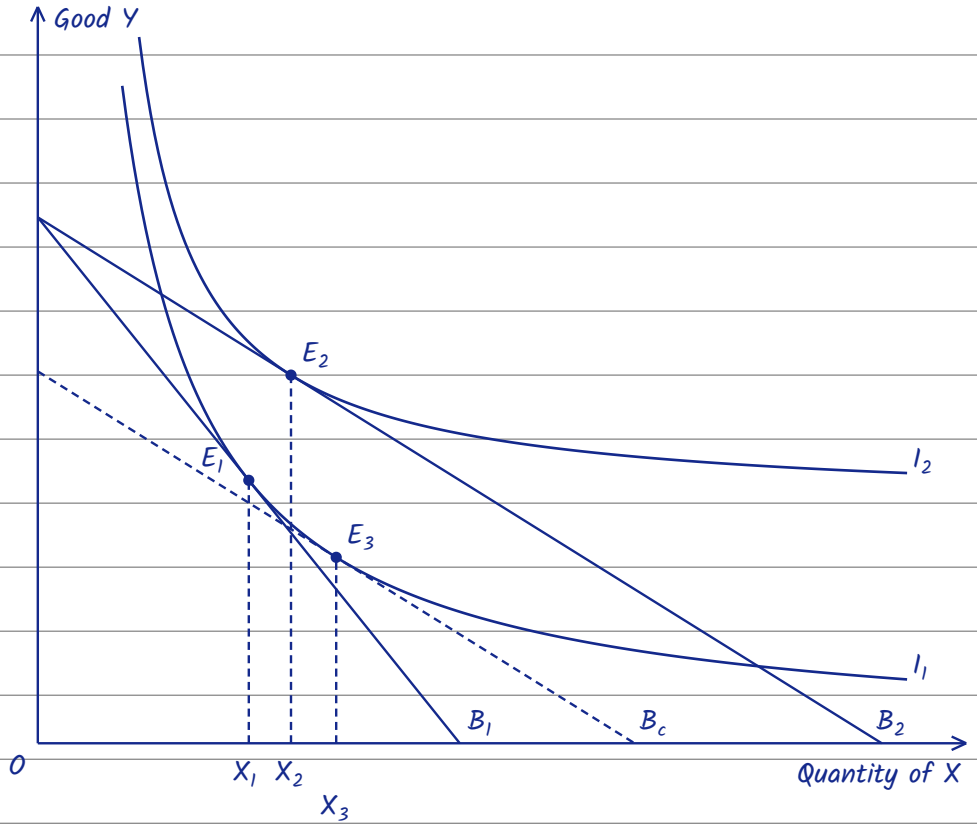
Plotting each price with the quantity chosen gives the demand curve: at price P1 the quantity is X1, at the higher price P2 it is X2, so the demand curve slopes downwards.



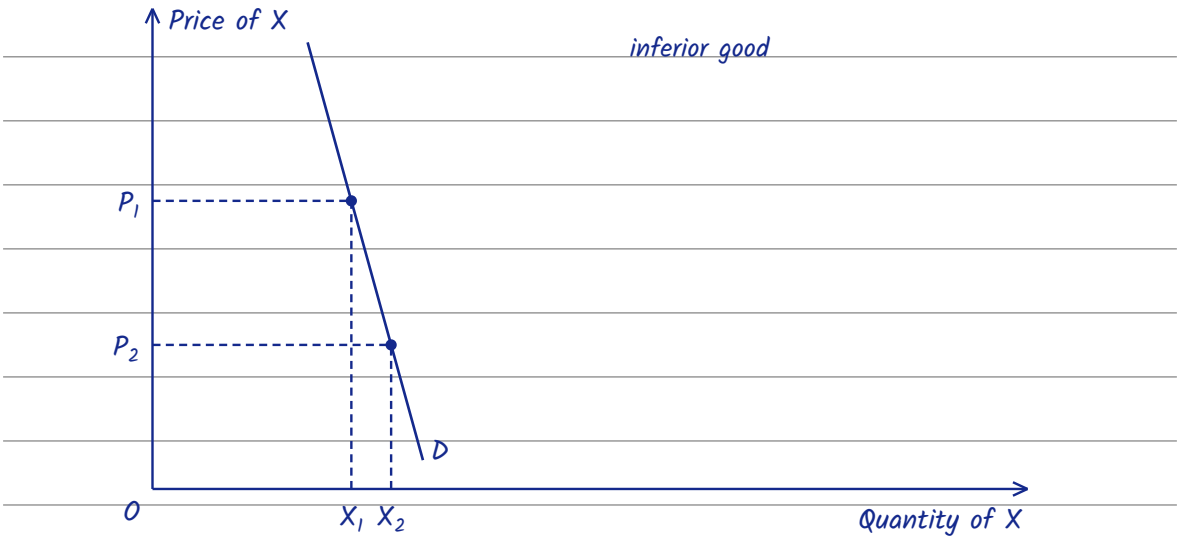
Inferior good: in the second diagram the price of X falls, pivoting the budget line out from B1 to B2 and moving the consumer from E1 to E2. The substitution effect, X1 to X3, increases quantity as X is relatively cheaper. But real income

Question number

rises, and for an inferior good less is bought when real income rises, so the income effect, X3 to X2, is negative and works against the substitution effect. As long as the substitution effect is larger, the overall quantity still rises from X1 to X2, so the demand curve still slopes downwards but is steeper (less price elastic) than for a normal good. Only if the negative income effect were larger than the substitution effect would the good be a Giffen good with an upward sloping demand curve.



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Evaluation: the analysis is useful because it explains why demand curves slope downwards without needing to measure utility in units, as it only needs consumers to rank combinations. It separates the substitution and income effects, which helps explain different price elasticities and the possibility of Giffen goods.

However, it has limitations. It assumes consumers are rational and calculating, comparing many combinations of goods in their heads, while behavioural economics shows people use rules of thumb, habits and are influenced by marketing. It uses a two-good world, while consumers actually choose between thousands of goods. Goods are assumed to be divisible and substitutable, which does not fit one-off durable purchases such as a fridge. It is static, but preferences change over time. Also, because a price fall raises the quantity demanded for both normal and inferior goods (unless Giffen), observing the demand curve alone does not tell us which type the good is.

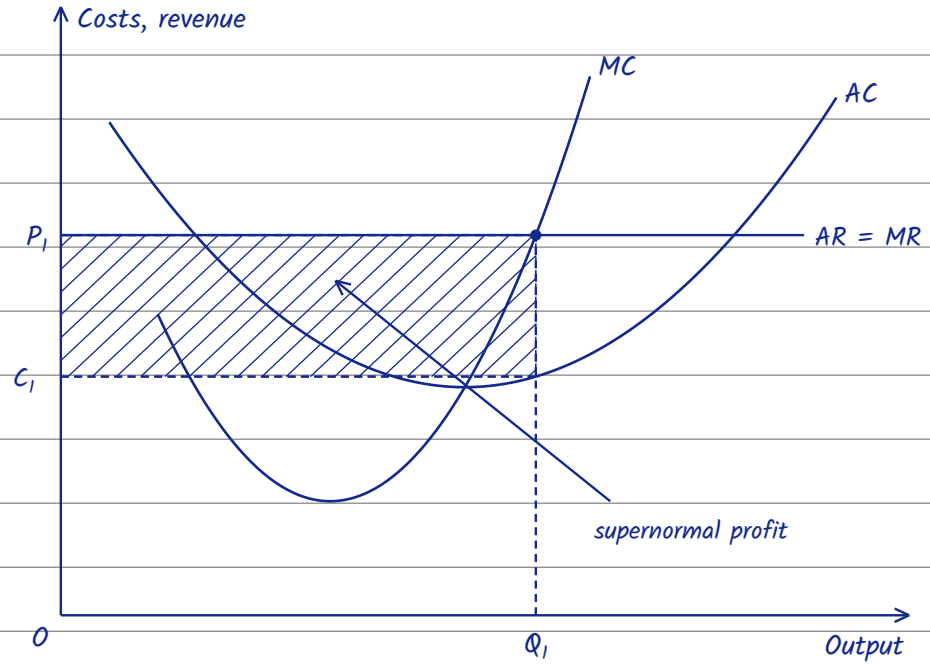
In conclusion, indifference curve analysis is a logical and useful way to derive demand curves and to show how normal and inferior goods differ through the income effect, but because of its unrealistic assumptions it is better as a theoretical explanation than as a precise prediction of real consumer behaviour.

3 Perfect competition is a market structure with many small firms selling an

Question number

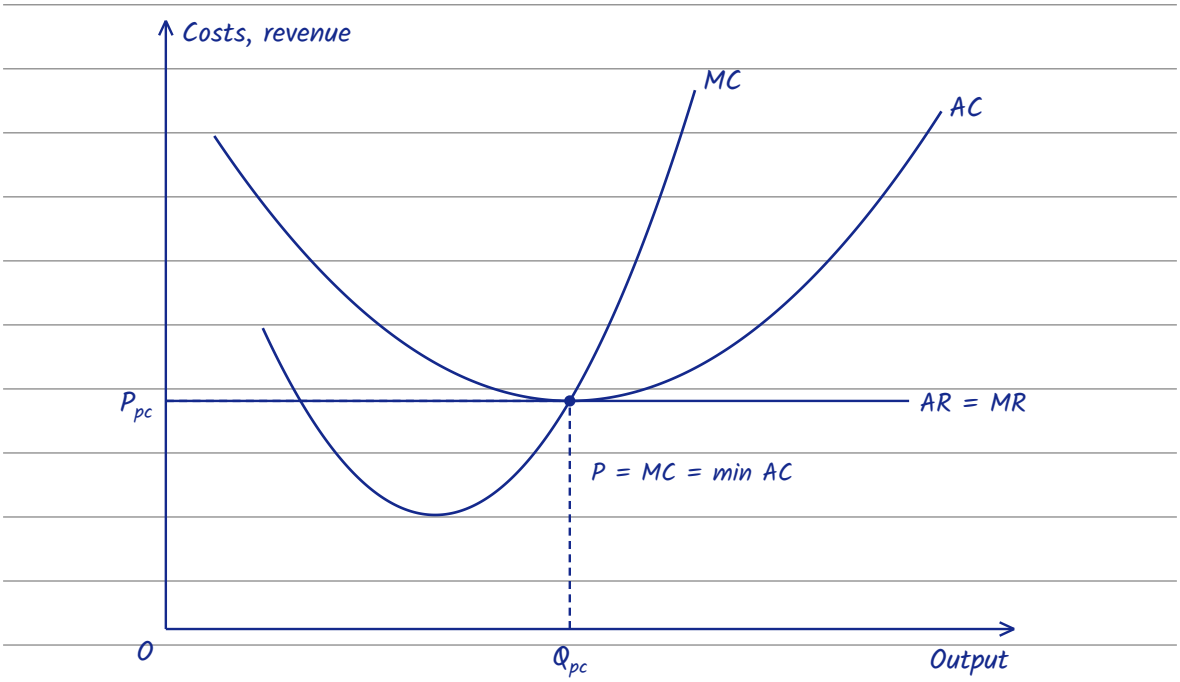
identical (homogeneous) product, perfect knowledge, and no barriers to entry or exit, so each firm is a price taker. Efficiency is about the use of scarce resources. Productive efficiency is producing at the lowest point of the average cost curve; allocative efficiency is producing where price = marginal cost, so resources go to the goods consumers value most.

In the short run, a perfectly competitive firm faces a horizontal demand curve, AR = MR, at the market price P1, and maximises profit where MC = MR at Q1. If P1 is above AC, it makes supernormal profit, shown by the shaded area (P1 − C1) × Q1.



Because there are no barriers to entry and perfect knowledge, new firms enter, market supply rises and the price falls until only normal profit is made. In the long-run diagram, the firm produces at Qpc where P = MC = minimum AC.

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This shows why perfect competition is seen as ideal. In the long run P = MC, so it is allocatively efficient, and output is at minimum AC, so it is productively efficient. Consumers pay the lowest price consistent with covering costs, there is no supernormal profit, and competition removes X-inefficiency, as inefficient firms make losses and leave. By contrast a monopoly sets MR = MC, so P > MC and output is not at minimum AC.

However, the statement can be challenged. Perfect competition is a theoretical model and real examples are very rare; some agricultural markets come close, but perfect knowledge and identical products almost never exist. So it is a benchmark rather than a realistic ideal.

More importantly, it may not be the most efficient in all senses. Firms make only normal profit in the long run, so they have no funds for research and development, and with perfect knowledge any new idea would be copied at once, so there is no incentive to innovate. There is therefore little dynamic efficiency. A monopoly or oligopoly can use supernormal profit to develop new products and technology, which lowers costs over time, as in pharmaceuticals or technology.

Small firms also cannot gain economies of scale. In industries with high fixed

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costs, a large firm can have a lower average cost than many small firms, so the price could be lower under monopoly than under perfect competition, as with natural monopolies. Identical products also mean no consumer choice or variety, which monopolistic competition provides. Finally, perfect competition does not deal with externalities or equity: price = MPC is not allocatively efficient if there are external costs, and the outcome can still be unfair.

In conclusion, perfect competition is productively and allocatively efficient in the long run, so it is a useful ideal against which other markets are judged. However, it lacks dynamic efficiency and economies of scale and is unrealistic, so it is not necessarily the ideal market structure; which structure is best depends on the industry, its costs and the importance of innovation.

Section C

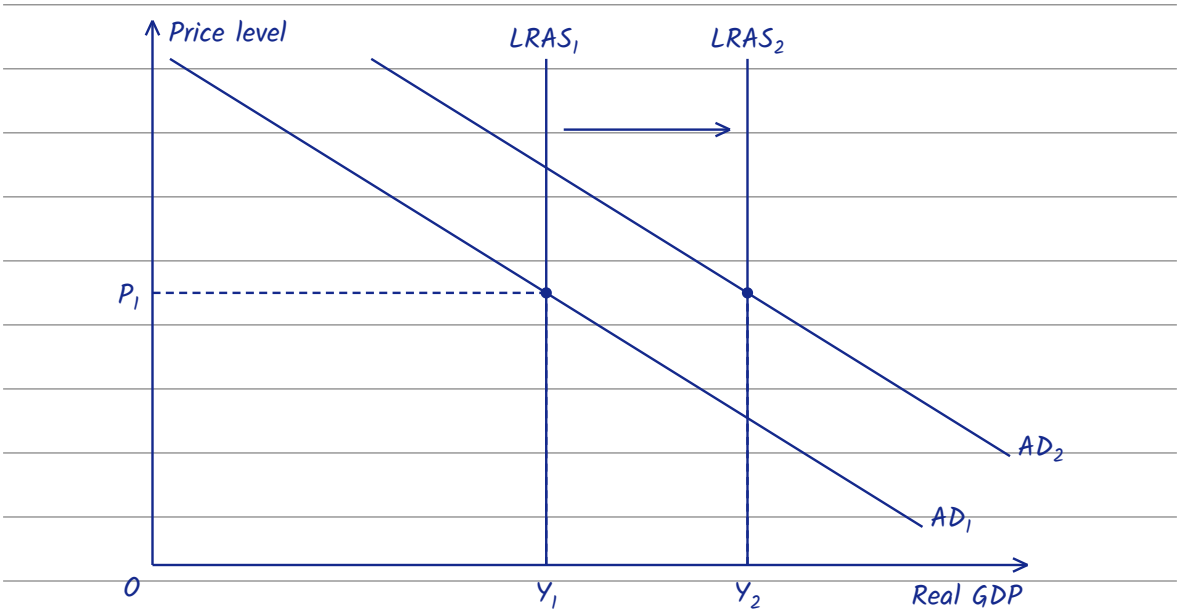
4 A multinational corporation (MNC) is a firm with its headquarters in one country and production or operations in other countries. Its investment in a low-income country is foreign direct investment (FDI). Actual economic growth is an increase in real GDP, while potential growth is an increase in the productive capacity of the economy, shown by an outward shift of the PPF or LRAS.

MNCs can promote growth in several ways. The FDI itself is an injection: building factories and buying machinery raises investment, so AD increases and, through the multiplier, real output and employment rise. Wages paid to local workers raise consumption, and MNCs buy from local suppliers, creating further jobs.

MNCs also raise potential growth. They bring capital, new technology and managerial skills, and train local workers, which raises labour productivity. Infrastructure built for the MNC, such as roads and ports, helps other firms too.

LRAS shifts right from LRAS1 to LRAS2, so output can grow from Y1 to Y2 without inflation.

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In addition, MNC profits and wages increase the tax base, so the government can spend more on education and health, improving human capital and long-term growth. If the MNC exports, it earns foreign currency, improving the current account and allowing imports of capital goods.

However, the word "always" is too strong. MNCs may use transfer pricing to declare profits in tax havens, so little tax is paid, and profits are repatriated to the home country, so GNI rises less than GDP. Governments often offer tax holidays and subsidies to attract them, which reduces the benefit.

The jobs created may be low-skilled and low-paid, while expatriates fill senior and skilled posts, so there is little transfer of skills. MNCs often import components rather than buy locally, reducing the multiplier. Large scale MNC production can destroy local firms that cannot compete, so the jobs lost may exceed the jobs created, and the MNC may become a local monopoly, raising prices and reducing output.

MNCs may also locate in low-income countries to avoid stricter environmental and safety laws at home, exporting "dirty" industries. Pollution and the depletion of natural resources, as in some mining and oil projects, can reduce future growth and living standards. MNCs are footloose and may leave when costs rise, causing

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sudden unemployment.

The impact therefore depends on the type of investment (manufacturing with training and local suppliers versus resource extraction), the bargaining power and governance of the host government, and whether profits are taxed and reinvested.

In conclusion, MNCs usually increase actual and potential growth in low-income countries, through investment, technology and jobs, but they do not always do so. With weak regulation, tax avoidance, crowding out of local firms and environmental damage, the net effect can be small or even negative, so the statement is only true when the host country manages MNCs well.

5

The standard of living is the level of economic welfare of the population, including material goods and services and quality of life factors such as health, education and the environment.

Gross national income (GNI) is the total income earned by a country's residents in a year: GDP plus net income from abroad, such as remittances from workers overseas and profits, interest and dividends from investments abroad. It is an aggregate monetary measure. To compare living standards it must be adjusted to real GNI per head, by removing the effects of inflation and dividing by the population, and to compare countries it is converted at purchasing power parity (PPP).

The multidimensional poverty index (MPI) measures acute poverty using non-monetary indicators in three dimensions, each with a weight of one third: health (child mortality and nutrition), education (years of schooling and school attendance), and living standards (cooking fuel, sanitation, drinking water, electricity, housing and assets). A person is multidimensionally poor if they are deprived in at least one third of the weighted indicators, and the MPI combines the proportion of people who are poor with the intensity of their deprivation.

Merits of GNI: data are available for almost every country (about 188), are

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collected regularly using well-established methods, and are easy to compare over time. Real GNI per head is a simple measure of growth in average income, which is strongly linked to the goods and services people can buy. It includes remittances and income from abroad, which matter for many developing countries.

Limitations of GNI: it is an average, so it hides the distribution of income; a country with high inequality may have high GNI per head but many people in poverty, so it needs to be used with a Gini coefficient. It excludes the informal and hidden economy and non-marketed output such as subsistence farming, so it understates living standards in low-income countries. It counts income from activities that create negative externalities, such as pollution, and it ignores leisure, health and education. Not all who are income-poor are multidimensionally poor, and economic growth is not always associated with less malnutrition or child mortality.

Merits of MPI: it measures what people actually lack, so it gives a more direct picture of quality of life and shows where the deprivation is, which helps governments target policies such as clean water or schooling. It measures the poorest households, which an average like GNI hides, and is linked to the development goals.

Limitations of MPI: it only covers about 100 low and middle-income countries, so it cannot compare with high-income countries. Data collection through household surveys is complex, costly and infrequent. The equal weights are a value judgement. Education is measured by inputs, such as attendance, not outputs: attending school is not the same as learning to read. It measures only acute poverty, not the living standards of the majority.

In conclusion, the two measures are fundamentally different: GNI measures the money income available, while the MPI measures deprivation of essential services. GNI is better for comparing all countries and measuring growth, but the MPI gives a better picture of living standards of the poor in low-income countries. Neither is enough on its own, so both monetary and non-monetary measures are needed,

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along with others such as the HDI.

Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/43**

Paper 4 A Level Data Response and Essays **October/November 2023**

2 hours

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You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **one** question.
  - Section C: answer **one** question.
- Follow the instructions on the front cover of the answer booklet. If you need additional answer paper, ask the invigilator for a continuation booklet.
- You may use a calculator.
- You may answer with reference to any economy you have studied where relevant to the question.

INFORMATION

- The total mark for this paper is 60.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages.

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Section A

Answer all parts of Question 1.

1 The decline of South Africa's economy

South Africa is the most industrialised country in the continent of Africa but it is also an economy with much economic inequality.

Recently governments in South Africa have aimed to reduce economic inequalities by redistributing incomes and increasing both job and investment opportunities for all sections of society. Unfortunately, the reforms have been undermined through poor organisation and management. State railways, port facilities, airways and electricity production have been affected.

Government statistics for the first quarter of 2020 show that South Africa's economy contracted by 3.2%, the biggest quarterly decline of actual economic growth in a decade (see Fig. 1.1). Gross domestic product (GDP) per capita was US$6130 in December 2019, 5.8% lower than in December 2018.

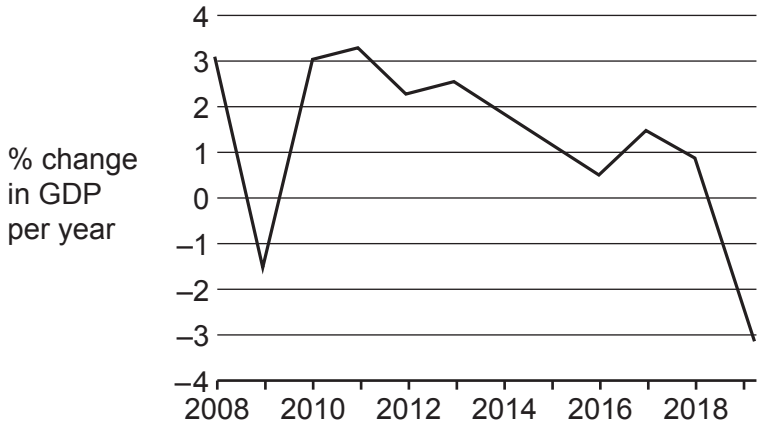


Fig. 1.1 South Africa annual growth rate, 2008 to 2019

This economic decline is reflected in the electricity supply industry, which is a state-owned monopoly. It is struggling to survive mainly due to mismanagement. For several months it rationed electricity consumption and introduced regular power cuts for households and industries. The rationing policy led to decreases in production and increases in unemployment. The company's debts added significantly to South Africa's current national debt to GDP ratio of 56% and are seen as the biggest threat to the economy.

Further evidence of economic difficulties can be found in the mining industry, a significant part of South Africa's economy. A controversial reform was introduced to give more equality of ownership. Already facing rising costs and growing bureaucracy, many mining firms, including multinational companies, stopped investing altogether which reduced potential economic growth. The mining industry declined. Thousands of jobs were lost despite South Africa having significant deposits of platinum, gold and iron ore.

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For South Africa's economy to grow it needs to address major infrastructure issues. Also, in disadvantaged communities the education system is weak contributing to a skills shortage and a rise in the unemployment rate to 27% (see Fig. 1.2). Increased production is further hindered by restrictive trade union practices.

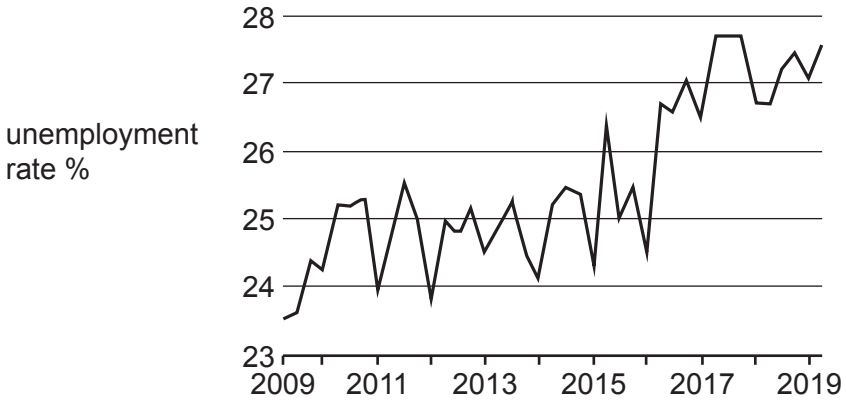


Fig. 1.2 South Africa's unemployment rate

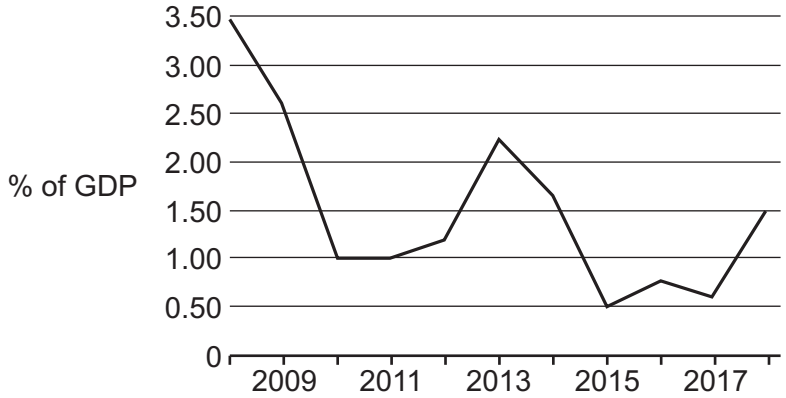


Fig. 1.3 South Africa's foreign direct investment (FDI) net inflows

An analyst said: 'A critical reason for low economic growth has been a lack of private sector investment and FDI (see Fig. 1.3). The lack of investment wasn't just due to the political policies but also to uncertainty and mismanagement which led to continued inequalities.'

Sources: The Daily Telegraph, 6 July 2019 and ceicdata.com

(a) Describe what is meant by economic equality and distinguish it from equity. [3]

(b) Define what is meant by actual economic growth and analyse the relationship between economic growth and unemployment as illustrated by Fig. 1.1 and Fig. 1.2. [5]

(c) Assess the evidence provided about the significance of the performance of the state-owned electricity monopoly as a contributor to the decline in South Africa's economy. [5]

(d) Evaluate whether attracting investment and managing uncertainty are the most effective ways to improve the prospects for South Africa's economy. [7]

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Section B

Answer **one** question.

EITHER

2 Pollution is caused when consumers or producers make decisions based on self-interest. This is a sign of market failure.

With the help of a diagram, evaluate the extent to which government policies should rely upon market forces to address this market failure. [20]

OR

3 Evaluate the view that monopolistically competitive firms will always charge lower prices and operate more efficiently than a monopoly firm. [20]

Section C

Answer **one** question.

EITHER

4 With the help of a diagram, assess the effectiveness of using fiscal policy to close a negative output gap in an economy [20]

OR

5 Assess the impact of international aid on the standard of living in low-income countries. [20]

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Surname	StemUp Model Solution
Answer booklet	Write the question number in the left-hand margin at the start of each answer.

Question number

Answers for paper 9708/43

1(a) Economic equality is when income, wealth and opportunities are distributed equally across all groups in society, for example equal access to jobs, earnings and education. Equity is different: it means fairness or justice, which is a value judgement. An equitable distribution need not be equal, for example people who work longer or have more skills may fairly earn more.

1(b) Actual economic growth is the percentage increase in a country's real national output (real GDP) over a period of time, usually a year.

Fig. 1.1 and Fig. 1.2 show an inverse relationship: when growth falls, unemployment rises. Growth was negative (about −1.5%) in 2009, and unemployment rose from about 23.5% to over 25% in 2009 to 2010. After 2011 the general trend of growth was falling, from over 3% to around 0.5% in 2016 and about −3% at the end of 2019, while unemployment fluctuated but had a rising trend, reaching about 27% to 27.5% in 2017 to 2019. The lowest growth rates coincide with the highest unemployment, because lower output means firms need fewer workers, since the demand for labour is derived from the demand for goods.

1(c) The evidence suggests it is very significant. Electricity is used by every industry and household, and the monopoly could not meet demand, so it rationed electricity with regular power cuts. The article states this led to decreases in production and increases in unemployment, which would reduce output in mining and manufacturing. Its debts added significantly to the national debt (56% of GDP), and the article says they are seen as the biggest threat to the economy.

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However, other factors also contributed, such as mismanagement of railways, ports and airways, rising costs and falling investment in mining, a skills shortage, restrictive trade union practices and falling FDI. No figures are given for the output lost because of the power cuts, so the exact significance of the electricity industry compared to these other factors cannot be measured.

1(d) Attracting investment is important. Fig. 1.3 shows FDI net inflows fell from about 3.5% of GDP in 2008 to about 0.5% in 2015, and the analyst says lack of private and foreign investment was a critical reason for low growth. Mining firms stopped investing, which reduced potential growth and cost thousands of jobs. More investment would raise AD through the multiplier, and also increase productive capacity, so it helps both actual and potential growth, with unemployment at 27% giving plenty of spare capacity.

Managing uncertainty is needed to achieve this, because government reforms and the poor performance of state industries have damaged confidence; firms and MNCs will not invest without stable policies and reliable electricity. There are signs of improvement, as FDI rose to about 1.5% of GDP in 2018.

However, they may not be the most effective ways on their own. In the short run, prospects are limited because high unemployment means low consumer spending and weak AD. In the long run, South Africa must reform its weak education system to overcome the skills shortage, reform restrictive trade union practices, and improve infrastructure and the management of the electricity monopoly. Without these supply-side reforms, investors will still be put off.

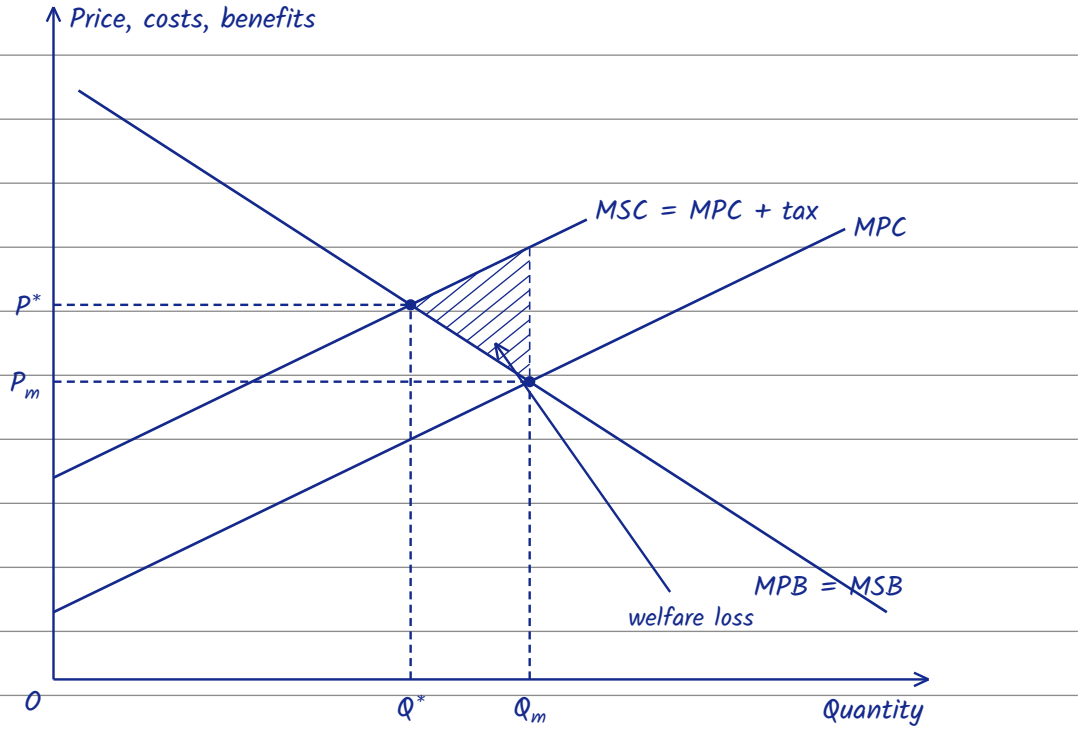
Overall, attracting investment and reducing uncertainty are probably necessary, but they are most effective when combined with improvements in infrastructure, education and the electricity supply.

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Section B

2 Market failure occurs when the free market leads to a misallocation of resources, so output is not allocatively efficient. Pollution is a negative externality: a cost of production or consumption that falls on third parties who are not compensated, such as people with breathing problems near a factory, or the effects of car exhaust fumes. It can come from producers, such as a power station, or consumers, such as drivers.

Consumers and producers acting in self-interest consider only their private costs and benefits. A firm produces where MPC = MPB, at Qm, and ignores the external cost. The marginal social cost, MSC = MPC + external cost, is higher, so the social optimum is Q^*, where MSC = MSB. Too much is produced ($Qm > Q^*$), the price Pm is too low, and the shaded triangle is the welfare loss.



Market-based policies change prices so that the market itself reduces pollution. An indirect tax equal to the marginal external cost raises the firm's costs, shifting MPC up to MSC = MPC + tax. The price rises to P^* and output falls to Q^*, where

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MSC = MSB, so the externality is internalised, the polluter pays and the welfare loss is removed. The tax revenue can be used to fund clean technology. Tradable pollution permits are another market solution: the government sets a total limit on pollution and issues permits that firms can buy and sell. Firms that can cut pollution cheaply sell permits, so pollution is reduced at the lowest cost, and the limit can be cut over time, as in the EU Emissions Trading System. Subsidies for cleaner alternatives, such as electric vehicles, and extending property rights also use market forces.

There are strong arguments for relying on market forces. They keep consumer and producer choice, give firms a continuous incentive to reduce pollution and develop cleaner technology, and achieve reductions at the lowest cost, while taxes and permit auctions raise revenue.

However, there are limitations. It is very difficult to measure the external cost in money terms, so the tax may be set too low, leaving over-production, or too high, causing government failure. If demand is price inelastic, as for petrol, a tax reduces pollution only a little and mainly raises revenue, while it is regressive.

Profit-maximising firms may pass the tax on to consumers rather than cut pollution, or move production abroad. With permits, if too many are issued their price collapses and there is little incentive to cut pollution, and monitoring is costly. The impact on price and output can take a long time to work.

Direct government intervention may be better in some cases. Regulations such as emission limits, or a complete ban, give more precise and quicker control, which is essential for highly toxic pollution where any amount is harmful. Information campaigns can change consumer behaviour, though advertising is costly and its effect is uncertain. However, regulation gives no incentive to cut pollution below the limit, needs inspection, and fines may be too low to deter.

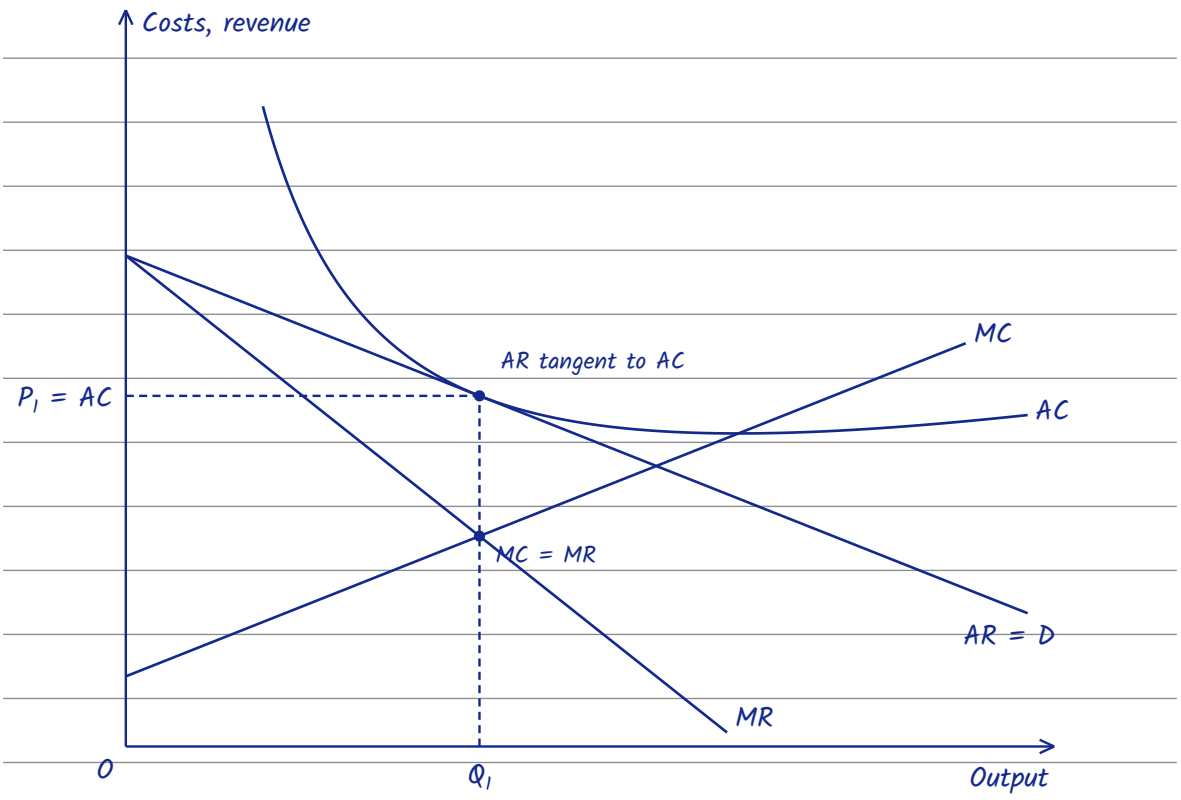
In conclusion, government policies should rely largely on market forces, such as taxes and tradable permits, because they correct the price signal and reduce

Question number

pollution at the lowest cost. However, the extent depends on the type of pollution and how well the external cost can be measured: for dangerous pollutants, or where demand is very inelastic, regulation and bans should be used alongside market-based policies, as no single policy is always effective.

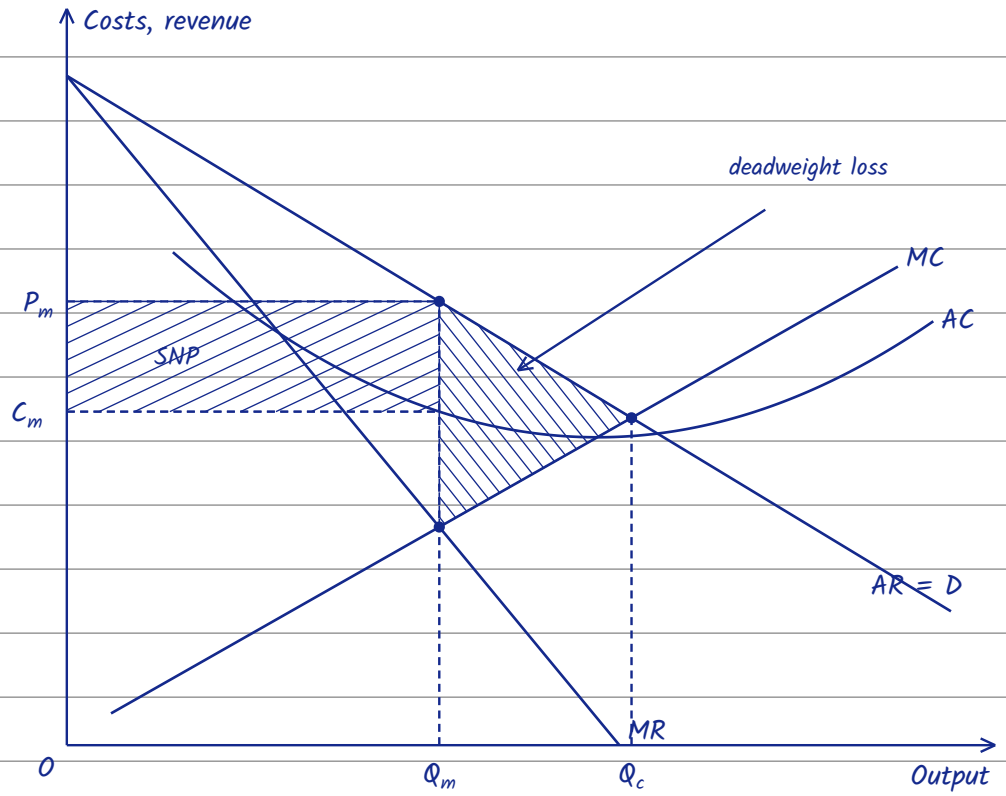
3 Monopolistic competition is a market with many firms selling differentiated products, for example restaurants or hairdressers, with low barriers to entry and exit. Each firm has some price-setting power, so it faces a downward sloping but fairly elastic demand curve. A monopoly is a single seller with a large market share, no close substitutes and high barriers to entry, so it is a price maker. Both maximise profit where MC = MR.

In the short run a monopolistically competitive firm can make supernormal profit. But because barriers to entry are low, new firms enter and take customers, so each firm's demand curve shifts left until AR is tangent to AC, and only normal profit is made in the long run (P1 = AC at Q1).



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A monopoly is protected by barriers to entry, so it can keep supernormal profit $(Pm - Cm) \times Qm$ in the long run, restricting output to Qm and charging Pm, well above MC, with a deadweight welfare loss compared with the competitive output Qc.



This supports the view. The monopolistically competitive firm earns only normal profit in the long run, so its price only covers average cost, while the monopoly's price includes supernormal profit. Competition from many rivals also keeps pressure on costs, reducing X-inefficiency, while the monopoly may become complacent.

However, the monopolistically competitive firm is not efficient either. In the long run it produces where AR is tangent to AC on the falling part of the AC curve, so it is not at minimum AC (productively inefficient, with excess capacity), and P > MC, so it is allocatively inefficient. It also spends on non-price competition, such as advertising and branding, which raises costs and so prices.

A monopoly may actually charge lower prices. A large firm can gain economies of scale, so its average cost may be far below that of many small firms, and even

Question number

with a profit mark-up its price can be lower, as in natural monopolies such as water supply. Its supernormal profit can fund research and development, giving dynamic efficiency: new technology lowers costs and improves products over time, which small firms making normal profit cannot afford. A monopoly in a contestable market, or one that is regulated with a price cap, may also keep prices low.

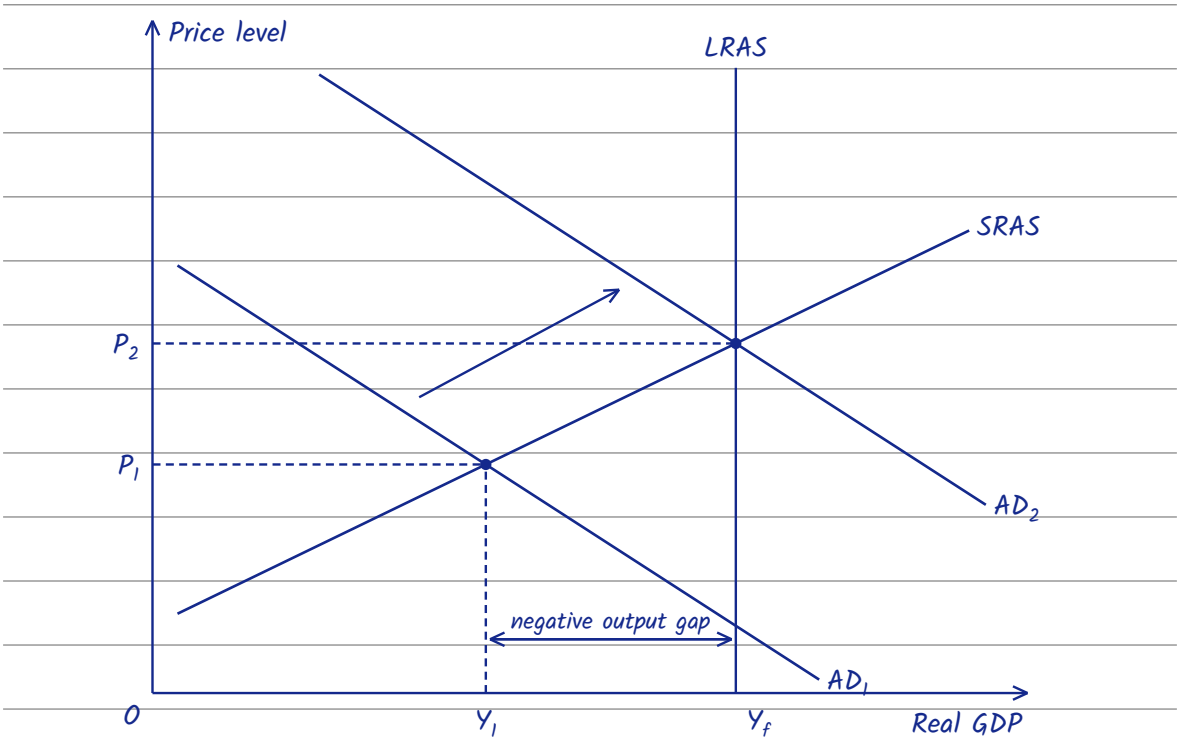
In conclusion, monopolistically competitive firms will often charge lower prices than a monopoly because they only make normal profit in the long run, but they are neither productively nor allocatively efficient. Where a monopoly gains large economies of scale and dynamic efficiency, it may charge lower prices and be more efficient, so the statement is not always true; it depends on the industry's cost conditions, contestability and regulation.

Section C

4 Fiscal policy is the use of government spending and taxation to influence the economy, including aggregate demand, growth, employment and inflation. An output gap is the difference between actual output and potential output. A negative output gap means actual output is below potential, so there is spare capacity and unemployment, usually because of insufficient aggregate demand.

In the diagram, AD1 gives equilibrium output Y1 below the full-employment level Yf, shown by the vertical LRAS, so there is a negative output gap. Expansionary fiscal policy, an increase in government spending (for example on infrastructure) or a cut in income or corporation tax, raises AD. Government spending is a direct injection, and lower taxes raise disposable income and so consumption, and raise post-tax profits and so investment. AD shifts right from AD1 to AD2 and output rises from Y1 to Yf, closing the gap.

Question number



The multiplier makes this more powerful: the extra spending becomes income for others, who spend part of it, so the final rise in national income is a multiple of the initial injection, k = 1 / (1 − MPC). A budget deficit therefore has a magnified effect on output, income and employment. Automatic stabilisers, such as falling tax receipts and rising benefit payments in a recession, also help.

However, there are limits to its effectiveness. It is difficult to forecast the size of the output gap and the value of the multiplier, so the government may do too little, or too much, which pushes AD beyond Yf and causes demand-pull inflation, as P rises from P1 to P2. There are time lags in recognising the problem, passing the budget and spending the money, so the policy may take effect after the economy has already recovered.

A larger budget deficit must be financed by borrowing. This may raise interest rates and crowd out private investment, reducing the net effect. If the national debt is already high, interest payments rise and future taxes may need to increase, and households expecting this may save tax cuts rather than spend them. If the deficit is financed by increasing the money supply, inflation may result in the long

Question number

run.

Tax cuts may be saved, especially when confidence is low, and if the marginal propensity to import is high, much of the extra spending leaks into imports, reducing the multiplier and worsening the current account of the balance of payments. Politically, it is easy to cut taxes but hard to reverse them later.

Alternatives can be compared. Monetary policy, such as cutting interest rates, can be changed more quickly, but is weak if rates are already near zero, when fiscal policy becomes more important. Supply-side policies can increase potential output and reduce inflation risk, but take a long time and do not raise demand in the short run.

In conclusion, fiscal policy can be effective in closing a negative output gap, particularly in a deep recession when there is plenty of spare capacity, the multiplier is large and monetary policy is weak. Its effectiveness is reduced by time lags, crowding out, high debt and import leakages, so it works best when it is well timed, targeted at spending with a high multiplier, and combined with monetary policy.

5

International aid is any assistance given to a country that would not be provided through normal market forces. It can be humanitarian aid for emergencies, such as food after a disaster, or development aid for long-term growth, such as grants or soft loans. It can be bilateral (from one government) or multilateral (through bodies such as the World Bank), and tied (it must be spent on the donor's goods) or untied. The standard of living is the economic welfare of the population, measured by real GNI per head and indicators such as health, education and the HDI.

Low-income countries have low GDP per head, low productivity, low savings and investment, high dependency ratios and dependence on primary exports. This creates a cycle of poverty: low income means low savings, so low investment and

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low productivity, so incomes stay low. Aid can break this cycle by filling the savings gap and the foreign exchange gap, funding investment in capital and imports of machinery.

Aid can raise living standards directly. Humanitarian aid saves lives in emergencies. Aid spent on health care, vaccination programmes, clean water and sanitation reduces child mortality and disease, and aid for schools raises literacy. These are merit goods that would otherwise be under-provided. Aid for infrastructure, such as roads, power and ports, and for new technology and training raises productivity, which increases output, employment and incomes and shifts the PPF outwards. As incomes rise, tax revenue rises, so the government can spend more on health, housing and education, improving living standards further.

However, the impact is not always positive. Corruption means aid may only reach a small part of the population or be spent on prestige projects. Aid is sometimes given for political or strategic reasons rather than to the countries with the greatest need. Tied aid forces the recipient to buy goods and services from the donor, which may be more expensive or unsuitable, so much of the benefit returns to the donor.

Aid in the form of loans adds to debt; interest and repayments take money away from health and education and can deepen the cycle of poverty. Food aid can depress local prices and harm local farmers. Long-term dependency on aid may reduce incentives for the government to reform, to collect taxes and to innovate, creating a welfare or dependency mentality.

The impact therefore depends on the type of aid (grants are better than loans, untied better than tied), how it is targeted, the quality of governance in the recipient country, and whether it is used for investment that raises productivity. Multilateral aid with conditions on spending and monitoring is more likely to be effective. Alternatives such as fair trade, debt relief and FDI may promote more sustainable development.

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In conclusion, international aid can improve the standard of living in low-income countries, especially humanitarian aid in emergencies and development aid for health, education and infrastructure in the short to medium term. However, its long-term impact is often limited by corruption, tied aid, debt and dependency, so it is most effective when it is well targeted, given as grants, and combined with good governance and trade.