Cambridge International A Level

Cambridge International Examinations
Cambridge International Advanced Level

ECONOMICS **9708/43**

Paper 4 Data Response and Essays (Supplement) **October/November 2014**

2 hours 15 minutes

No Additional Materials are required.

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READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

Section A
Answer **Question 1**.

Section B
Answer any **two** questions.

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

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **4** printed pages and **1** insert.

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Section A

Answer this question.

Tax rates and growth

1 It is suggested that lower tax rates will cause economic growth. If the marginal tax rate is cut and disposable income rises, labour has more incentive to work additional hours to increase their earnings, and entrepreneurs may invest in a new enterprise. The question is whether these incentive effects are large. If they are, they could cause a sustained increase in economic activity and growth. This idea is one of the key features of supply-side economic policy.

If, however, the incentive effects are small then the outcome would be quite different. Cutting taxes would raise output in the short run by putting money in people's pockets which would allow them to increase their spending. This would cause a temporary inflationary demand-side effect. If the effect is small, cutting taxes would not raise output on the supply side in the long run.

Since 1945, the top rate of income tax in the US has varied from more than 90% to less than 30%. There does not appear to be any consistent link between these tax rates and economic performance. Tax rates were lower in the 1960s than the 1970s, and economic growth was higher in the 1960s than the 1970s. However, tax rates were higher in the 1990s than the 2000s, and economic growth was higher in the 1990s than the 2000s.

Of course, many other factors affect economic growth so a lack of a consistent link between tax rates and economic growth does not prove that tax rate changes have little or no effect. A useful measure of the supply-side effects is what happens to hours worked as a result of the marginal tax rate change. Governments are also interested in the effects of tax changes because they wish to calculate the amount of revenue they could collect.

If people work longer when the tax rate is reduced, then their income will rise. Those who believe in supply-side economic policy say that this response to marginal tax rate changes is greater than one. This implies that changes in government revenue will have a similar effect to changes in a firm's revenue if it has a price elasticity of demand greater than one.

However, a review of several income groups after recent tax changes concluded that the best estimate of this response to tax rate changes ranges from 0.12 to 0.40 and is not greater than one. There is an alternative proposed to tax rate changes as a means of raising revenue which is to remove opportunities for tax avoidance.

Source: International Herald Tribune, 2012

(a) Explain what is meant by economic growth. [2]

(b) Explain why cutting tax rates is considered a supply-side policy. [3]

(c) Analyse, with the aid of a diagram, how the supply of labour might change as the marginal rate of income tax falls. [4]

(d) Explain, using the information above, what would happen to government revenue if tax rates were reduced, and the response to marginal tax rate changes is greater than one. [4]

(e) Discuss whether the evidence from the data shows that economic growth is improved by tax reductions. [7]

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Section B

Answer **two** questions.

2 The link between marginal utility and price has a similar significance for the consumer as the link between marginal cost and price for the producer.

Consider whether this statement is an accurate reflection of the economic analysis of consumer and producer equilibrium. [25]

3 **(a)** Cunard is a company that operates large passenger liners providing transatlantic crossings between the US and the UK. Larger cabins, or cabins with balconies are priced higher than the smaller cabins. Also for any cabin, passengers purchasing the voyage in the US pay a much lower price than passengers purchasing the voyage in the UK. Cunard insist that in order to make the purchase in the US the passenger must have a US address.

Explain whether these are examples of price discrimination and consider whether price discrimination can be justified. [12]

(b) Discuss whether firms operating in a market structure of monopolistic competition are less efficient than those operating in perfect competition. [13]

4 **(a)** Explain what economists mean when they say that the labour market is imperfect rather than perfect. [12]

(b) Does the use of the term 'imperfect' mean that there is some failure in the labour market that should be corrected by government intervention? [13]

5 In 2012, after a period of low demand in an economy, private consumption and investment increased and there was economic growth. This was not entirely advantageous as the increase in economic growth can conflict with other government objectives.

Explain why an increase in private consumption and investment might have led to an increase in economic growth and consider whether you agree that this may conflict with other government objectives. [25]

6 It is suggested that the use of credit cards has resulted in huge debts as people spend far more than they earn.

(a) Explain whether the liquidity preference theory of the demand for money can be applied to the use of credit cards. [12]

(b) Use the liquidity preference theory to discuss the possible consequences of an increase in the supply of money. [13]

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[Turn over

7 **(a)** The main characteristics of a developing country are a small service sector and a lack of international trade.

Do you agree with this statement? [12]

(b) It was reported that in the last quarter of 2012 a developing economy 'had performed well in terms of its GDP compared with other countries'. Explain what this statement means and discuss whether a comparison using GDP is a valid way of measuring economic performance between countries. [13]

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Question 1 *International Herald Tribune: 17-18 March 2012. P14, 16*

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