Cambridge Assessment International Education

Script F – Paper 4

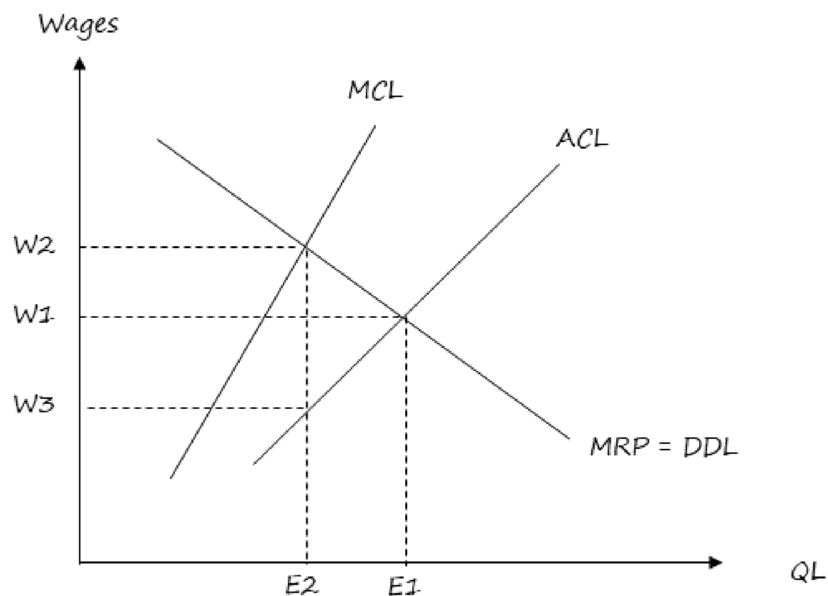
1a Loyalty cards help supermarkets to build barriers between retailers to gain a marketing advantage. It prevents consumers from switching between brands and prevents smaller retailers to survive due to high initial costs. Loyalty cards also cause misunderstanding of information to consumers leading to imperfect knowledge.

1b Price elasticity of demand refers to the responsiveness of consumers' demand due to the change in the price of the product. Consumer loyalty will make the demand of the consumers become inelastic as they are unlikely to change retailers. When the demand of the consumers becomes inelastic, supermarkets will increase the price in order to maximize their revenue and profit.

1c Loyalty cards are effective towards retailers as they allow them to gather data on consumers and their buying preferences. This will allow the retailers to provide special discounts and promotions flavoured towards the consumers. On the other hand, price is not the most significant factor to determine the choice. Based on the article, it has been found that 43% of consumers are looking for a one-stop shopping factor when determining their choice of buying compared to the price factor (18%). In addition, when a consumer has a low emotional attachment to the product, the price will be less of a determining factor for the purchase of goods. Overall, there is contradicting evidence in the articles on the effectiveness of loyalty cards which offer price discounts.

1d Consumers act rationality in which they always aim to maximize their satisfaction when purchasing goods or services. Within the indifference curve analysis, the consumers are able to rationally compare the price (cost) that they pay and the satisfaction (benefit) that they gain. They know the combinations between which there is indifference before making choices in a rational way. They will make rational choices between two goods without having any imperfect market information and not decide on any choices under a situation of uncertainty.

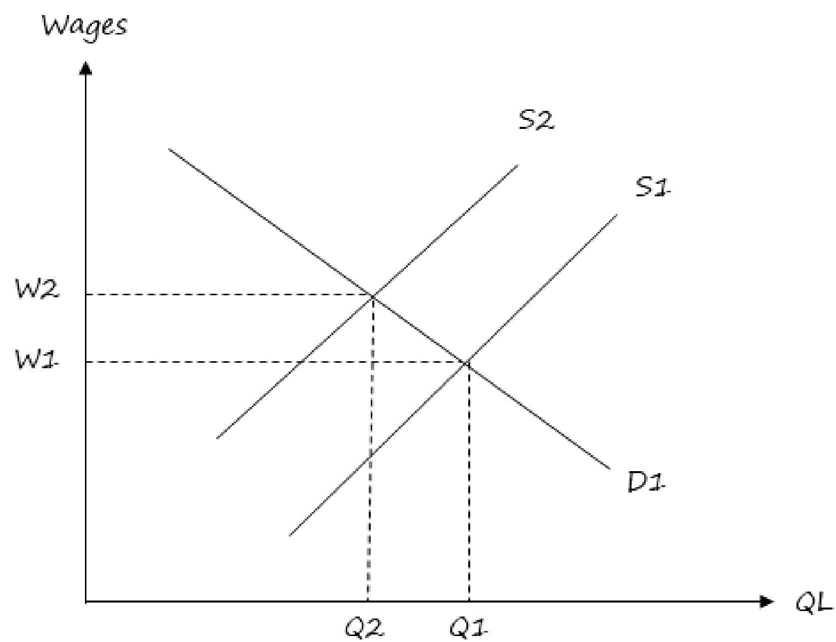
3 Imperfect labour market is a market in which there is a single buyer of a good, service or factor of production. This means that in the labour market, there is only one employer. A firm will demand workers based on the marginal revenue product theory which is calculated using MPP multiplied by MR. It is the additional revenue generated for a firm by employing one more unit of labour.



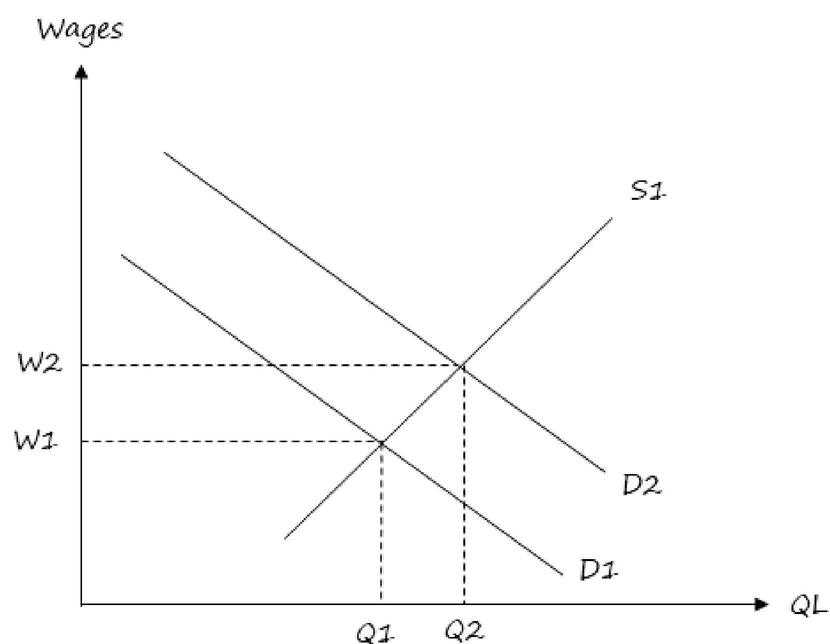
In a monopsony market, there will be an upward-sloping labour supply curve, as the firm will have to offer higher wages in order to attract more workers into the industry.

A firm will employ labour up to point E2 where the revenue received by adding an additional unit of labour is equal to the cost of employing them where MRPL = MCL on the diagram. Imperfect labour markets can lead to lower wages and higher unemployment. This is because since there is a single employer, the firm can pay workers a wage level for what they are willing to work for. This results in the firm paying a wage rate of W3 for employing E2 number of workers, rather than where demand is equal to supply at the point W1E1, which would be allocatively efficient. This means that a monopsony will employ fewer workers from E1 to E2 and pay a lower wage from W1 to W3 in comparison to a firm operating in competitive conditions.

Trade unions, however, can intervene in order to alter wage levels within imperfect labour markets. Trade unions may restrict the supply of labour in return for a higher wage level from the firm. This will lead to higher wages but also higher unemployment.

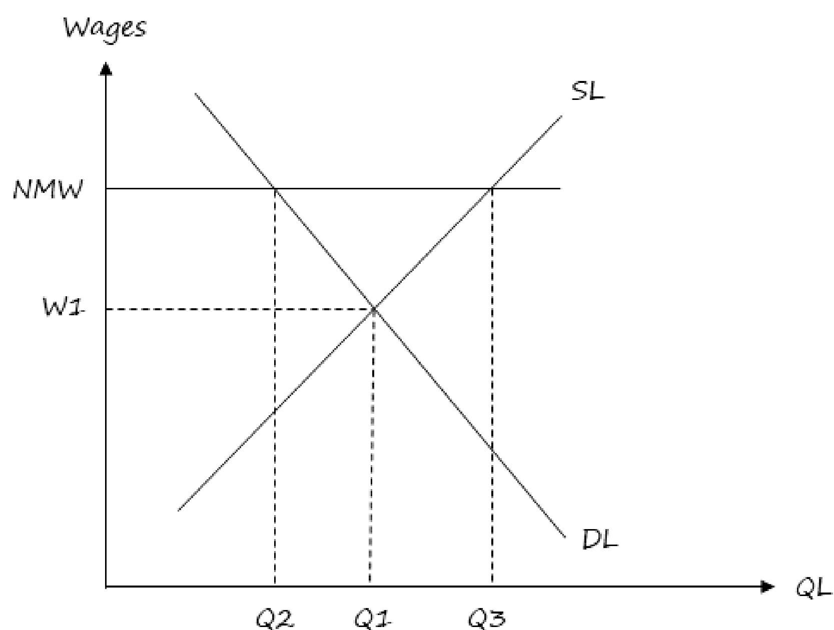


As trade unions restrict supply from S1 to S2, the wage level would increase from W1 to W2. However, there is higher unemployment from Q1 to Q2. Trade unions can also increase the productivity of labour (MPP) by providing additional training or programs in order to increase the skill of labour. Increasing the marginal physical product of labour would increase the marginal revenue product, essentially increasing the demand for labour.



The increase in productivity will lead to an increase in the demand for labour (MRP) and demand shifts from D1 to D2. This will create both higher wages from W1 to W2 and more employment from Q1 to Q2. However, trade unions may not always be successful in bargaining for higher wages. The success of trade unions depends on the availability of substitute factors of production. If it is relatively easy to substitute labour for another factor of production (like capital for example), this means that as unions demand more wages, firms will simply replace labour for capital. For example, in manufacturing industries. If workers demand higher wages, the firms can simply replace them with cheaper machinery. Hence trade unions will avoid requesting higher wages. Furthermore, the proportion of total costs which the wages of trade union members represent also affects the bargaining strength of trade unions. If labour costs form a large proportion of total costs, bargaining for higher wages will be more difficult compared to if labour costs only make up a small proportion of total costs. However, labour productivity will also affect bargaining strengths. If the marginal physical product of each worker is rising, then it is more likely that firms will agree to wage increases as rising productivity leads to more revenue that can be used to pay for the wage increases. This is why increasing productivity through training by trade unions will lead to both increases in wages and increases in employment.

In addition, government intervention can alter the wage and employment level within an imperfect labour market.



If governments choose to introduce a minimum wage level above the market equilibrium wage at NMW, this will lead to an increase in the wage rate from W1 to NMW but there will be an increase in unemployment from Q3-Q2. This is because firms will want to reduce the costs of labour following wage increases by laying off more workers. However, whether or not minimum wages result in unemployment depends on the elasticity of demand and supply for labour. If the demand and supply for labour are relatively inelastic due to the labour not being easily substituted for capital, the skill required for the job, and the number of qualified people for the job is low, then the introduction of a minimum wage will not cause much change in the employment level. For example, if there are wage rises introduced for doctors, there will not be much of a change in employment levels due to the skill and training required for the job.

In conclusion, imperfect labour markets will not always lead to lower wages and higher unemployment. Bargaining powers of trade unions and government intervention in minimum wages are the main factors and have the ability to lead to higher wages and more employment. For example, in developing economies, government tends to set a lower level of the minimum wage, and fewer members are included within a trade union, hence their bargaining power is less effective. Therefore, lower wages and greater unemployment are likely to happen in the imperfect labour markets. However, in developed economies, labour union tends to be strong and powerful, and the government tends to set a higher level of minimum wage. Therefore, higher wages and greater employment are likely to happen in the imperfect labour market.

5 Foreign Direct Investment is an investment from a country made by MNCs within foreign countries. Low-income countries are developing countries that are facing fast population growth, high inequality of income distribution, and are highly reliant on primary and secondary sectors. Living standards are the level of wealth, comfort, material goods and necessities available to a socioeconomic class or geographic area.

FDI can lead to an improvement in economic performance such as increases in GDP per capita which can be linked to an increase in the standard of living. FDI can have a positive impact on the standard of living in low-income countries. FDI increases employment within low-income countries as they create more job opportunities for the local people. This increase in employment will lead to an increase in national income as more individuals are working and generating output. Therefore, the standard of living increases as individuals have more disposable income to afford necessities such as housing, food and clothing. However, through this employment of locals by MNCs, there arises a problem of the exploitation of local workers. Although MNCs may provide employment for the local

people, they may be provided with very poor working conditions such as sweatshops and they may be forced to work long hours with very little wage payments. This massively reduces the standard of living of the local people within low-income countries.

FDI can increase innovation through technology and the transfer of expertise. Many MNCs will bring and set up their own technology to operate within low-income countries. This allows the government to potentially utilise this new technology for the development of its own economy. Furthermore, the local workers can be taught how to operate and use the new technology and machinery by the MNCs which provides them with a wider range of skills that can be used in the future. This new innovation and technology can help increase the overall productivity of the economy. However, there is no guarantee that MNCs will educate the local population on how to utilise the new technology or machinery. MNCs can choose to bring along their own experts from their home country to operate the machinery themselves. This leaves the local workers with manual labour jobs instead of being taught how to utilise the machines. Furthermore, MNCs may only teach local workers skills that are only applicable within their own company. This means that they are not being taught any useful transferable skills that will benefit them in the long run. For example, local workers may only be taught how to operate specific machines for the MNC that have no use outside of the industry. This means that they are unable to utilise the skills outside of the MNC.

In addition, the local government can obtain more tax revenue from MNCs as they apply indirect taxes to the goods and services produced by them. This will ultimately allow the government to spend more revenue on essential infrastructure such as healthcare and education or to correct market failures by providing public goods for example. However, it is not guaranteed that the government will spend the extra tax revenue on essential sectors of the economy such as healthcare or education. Governments, especially if they are corrupt, can spend the extra revenue to gain political advantages.

In the long run, MNCs may remit profits back towards their home country. This means that the profits generated by FDI are not reinvested into the low-income country. This prevents any economic growth from occurring within the low-income country.

In conclusion, FDI can be very beneficial towards low-income countries as they provide new technology, employment and tax revenue. However, FDI can also negatively impact the low-income country. The contribution of FDI towards low-income countries can highly depend on the time frame. In the short run, FDI can be seen as being very beneficial towards low-income countries due to an increase in job opportunities and technology.

However, in the long run, FDI may present pollution problems and produce more negative externalities than the benefits that it provides. This will ultimately lower the standard of living in the long run. Furthermore, we must consider how the standard of living is measured. If it is being measured through GDP per capita, this will not accurately represent the living standard within the low-income country. Increases in GDP per capita may not necessarily mean that individuals within the low-income country are living better.

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