Cambridge Assessment International Education

# Specimen Paper Answers – Paper 4

# Cambridge International AS & A Level Economics 9708

For examination from 2023

# Contents

# Introduction

These specimen answers have been produced by Cambridge ahead of the examination in 2023 to exemplify standards for those teaching Cambridge International AS & A Level Economics 9708. We have selected questions from Specimen Paper 4, Questions 1, 2 and 5.

The marks given are for guidance only and are accompanied by a brief commentary explaining the strengths and weaknesses of the answers. Comments are given to indicate where and why marks were awarded, and how additional marks could be obtained. There is also a list of common mistakes and guidance for candidates for each question.

The specimen materials are available to download from the School Support Hub.

**2023 Specimen Paper 04**

**2023 Specimen Paper Mark Scheme 04**

Past exam resources and other teaching and learning resources are available from the School Support Hub.

# Details of the assessment

## Paper 4 A Level Data Response and Essays

Written paper, 2 hours, 60 marks

Section A has **one** compulsory data response question (20 marks).

Section B has two questions focusing mainly on microeconomics; candidates answer **one** question (20 marks).

Section C has two questions focusing mainly on macroeconomics; candidates answer **one** question (20 marks).

The Sections B and C essay questions are unstructured with no parts. All questions are based on the A Level subject content; knowledge of material from the AS Level subject content is assumed.

Externally assessed

33% of the A Level

## Assessment objectives

**AO1 Knowledge and understanding**

- Show knowledge of syllabus content, recalling facts, formulae and definitions.
- Demonstrate understanding of syllabus content, giving appropriate explanations and examples.
- Apply knowledge and understanding to economic information using written, numerical and diagrammatic forms.

**AO2 Analysis**

- Examine economic issues and relationships, using relevant economic concepts, theories and information.
- Select, interpret and organise economic information in written, numerical and diagrammatic form.
- Use economic information to recognise patterns, relationships, causes and effects.
- Explain the impacts and consequences of changes in economic variables.

**AO3 Evaluation**

- Recognise assumptions and limitations of economic information and models.
- Assess economic information and the strengths and weaknesses of arguments.
- Recognise that some economic decisions involve consideration of factors such as priorities and value judgements.
- Communicate reasoned judgements, conclusions and decisions, based on the arguments.

## Assessment objectives as a percentage of Paper 4

| | |
|---|---|
| AO1 Knowledge and understanding | 33% |
| AO2 Analysis | 37% |
| AO3 Evaluation | 30% |

# Question 1

(a) What evidence is there in the article to suggest that loyalty cards make markets imperfectly competitive? [4]

## Specimen answer

*Loyalty cards create barriers to competition by reducing switching between supermarkets. The costs are funded by higher prices which are passed onto the consumer. The cost of setting up loyalty card schemes may be $60m – this is not affordable by smaller firms which limits their ability to compete. The additional information which the consumer has to process may cause confusion, leading to imperfect knowledge.*

**Mark awarded = 4 out of 4**

## Examiner comment

The question asks "What" – this question phrase, together with the mark allocation, requires the candidate to identify 4 features from the article. This answer identifies 4 points that are based on the information in the article.

## Common errors and general guidance for candidates

Candidates may make fewer than 4 points or the points made may not relate to the article. Candidates may write at length on 1 or more of the points rather than keeping the response focused. A general explanation of the meaning of imperfect markets is offered.

(b) Explain why a profit-maximising retailer may be interested in the link between consumers' loyalty and price elasticity of demand. [4]

## Specimen answer

*Price elasticity of demand (PED) is the responsiveness of demand to a change in price. If consumers' loyalty to one supermarket increases, this reduces their PED. The effect of a reduction in PED is that retailers can increase their price, consumers remain with them and, as long as PED inelastic, the total revenue will increase.*

**Mark awarded = 4 out of 4**

## Examiner comment

The command word "Explain" requires the response to offer a reasoned development of a point or the linking of points. This answer provides a clear definition of PED and indicates the link between higher loyalty and lower PED. This refers to the supermarkets which are the focus of the article. The response closes with some development which links an increase in prices to an increase in total revenue.

## Common errors and general guidance for candidates

The answer asserts rather than explains the point made. The answer may omit key elements (see the suggested answer above). A definition of PED may not be given, nor might the link between a low PED and the total revenue be identified.

(c) Consider whether there is conflicting evidence in the article about the effectiveness of loyalty cards which offer price discounts. [5]

## Specimen answer

*The effectiveness of loyalty cards is shown by the ability of a retailer to identify spending patterns of consumers. This allows them to target promotions and offer targeted discounts to their cardholders.*

*The article also suggests that loyalty cards are not that effective – consumers buy out of habit or do not regard price as the most important factor in determining choice.*

*In conclusion the evidence is mixed – customer hold more than one loyalty card and use them selectively.*

**Mark awarded = 5 out of 5**

## Examiner comment

The response is two sided which, with the command word “consider”, is the required approach. With 5 marks on offer the answer considers one piece of evidence in the article which is developed in favour of the effectiveness of loyalty cards and makes two points regarding their lack of effectiveness. A brief conclusion based on the evidence offered is given.

## Common errors and general guidance for candidates

Some candidates may produce a one-sided argument, and the points made may be poorly developed or a conclusion is omitted which the command word requires.

(d) Assess how the idea of rationality is used in the indifference curve theory of consumer behaviour. [7]

## Specimen answer

*The theory of consumer behaviour assumes that the consumer has perfect information on which to base decisions and often this is not true.*

*It also suggests that consumers can order choices in a rational manner, e.g., if A is preferred to B and B is preferred to C, A is preferred to C.*

*Indifference curve analysis is based on a smooth curve but in practice choice for many purchases does not show this gradual change, especially when buying large ticket items such as cars.*

*Can the consumer rationally compare the satisfaction which is received when purchasing a good with the price of that good, especially if consumption takes place sometime after the purchase?*

*The outcome of all purchases cannot be known for certain; for example buying a holiday in Thailand or Sri Lanka – perhaps the weather at the destination will determine the satisfaction.*

*The rational consumer buys goods to maximise satisfaction. This suggests maximum satisfaction can be known before the items are purchased. It does not indicate the time period over which the choice is being made. Many people when young only regret not buying a pension when they are older but were they irrational not to buy one when young.*

*People lead busy lives, and in many cases, make satisficing purchases which are available at the time.*

*In the context of the article, not all supermarkets stock all items – does the rational time constrained shopper tour the supermarkets to make the ideal choice?*

**Mark awarded = 5 out of 7**

## Examiner comment

This answer makes 5 good points regarding rationality but does not make any judgement at the end of the answer.

## Common errors and general guidance for candidates

- Candidates may make fewer points than the mark allocation suggests, or not make a judgement at the end to summarise the outcome of the points made.
- Candidates may attempt to answer the data response question without a thorough reading of the data provided. This makes it difficult to be aware of all the relevant points in the article when the question specifies ‘from the article’.

**Total marks awarded = 18 out of 20**

# Question 2

With the help of a diagram, assess the view that government intervention can be used successfully to correct market failure caused by positive externalities. [20]

## Specimen answer

This question deals with aspect of allocative efficiency, as the market failure caused by positive externalities is one of under provision of the good concerned. Allocative efficiency occurs when price = marginal cost (P = MC). This implies that the cost of a unit of output MC is equal to the value placed on by the consumer, the price. This can be shown in the diagram below.

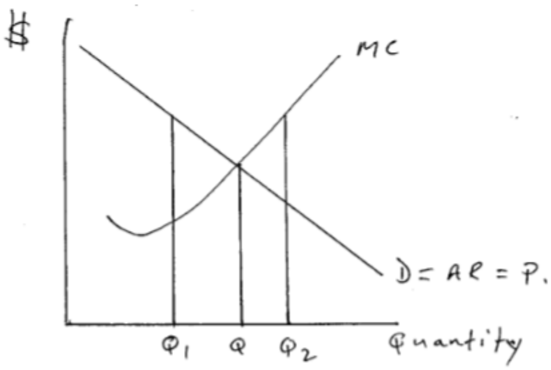


Diagram 1

At output $Q_1$ the marginal cost is less than the price showing that consumers value the product more highly than the cost of producing that item, MC thus output should be increased. At output $Q_2$ the reverse applies the consumer values the item less highly than it costs to produce and output should be reduced. It is only at Q where P=MC that these there is no reason to change output.

Externalities are the "spill over" effects of production or consumption. This means that people other than the seller and the purchaser of a good are affected by its production or consumption. Positive externalities can take place both during the production of a good or as a result of its consumption. In the case of a positive externality in consumption there is a benefit to a third party from the consumption of a good. An example of a positive consumption externality is education. In the case of education not only does the individual benefit from being able to read, write etc. and the private provider of education make a profit, but also future employers of educated people also benefit. This is reflected in the higher productivity of workers. This is shown in diagram 2.

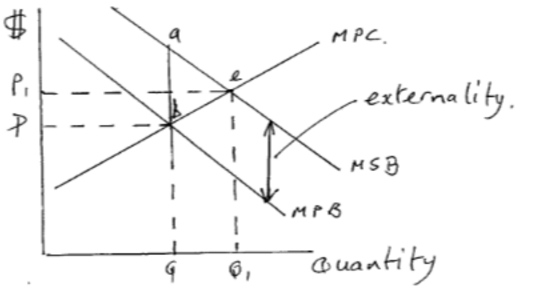


Diagram 2

*In diagram 2, the market solution is shown by marginal private benefit (MPB) = marginal private cost (MPC) to give an equilibrium output Q and price P. The positive consumption externality shifts the demand curve to marginal social benefit (MSB). The difference between MPB and MSB is the extent of the externality. This shifts the equilibrium to $Q_1$, $P_1$. The shaded triangle 'a e b' shows the welfare gain which is shared by the consumer and producer of the good or service.*

*Government intervention in the education market can take place in a number of ways. First it may offer a subsidy to parents to send their children to school. This may be in the form of a voucher which can only be used to "buy" education. The extent of the subsidy should be equal to the positive externality. But difficulties arise, the extent of the externality is difficult to calculate especially for education where the additional benefit to one person may differ from another. Also, families are not a homogeneous group and the subsidy needed by one family to send their children to school will differ from that needed by another family. Also, it is possible that the government over-compensates parents and money is wasted.*

*Secondly, if lack information of the benefits of education means parents do not send their children to school then an advertising campaign indicating the benefits of education could be undertaken. In the modern world this could be carried out by text and social media campaigns. The amount of advertising needed to increase the level of education to the required level is unknown and a great deal of money may be spent some of which is wasted if the message is poorly targeted.*

*Thirdly, the government may legislate to make education up to a given age is compulsory. This policy would almost certainly require a degree of enforcement with inspectors checking that attendances were high. The cost of enforcement may be difficult and involve penalties for the parent which they are unable to afford. This will reduce the family's standard of living.*

*All the policies have an opportunity cost, in terms of less government expenditure is available to spend on alternative projects for example, industrial development. The objective that is preferred will be a political decision. But more education may reduce the opportunity cost by* *allowing the government to achieve other policy objectives at the same time. A better educated workforce may make the country more attractive to foreign direct investment (FDI) which sets it on the path to industrialization, higher economic growth and higher employment.*

*Parents may not send their children to school whatever policy is implemented. The level of economic development of a country may be such that none of the suggested solutions are feasible. If, a largely subsistence farming economy requires children to work in the fields to produce enough food to survive, education will not be a priority.*

*A final point can be made, that it is certain that whichever of the suggested solutions is implemented the level of education will move towards optimum level of consumption $Q_1$ in diagram 2. The welfare loss will be reduced.*

**Total marks awarded = 18 out of 20 (13/14 + 5/6)**

## Examiner comment

The answer achieves Level 3 for AO1 Knowledge and Understanding/AO2 Analysis combined. In terms of AO1, this is shown through good knowledge and understanding of the meaning of the terms allocative efficiency, positive externality and its sub-division into consumer and producer externalities. A correct example of a positive consumer externality is selected that allows the response to develop a real-world scenario. The answer identifies three forms of government intervention: a subsidy, advertising and legislation which may be applied to solving the stated problem. In terms of AO2, a high level of analysis is achieved through good theoretical discussion of how the allocatively efficient output is determined. This relied on an accurately drawn diagram (the need for a diagram was specified in the question). The diagram was correctly labelled, and it was used in the analysis. Similarly, a correctly drawn and labelled diagram was used to analyse the effect of a positive consumption externality on the equilibrium level output.

Level 2 is achieved for AO3 Evaluation. The three policies to the under-consumption of education are evaluated in some depth. For two of the policies the evaluation is extensive with two sides of the effectiveness of the policy suggested. A conclusion is drawn.

## Common errors and general guidance for candidates

- Terms used, such as MC are not explained.
- Answers which assert the allocatively efficient output is P = MC without providing an explanation of why this is so.
- Diagrams that are incorrectly drawn or labelled which are not referred to in the answer. The size of some diagrams make the interpretation very difficult. The answer states “as shown in the diagram” with no explanation. Some answers may not include a diagram.
- In this topic area answers may often contain a large amount of material on negative externalities.
- The suggested policies are stated but not fully explained. Evaluative points need to be developed and where possible both the advantage and disadvantage of a suggested policy (e.g. advertising) need to explained.
- No attempt may be made to draw a conclusion.

# Question 5

Assess the contribution of Foreign Direct Investment (FDI) to the improvement of the standard of living in low-income countries. [20]

## Specimen answer

Foreign direct investment (FDI) is defined as an investment reflecting a long-term investment by a company or resident in one economy (the home country), in a business or directly in another economy (the host country). The investment may take place in existing companies or may involve the establishment of a new company.

Those countries with gross national incomes (GNI) less than $1050 per head pa are defined as low income and includes those living in poverty on less than $730 per head pa.

The principal reasons why FDI may take place are to gain access to resources e.g. minerals, cheaper labour or develop new markets. All of these will require some physical or intellectual investment in the host country. In economic terms this can be thought of as an injection into the circular flow of income of the host country. The circular flow of income is made up of consumption (C) + investment (I) + government (G) + (exports – imports) ( X - M) = Aggregate Demand (AD). An increase in investment (I) will increase AD. The extent of the final increase in GNI will depend on the strength of the multiplier effect M = 1/(1-MPC). MPC is the marginal propensity to consume, the change in consumption from an increase in income. A MPC of 0.8 will create a multiplier effect of 1/(1 - 0.8) = 1/0.2 = 5. In low-income countries the propensity to consume will probably be high as many needs remain unsatisfied. The effect of an increase in aggregate demand is shown in diagram 1.

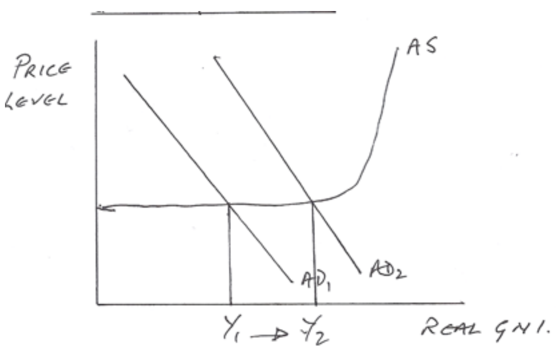


Diagram 1

*AS is the aggregate supply curve and $AD_1$ the initial aggregate demand curve the increase in investment will shift $AD_1$ to the right to $AD_2$ this will increase the level of national income from $Y_1$ to $Y_2$. As many low-income countries suffer from chronic underemployment or unemployment this is likely to take place where the aggregate supply curve (AS) is perfectly elastic, there will be no effect on the price level. This lack of inflation benefits the people in low-income countries as the cost of living is not increased and their standard of living is not reduced.*

*Economic growth, where unemployed resources are used is referred to as actual economic growth. This is shown in diagram 2 the level of economic activity moves from point 'x' to point 'a' on production possibility curve (PPC) $P_1$.*

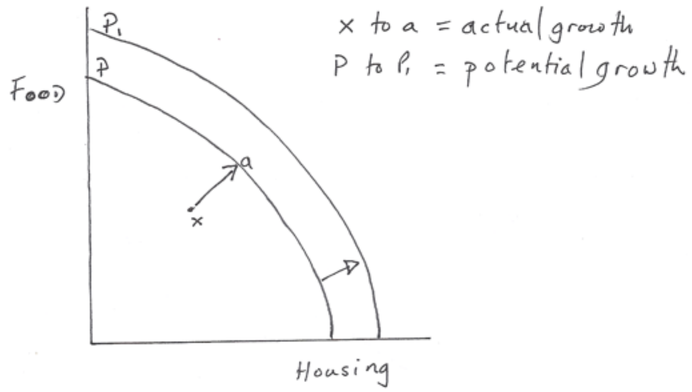


Diagram 2

*In many cases the FDI leads to the development of new resources such as the opening of new mines, building new factories and training workers to higher level skills all of which increase the potential output of the country. This is shown by the shift of the PPC to $P_2$. This is equivalent to a rightwards shift in the AS. $AS_1$ in diagram 1.*

*Whilst the level of national income rises the effect on the standard of living of the host country's population depends on how the standard of living is defined. If a simple view that the standard of living is given by real GNI per head pa, then if GNI is rising by more than population growth and inflation then the standard of living is improving. But this ignores some limitations. Is the Gini coefficient a measure of income inequality, rising or falling? Often in the case of mineral extraction the major benefits go to those in power and little benefit is seen by the majority of the population. On the other hand, rising GNI is associated with better housing, education and health provision, all of which are aspects of an improvement in the qualitative standard of living in low-income countries. These are reflected in broader measures of the standard of living such as the Human Development Index (HDI)*

*Again, using a broader view of the standard of living, the financial benefits of FDI may be offset by non-monetary aspects such as a higher level of pollution or has happened the destruction of the sacred lands of indigenous populations or the destruction populations themselves and other negative externalities. On a simpler level the change in activity from farming to a factory system can bring significant adverse social change.*

*If the FDI takes place in manufacturing a product for sale in the host country, the new factory may be so efficient that it eliminates the local manufacturers of that product in the host country. This may perversely lead to an increase in unemployment as the domestic producers shut down. A local but foreign owned monopoly able to exploit the consumer may develop and reduce the standard of living.*

*There may be balance of payments effects from FDI. Initially the new investment may replace imported goods. This will improve the balance of payment. In the long run export markets may be developed. This will have the dual effect of reducing imports and increasing export (X-M) will increase. In terms of AD, mentioned above this will be a further injection into the circular flow of income and an additional multiplier effect will take place. An additional effect of the balance of payments improvement is the ability of a low-income country to service any international debt that it has. This will reduce the likelihood of the country having to agree to IMF austerity measures which usually reduce government spending and the standard of living. It also allows for a more products to be imported. This will improve the standard of living as it gives the consumer a wider choice.*

*The impact of FDI depends on the form it takes. Where the FDI is direct investment in new plant and equipment then the impact is likely to be greater than where FDI is directed towards the purchase of a local supplier when other than change of ownership little significant may change.*

*Overall, it is not possible to determine whether FDI is a benefit to the standard of living of a low-income country it will depend on the nature of the investment, the distribution of the returns from the investment in the host country and the impact of externalities on the host population.*

## Examiner comment

The answer is awarded at Level 3 for AO1 Knowledge and Understanding/AO2 Analysis combined. In terms of AO1, the answer starts with a clear definition of FDI. It clarifies the difference between the home and host countries which often cause confusion. Low-income countries are identified by the use of the World Bank definition. The concept of the meaning of the standard of living is explained. The answer identifies a number of impacts of FDI on the economy of the low-income host country. In terms of AO2, this is shown by the analysis of FDI in the form of its contribution to AD. The AD analysis is linked directly to the level of national income. There is also analysis of two forms of economic growth and how FDI affects them This analysis is extended by the use of the multiplier to analyse the full effect of the injection into the circular floe of income on the level of national income.

Level 2 is awarded for AO3 Evaluation. Three aspects of the effect of FDI are identified. In each case the evaluation is developed in the form of a two-sided discussion of the effect of FDI but importantly this discussion is also linked to low-income countries which are the focus of the question. A conclusion is drawn.

## Common errors and general guidance for candidates

- This question has three elements - FDI, standard of living and low-income countries. Answers will be incomplete if only one or two of these elements is addressed.
- Answers frequently do not define the terms which are used, in this case foreign direct investment. Some confusion often exists when identifying the country from which the investment flows to the country receiving it.
- Answers are abstract where there are no examples of the type of industry which might attract FDI. The split of FDI between new investment and secondary investment in existing companies and the consequences this may have is not made.
- Candidates may have only referred to the multiplier rather than analyse the effect it would have in amplifying the impact of the initial investment. The distinction between actual and potential growth may not be considered. This level of analysis lacks depth.
- Evaluation may be limited if the answer only partially addresses the question, and either doesn't provide a conclusion or provides one that is limited.

**Total marks awarded = 18 out of 20 (13/14 + 5/6)**

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