Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/43**

Paper 4 Data Response and Essays **October/November 2018**

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 **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.

1 The government and market failures

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

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

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

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

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

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

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

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

Source: RSA Journal, Issue 2, 2015

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

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

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

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

Section B

Answer **two** questions.

2 A city bus company proposes to reduce passenger fares.

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

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

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

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

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

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

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

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

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

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

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

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

Critically evaluate this view. [13]

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

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

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

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

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