Script E – Paper 4

1a The article suggests that loyalty cards make markets imperfectly competitive as it builds barriers between retailers to gain a marketing advantage. It hinders free competition and prevents switching between brands causing the demand for that good to decrease from a particular brand. The discounts used by the schemes are often confusing and can lead to imperfect knowledge, it may also be harder for consumers to understand making it more difficult to consume goods and services and will ultimately decrease the demand. It is also very expensive in terms of initial cost making it expensive for smaller firms to afford and enter into the industry.

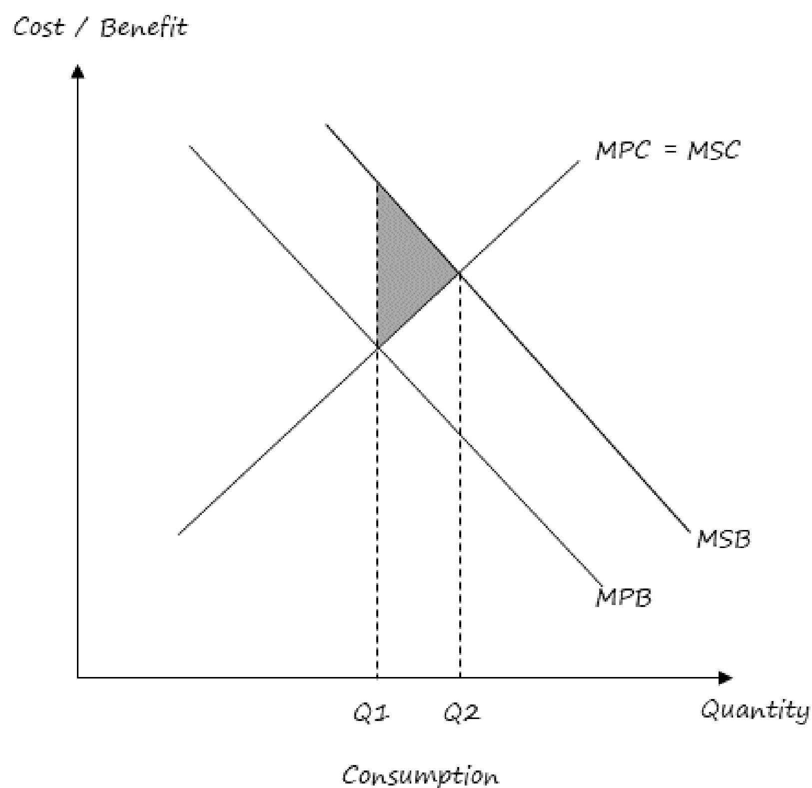
1b Profit-maximizing retailers may be interested in the link between consumers ' loyalty and the price elasticity of demand because there is a risk for retailers to invest in loyalty cards. Loyal cards are introduced to customers to hinder competition and prevent switching between brands. It also gives customers discounts as reward points. However, it has been found that 70% of customers had a loyalty card but only 10% were loyal to a particular card. Thus, it can be said that the loyalty card might not achieve the goals that the firms are expecting.

1c Conflicting evidence about the effectiveness of loyalty cards which offer price discounts is shown in the part where it says loyalty schemes are thus sometimes less about loyalty and more about understanding customers' wants. Companies use loyalty cards to gather data on customers and their buying preferences thus directing future offers to customers' wishes in specific promotions both online and in the mail.

1d Idea of rationality used in the indifference curve theory of consumer behaviour refers to the assumption that consumers make choices based on their preferences and try to maximize their overall satisfaction or utility. This provides a framework to analyze consumer choices and predict their behaviour to the changes in prices, income or preferences. The key elements of rationality in indifference curve theory are preferences, completeness and optimization whereby rational consumers are able to know the combination of consumption based on their own preferences and make consistent choices for utility maximization within the given budget. The tangency of the indifference curve and the budget line shows the highest level of satisfaction with a given budget.

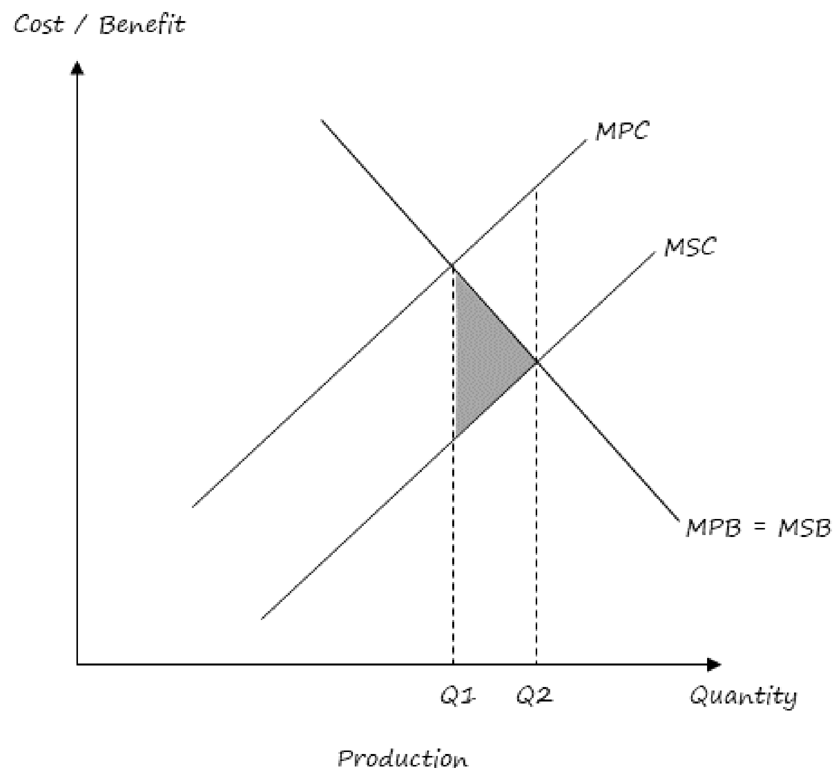
2 Market failure refers to a situation in which the allocation of goods and services by the free market mechanism is inefficient, resulting in undesirable outcomes. Misallocation of goods, services and resources can be caused by externalities as the cost or benefit associated is not fully considered in the decision-making process. Positive externalities, on the other hand, are beneficial spill-over effects that occur when the actions of individuals or firms generate benefits for third parties. For example, research and development aim to generate renewable energy to save the environment. Thus, government intervention is necessary to correct market failures that cause positive externalities.

With positive externalities, the benefit to society is greater than the private benefit, as shown in the diagram below. In a free market, consumption will be at Q1 as the demand equals supply which means the private benefit equals private cost. However, this is socially inefficient as the social marginal cost is lesser than the social marginal benefit. In Q1, there is an underconsumption of the positive externality.



For production, the social marginal cost is less than the private marginal cost because there are positive externalities in production. In a free market, a firm will ignore benefits to third parties and will produce at Q1. However, the socially efficient level will be at Q2

where social marginal cost equals social marginal benefit. For example, getting a vaccination that provides a benefit to other people in society as it stops the infectious disease from spreading.



Direct provision is one of the effective ways to correct the market failure caused by positive externalities. The government can take the initiative to build public libraries and health care centres that are deemed to be beneficial to the people. This is because profit-seeking firms in private firms have no incentive to provide such goods because of the 'free rider'. Issues like free riders arise because some of people neglect to pay for goods and services due to imperfect knowledge. Therefore, the government played a big role in educating and heightening their awareness about the benefits that they can derive from the goods and services that are provided. Furthermore, the government can collaborate with private entities through public-private partnerships (PPS) to address positive externalities. This involves sharing resources, expertise and undertaking projects that generate positive spill-over effects. For instance, infrastructure development projects promote technology transfer and innovation.

In conclusion, when positive externalities exist, the market mechanism tends to under-allocated resources towards activities that generate these spill-over effects. Therefore, the

government should carefully implement policies to correct market failures caused by positive externalities. The specific policy approach may vary depending on the nature of positive externalities and other factors.

5 Foreign Direct Investment (FDI) refers to the investment made by an individual, company or entity from one country into another country with the intention of establishing a lasting interest and significant control in the host's country business operations. To reduce poverty, the government should take the initiative to attract more investors to promote economic growth and a more equitable society.

Firstly, the government should ensure policies implemented do not conflict with any political opinion or the advantages of trading partners which will affect the stability of the currency. This will gain more trust and confidence of investors as the risk will be more certainly and easily predictable. Government can also offer a lower tax rate to attract investors and multinational companies to establish their operations in the country. For example, Ireland has been known for its competitive corporate tax rate. Many major technology companies like Google, Facebook, Microsoft and Apple have chosen Ireland as a base for their European operations due to favourable tax and access to a highly skilled workforce.

FDI is beneficial to low-income countries as it can bring new employment opportunities to low-income countries. This will then lead to an increase in real national income GDP and a reduction in the unemployment rate. Other than this, FDI can bring advanced technology and hands-on management practices that can be helped to develop the low-income countries. Foreign investors and companies often introduce new production methods, techniques and skills that can enhance productivity and efficiency in local industries. Not just so, operations of foreign companies also benefit the economic development of the country, facilitating trade, transportation and connectivity overall.

When there is more FDI and more inflow of money, the current account of the balance of payment will be in surplus. The government will have more funds to provide transfer payment which is payment from tax revenue that is used as financial support to the lower-income population. For example, old age pensions and unemployment benefits. Furthermore, the government can also use the funds to provide training to the low-income population so that they are skilled and able to get a job. With that, people will be less dependent on government support and there will be more output produced which can enhance a country's capacity to engage in international trade and boost its exports.

In conclusion, FDI can bring significant benefits, it is important for low-income countries to have effective policies and regulatory frameworks in place to ensure that the benefits are maximized and potential risks are mitigated. This includes measures to protect workers' rights, safeguard the environment and ensure fair redistribution of wealth and income.

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