Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/42**

Paper 4 Data Response and Essays **February/March 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.

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Section A

Answer this question.

1 Problems in the steel industry

By 2016, China's steel industry had expanded rapidly and accounted for just over half of world production but China's economy had huge excess capacity: 30% in the case of steel which led to cheap export prices. Chinese economic growth in real terms was slowing and aggregate supply was greater than aggregate demand. Profit margins were already small but the collapse of world steel prices which fell significantly in 2015 (as shown in Fig. 1.1) worsened the situation.

The dumping of cheap Chinese imports of steel caused problems for the United Kingdom (UK) steel industry. There were thousands of job losses at three major steel factories which was devastating news for UK steel workers and the regional economies.

Some argued that despite this there was no case for the UK Government to intervene to save the steel factories.

Steel is used in the construction industry and in the production of cars, household appliances and many other goods. Companies that use steel are much more numerous than companies that produce it. If steel prices are low, the costs of companies that use steel are reduced. So there should be no complaints or pleas for government intervention about supposedly unfair competition from cut-price imports.

Industrial policy is a valid aim of government when it comes to identifying market failures. There is even a strong case for rescuing industries that face temporary external shocks, such as occurred with the United States (US) Government's rescue of Chrysler and General Motors in 2008 as the economy fell into deep recession. For steel, however, it is a buyers' market. The closure of unprofitable steel factories is not a market failure at all. It is a reflection of costs being too high and the industry being uncompetitive. Rescuing steel factories with public money would do nothing to alleviate the problem of overcapacity. It would divert scarce resources from more productive uses such as long term investment in infrastructure.

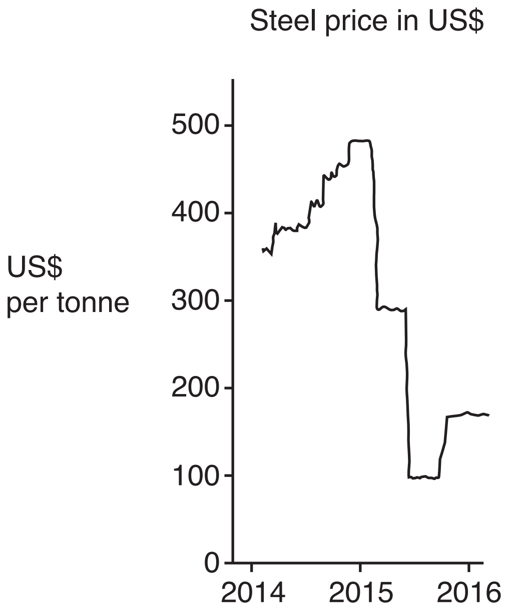

Fig. 1.1: Changes in world steel price, 2014–2016

Sources: The Times, 21 October 2015 and The Observer, 25 October 2015

(a) What is meant by economic growth per capita in real terms? [.]

(b) Explain the difference between a firm's variable costs and fixed costs. Consider which would be changed as a result of the changes in steel prices in 2015. [4]

(c) Why is the market for steel described in the article as "a buyers' market"? [4]

(d) Explain what is meant by market failure. Discuss whether there is any evidence in the information that the government should support the steel industry because there is market failure. [8]

Section B

Answer **two** questions.

2 The UK Government has established a behavioural insight team known as the 'nudge unit,' which attempts to change consumer behaviour by persuasion.

Explain how indifference curve theory predicts a consumer will react to changes in income and changes in the price of a product in order to maximise satisfaction. Consider whether the use of 'nudge' theory (persuasion) conflicts with this theory of maximising satisfaction. [25]

3 **(a)** Explain what is meant by equity, allocative efficiency and Pareto optimality. Consider whether they are linked. [12]

(b) Discuss whether a better use of resources is always achieved if there is a market structure in which firms remain small. [13]

4 In 2016, a country's largest yacht builder said it would have to make 350 people redundant. The company, which builds luxury yachts, said demand had decreased in the recession.

(a) Explain, with the help of a diagram, how this situation could be incorporated into the marginal revenue productivity theory of wage and employment determination. [12]

(b) The price of the company's product was above the average total cost. Discuss whether in an imperfectly competitive market structure a firm's aim would necessarily mean it would stop production if the price has to fall because of reduced demand. [13]

5 **(a)** Distinguish between the transactions demand for money and the speculative demand for money. Consider which is likely to be more important for a consumer in a modern economy. [12]

(b) Some economists argue that large budget deficits will increase the demand for money while others argue that large budget deficits will decrease the demand for money.

Discuss whether it is possible to reconcile these views. [13]

6 **(a)** Explain the difference between autonomous investment and induced investment. Consider whether there is a link between these two types of investment. [12]

(b) ‘Governments should concentrate upon providing favourable conditions for investment by firms in the private sector. This would allow all investment in an economy to be carried out by firms in the private sector.’

How far would you support this view? [13]

7 Some developing countries pursue export-led growth and argue that the overall growth of the economy can be generated not only by increasing the amounts of labour and capital but also by expanding exports.

Other developing countries prefer to promote growth by encouraging investment by foreign multinational corporations.

Compare these approaches and assess which is likely to be the more effective. [25]