UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays (Supplement) **May/June 2013**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

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READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.
Write your Centre number, candidate number and name on all the work you hand in.
Write in dark blue or black pen.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A
Answer **Question 1**.

Section B
Answer any **two** questions.

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

At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

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Section A

Answer this question.

1 Macroeconomic decisions: microeconomic effects.

In 2011 many countries experienced a recession. Most industries, even monopolies, in those countries saw a decline in demand, consumer spending and profits. However the decline was less severe in some firms, for example those in the food and beverage industry, than for others, for example those in the leisure industry. This fall in consumer spending and in consumer confidence might have been caused by anticipated job losses as governments announced reductions in public sector expenditure.

Governments decided to reduce expenditure because they had very large budget deficits. Apart from public sector employment reductions the macroeconomic measures they introduced included fewer subsidies, tax increases and a more restrictive monetary policy.

Tax increases did not help businesses. For example they made it more necessary for firms to make the control of any credit they gave a priority, and to monitor their cash flow very carefully. Increasing prices to match indirect tax increases in order to retain profit levels was not always possible when consumer demand was reduced. The alternative of reducing costs was also a problem. Some argued that firms operating with a high proportion of fixed costs found the market conditions increasingly difficult as their revenues failed to recover and the possibility for further cost reductions became more limited. Others thought that firms with a higher proportion of variable costs faced greater difficulties.

Some governments also reduced investment allowances and subsidies to firms. These tax-free allowances enabled firms to deduct some of the investment cost from what they had to pay in tax. However, a reduction in the allowances had no effect on those industries that did not invest in new equipment. It did harm small and medium-sized enterprises that wanted to buy new machinery, or undertake research in order to become more efficient, or improve their products.

The situation was not helped by increased restrictions imposed by the government on banks' ability to lend. These restrictions meant borrowing for house purchases was more difficult and this again reduced consumer expenditure.

(adapted from The Guardian)

(a) Use the information to explain how macroeconomic changes can be linked to microeconomic decisions. [5]

(b) Analyse with the aid of a diagram, showing costs and revenue for a monopoly, what is likely to happen to the firm's profits when there is a fall in demand in the industry due to a recession. [5]

(c) Suggest, using the concept of income elasticity of demand, why the decline in profits was less severe during the recession in the food industry than in the leisure industry. [4]

(d) Do you support the opinion in the information that a recession is likely to be worse for firms with a high proportion of fixed costs than firms with a higher proportion of variable costs? [6]

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Section B

Answer **two** questions.

2 It is important that an economy makes the most efficient use of its resources. This can only be done if firms are allowed to increase in size. Government regulation of firms should, therefore, be minimised.

Discuss whether you agree with this statement. [25]

3 **(a)** Explain how the quantity of labour employed and the wage rate are determined by a firm in a perfectly competitive labour market. [12]

(b) Discuss why wage rates might be different in practice from those in a perfectly competitive labour market. [13]

4 Governments often suggest that there has been an improvement in the standard of living in their economy and support their statement by referring to a range of economic indicators. One of the indicators they use is GDP.

Discuss whether GDP is a reliable indicator of changes in the standard of living in an economy. [25]

5 **(a)** What distinguishes a developed economy from a developing economy? [12]

(b) Developing economies are often keen to encourage industrial development in rural areas. Developed economies, by contrast, often prevent industrial development in rural areas.

Discuss why there might be this difference in policies. [13]

6 **(a)** Explain how a fall in interest rates might influence the level of investment and, as a result, national income. [12]

(b) Discuss, with reference to liquidity preference theory, whether interest rates are the main determinant of consumers' demand for money. [13]

7 **(a)** A newspaper reported that 'unemployment had risen for the third consecutive month.' What might be the cause of a rise in unemployment? [12]

(b) Discuss whether achieving a fall in the level of unemployment should be the main macroeconomic aim of a government. [13]

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Copyright Acknowledgements:

Question 1 © adapted: Graeme Wearden; *Surge in companies showing signs of financial distress*; The Financial Section; The Guardian News and Media Ltd; 14 April 2011.

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