UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essays (Supplement) **October/November 2013**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

8178552153

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Section A
Answer **Question 1**.

Section B
Answer any **two** questions.

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DC (NH) 65426/3

UNIVERSITY *of* CAMBRIDGE International Examinations

Section A

Answer this question.

1 **Banks, supermarkets and oligopoly market power**

Some banks have been accused of having a control over the market that enabled them to get away with poor service, confusing products and dishonest claims about free banking. However, the banks maintained that their size created economies of scale, the benefits of which were passed on to consumers in the form of lower prices. A report stated that the banks' claim was not correct. Any benefits went mainly to shareholders and not to consumers. The banking industry, it said, had many of the characteristics of an oligopolistic market. The report said that charges for services were often difficult to determine and that obstacles which prevented customers switching accounts to rival banks meant that the banking industry was not competitive. *(Source: The Independent)*

Another industry dominated by a few large firms is food retailing. Morrisons is such a firm with 420 stores. It is the fourth biggest supermarket in the UK with a 12.3% market share in 2011 (its three main rivals had market shares of 30.3%, 16.9% and 16.5% based on the value of total sales). Unlike its bigger competitors, Morrisons owns many of the factories from which it gets its food. This vertical integration gives it an advantage over rivals. In addition, some of the products it sells are made in its supermarkets. It started to produce its own products in order to save costs. The stores have, for example, their own bakeries and butchers. The supermarket has plans to introduce home deliveries, on-line ordering and take-away meals. Its aim is to grow further. It recognises that it would take years to match the market share of its bigger rivals but it wants to be a 'more dangerous' competitor. (*Source: The Sunday Telegraph)*

Table 1: Sales and Market share of UK supermarkets and smaller shops

Supermarket and shops	Value of Sales December 2009 to February 2010 £m	Market Share % of total Sales 2010	Value of Sales December 2010 to February 2011 £m	Market Share % of total Sales 2011	% Sales change Dec. 2009–Feb. 2010 compared to Dec. 2010–Feb. 2011
Tesco	7102	30.4	7352	30.3	3.5
Asda	3973	17.0	4095	16.9	3.1
Sainsbury's	3799	16.3	3998	16.5	5.2
Morrisons	2865	12.3	2992	12.3	4.4
All other food shops	5630	24.0	5851	24.0	3.9
Total	23369	100.0	24288	100.0	3.9

(Source: http://www.kamcity.com)

(a) The supermarket claims that it benefits from integration. The banks maintain they have economies of scale. Distinguish between integration and economies of scale. [4]

(b) Analyse how any increased integration might affect the costs of a supermarket. [4]

(c) Comment on the performance of Morrisons between 2009–2011 compared with its larger competitors. [4]

(d) Is there enough evidence in the information to conclude that banking and food retailing are oligopolistic markets? [8]

Section B

Answer **two** questions.

2 Choice is an essential part of the analysis in economic texts.

(a) Explain how economic analysis suggests that consumers make a choice when buying products and how they react to price changes. [12]

(b) Discuss the possible choices a firm might face when deciding what business objective it should have. [13]

3 The economic theory of wages can explain wage determination in a perfect market. This, however, is of little use as all markets are imperfect and the theory has no relevance in such markets.

Discuss whether you agree with this statement. [25]

4 In 2011, an economic advisor recommended that low interest rates in a country should continue because of the uncertainty about the ability of the economy to grow. *(Source: The Independent)*

(a) Explain the possible link between interest rates and the economic growth of an economy. [12]

(b) Discuss what other policies a government might use to encourage economic growth. [13]

5 'The many difficulties involved in measuring living standards mean that it is never possible to be certain that the people in one country are better off than those in another country.'

How far do you agree with this comment? [25]

Please turn over for rest of the questions.

6 **(a)** Explain the possible causes of a rise in unemployment. [12]

(b) In 2011, a government announced that it would reduce the number of people employed in the public sector and that pensions would be paid at age 65 rather than age 60.

Discuss how, according to the liquidity preference theory, a person's demand for money might be affected by the above announcement. [13]

7 The increase in air travel has led to the pressure to build larger or extra airports. Airports create jobs, provide the facilities for international trade and bring income to the country. They also can cause noise pollution and sometimes destroy areas of natural beauty.

(a) Explain what is meant by efficiency in the use and the exploitation of resources. [12]

(b) Discuss whether the creation of income through such projects as the building of airports should be left to the private sector. [13]

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ECONOMICS **9708/42**

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2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

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UNIVERSITY *of* CAMBRIDGE
International Examinations

[Turn over

Section A

Answer this question.

1 **The objectives of firms**

Unilever, a multinational global food manufacturer, with many branded products, has announced a partnership with Oxfam, the international relief agency, to help farmers in developing countries. Unilever welcomed the partnership and said that their objective was 'to double the size of our business while halving our environmental impact. We want to do this by maximising the positive social impact of our business. A major element of this is to promote better livelihoods by incorporating 500 000 small farms in developing countries and small-scale distributors into our supply chain. This way we hope to have a positive impact on the lives of people living in poverty.'

Historically, companies in the food and drink industry have tried to improve efficiency and minimise costs by reducing the number of international suppliers they use. However, Oxfam said that firms are now starting to consider new ethical business models about how they source their produce. There is a need to move away from a short-term focus on profit margins and consider long-term objectives.

In 2011 a drugs company, GlaxoSmithKline, (GSK), manufactured a new medicine which had a higher market price than a rival medicine from another company. The medicine was expensive to research and produce. The expected annual revenue for the company from the sale of the medicine was estimated to be around US$314m; the annual cost of hospital treatment with the medicine for just one patient was around US$23 000. A government negotiated a new type of deal with GSK. The company agreed that it would supply public sector hospitals with the medicine at the same price as its rival's product. It would also return some of the revenue it received from the hospitals if its product proved to be less successful than the rival product. The government said it was introducing a 'value-based pricing model'. A spokesperson for GSK said 'we are moving in the direction where price is determined by value and value is determined by evidence'.

(Source: The Sunday Telegraph)

(a) In what type of market structure is Unilever likely to be operating? Explain your answer. [3]

(b) Why might it be thought that there could be a conflict between Unilever's stated objective and its policy concerning its suppliers? [5]

(c) GSK's new drug was expensive to research and develop. Why might a company conduct research and development (R&D) if it is so expensive? [4]

(d) Discuss whether there is enough evidence in the information to conclude that the objective of Unilever and GSK is not that of profit maximisation. [8]

Section B

Answer **two** questions.

2 **(a)** Use the theory of marginal utility to analyse how a consumer will normally buy more of a product at a lower price than at a higher price and explain how this theory can be used to derive a market demand curve. [12]

(b) Economic texts examine market equilibrium. Discuss whether it is the consumer or the producer who determines the equilibrium market price and whether consumers have the same power in all types of market structure. [13]

3 **(a)** Analyse whether in a perfectly competitive labour market it is true that a profit maximising firm will employ labour only up to the point where the marginal revenue product of labour is at its maximum. [12]

(b) Discuss whether the marginal revenue productivity theory of wages is useful in explaining wage determination in an imperfect market where there is a trade union. [13]

4 In the economic recession of 2011 many private sector firms were still able to announce that they were successful and had made substantial profits. Large bonuses were paid to directors and shareholders received large dividends.

Discuss whether it is better for an economy if the allocation of resources is left entirely to the private sector operating through the market system. [25]

5 **(a)** Explain, using the concept of the multiplier, the possible link between a fall in interest rates and an increase in national income. [12]

(b) Discuss whether the use of fiscal policy is the only effective means of stimulating economic growth. [13]

6 While the overall aim may be to improve the economy, governments find that their macroeconomic policies sometimes conflict with each other. Explain why some government economic policies may conflict with each other and discuss which should be given priority. [25]

7 A country has a high level of unemployment and a low level of GDP. Discuss whether this situation is a good indication that the country is a developing country. [25]

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Copyright Acknowledgements:

Question 1 © ADAPTED: Jonathan Sibun; *Glaxo offers NHS rebate if latest cancer drug fails to outperform Pfizer's rival*; Business Section; Sunday Telegraph; 26 December 2010.
Question 1 © ADAPTED: Kamal Ahmed; *Unilever seals Oxfam deal*; Business Section; Sunday Telegraph; 26 December 2010.

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ECONOMICS **9708/43**

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UNIVERSITY *of* CAMBRIDGE International Examinations

[Turn over

Section A

Answer this question.

1 **The effect of oil price rises**

In 2011, there were big increases in oil prices which led to comparisons with a period in the 1970s when oil prices also rose steeply. In the 1970s, the macroeconomic policy used in the UK was to increase budget deficits. By contrast, in 2011, the macroeconomic policy was to try to reduce the budget deficit.

In the 1970s some thought the effect of oil price increases would be inflationary while others thought the effect would be deflationary. The following points were made.

In the 1970s

- consumers would have to spend more on oil but they would spend less on other things.
- consumers would not spend their savings.
- firms could pass on the increased cost of production, caused by higher oil prices, to consumers.
- oil prices were an important item used in the construction of the consumer price index.
- oil producers and suppliers would not necessarily spend their increased revenues.

Table 1 below shows the rate of inflation in the UK in the 1970s.

Table 1: UK inflation rates in the 1970s

Year	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Inflation rate %	6.40	9.40	7.10	9.20	16.00	24.20	16.50	15.80	8.30	13.40

(Source for Table 1: http://www.whatsthecost.com)

In 2011, oil prices increased again. The question then was whether the outcome would be the same as in the 1970s. Again some said there would be deflationary effects, while others predicted inflationary effects. In addition to the points that were made about the 1970s price increase, these further points connected with the economic context of 2011 were considered.

In 2011

- oil prices rose by 50% compared with 240% in the early 1970s.
- consumers faced potential unemployment in the private sector from low growth rates as economies tried to recover from a world banking crisis and recession.
- consumer spending on oil as a percentage of GDP was about 40% lower than its 1970s level.
- economies were less dependent on oil than in the 1970s.
- workers in the public sector were worried about possible unemployment as the public sector was reduced in size.
- reduced government spending had a downward effect on employment in all sectors.

(Source: The Daily Telegraph)

(a) The information mentions that some thought the effect of oil price increases would be deflationary. Explain what economists mean by 'deflationary'. [2]

(b) Refer to what actually happened to the rate of inflation in the UK as shown in Table 1:

(i) Explain which, if any, of the points made about the 1970s could have caused what is shown in Table 1. [4]

(ii) In the 1970s the UK government had a macroeconomic policy of increasing the budget deficit. Explain how this policy might have contributed to what is shown in Table 1. [6]

(c) From the information given consider whether the effect of the rise in oil prices in 2011 was more likely or less likely to have been inflationary compared with the 1970s. [8]

Section B

Answer **two** questions.

2 **(a)** Explain how, according to marginal utility theory, consumers reallocate their expenditure between different products as prices change. [12]

(b) In reality perfect competition is seldom found, and firms use advertising to persuade consumers to buy their products.

Discuss whether imperfect competition means that markets are controlled only by producers and the traditional idea that the consumer determines what happens in the market based upon utility theory is no longer valid. [13]

3 **(a)** Do you agree with the view that in a perfectly competitive labour market wages are higher in some occupations than others only because of the differences in the supply of labour? [12]

(b) A country has a minimum wage rate fixed by law. Discuss whether this can be included in the economic analysis of the theory of wages in an imperfectly competitive labour market. [13]

4 Some companies claim that restrictive regulation by governments is the biggest threat to business growth. *(Source: The Independent)*

(a) Explain what is meant by:

(i) a deadweight loss, and

(ii) price discrimination. [12]

(b) Discuss which is more beneficial, firms that remain small or firms that grow in size. [13]

5 Governments of developing countries often argue that the economy has improved while they have been in power. Explain what economic indicators might be used to support their argument and discuss the usefulness of that data in illustrating an improvement in a developing economy. [25]

6 Some governments place great emphasis on the aims of economic growth and keeping the level of unemployment low. How far do you agree that these aims should be the most important of a government? [25]

7 It is said that the market does not allocate resources efficiently and that market failures occur. However, there need be no concern about market failure. All types of market failure can easily be overcome if the government intervened in the price system.

Discuss this argument. [25]

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Section A Question 1 © ADAPTED: Roger Bootle; *Comment: A continued high oil price will bring ups and downs …* ; Business Section; The Daily Telegraph;
Section A Question 1 © ADAPTED: http://www.whatsthecost.com/historic.cpi; 27 July 2011.
Section B Question 4 © ADAPTED: Business Section; The Independent; 4 April 2011.