UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Level

ECONOMICS **9708/41**

Paper 4 Data Response and Essay (Supplement) **May/June 2011**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.
Write your Centre number, candidate number and name on all the work you hand in.
Write in dark blue or black pen.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Section A
Answer **Question 1**.

Section B
Answer any **two** questions.

You may answer with reference to your own economy or other economies that you have studied where relevant to the question.

At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **3** printed pages and **1** blank page.

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Section A

Answer this question.

1 **High taxes do not help in a recession**

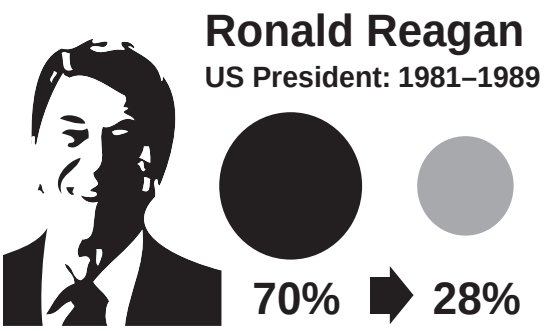
In 2009, there was an economic recession in many countries. One aspect of the recession was that unemployment rose. Governments paid large subsidies to a number of industries to try to stop the rise in unemployment. This increased the governments' debt and affected its other expenditure.

In an attempt to recover part of the extra expenditure, some governments had a policy of increased income tax rates on people who had high salaries.

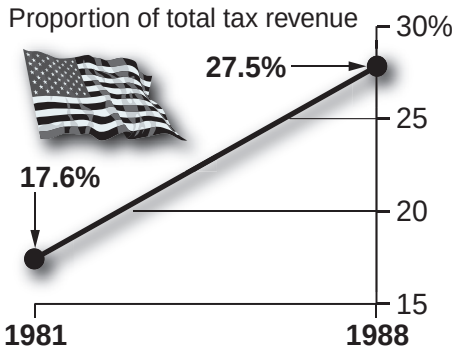
However, critics of this policy argue that higher tax rates do not work. They say that the proportion of revenue received from top taxpayers falls and does not rise as taxes increase and the higher taxes cause damaging effects on the economy. It is better they say to decrease taxes. The decrease in taxes brings the government more revenue, not less revenue. Their opinion is supported by evidence from the past as is seen in the effect on tax receipts of changing tax rates in the US as shown in Fig. 1.

FIG. 1 CUTTING TAXES RAISES REVENUE

Top-rate income tax cuts



What the top 1% paid in tax



(Source: The Times, May 7 2009 p. 28.)

It is suggested that this opposite policy of reducing tax rates is better. Lower tax rates actually boost both the economy and tax revenues. For example, Russia, Latvia and Estonia reduced their highest tax rate and replaced a complicated system of taxes with a single income tax rate of 10%. They enjoyed a huge economic boost as a result.

Another aspect of the recession was that businesses found it difficult to borrow money from the commercial banks. In order to try and make borrowing easier and help businesses, some central banks lowered their interest rates. The central banks also bought government bonds in an attempt to increase the supply of money in the economy.

(a) Explain what is meant by a recession. [3]

(b) The article states that 'higher tax rates do not work'.

(i) What does the article mean by this statement? [3]

(ii) Is there enough evidence in the article to justify this statement? [6]

(c) Discuss why the actions of the central banks mentioned in the article might have been expected to ease the recession. [8]

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Section B

Answer **two** questions.

2 Discuss whether economic efficiency can be improved if governments are involved in the regulation and provision of goods and services when there is market failure. [25]

3 **(a)** Analyse, with the aid of a diagram, whether there is a link between diminishing marginal returns and economies of scale. [12]

(b) Discuss whether the objectives of a firm in a perfectly competitive market are likely to be different from the objectives of a firm in an imperfect market structure. [13]

4 Do you agree that the wage of labour is determined by the market like any other price? [25]

5 **(a)** Explain what is meant by GDP and describe the alternative methods by which it is calculated. [12]

(b) 'GDP figures tell us many things except that which makes life worthwhile. They tell us nothing about education, health and quality of life. They are, therefore, of little value.' Discuss the extent to which you agree with this argument. [13]

6 **(a)** Explain how the impact of the Keynesian multiplier process will change if a free-market closed economy becomes a mixed economy with foreign trade. [12]

(b) Analyse how a change to the equilibrium level of income resulting from the multiplier process might lead to unemployment or inflation. [13]

7 The main way a developing country could become a developed country is for government policy to concentrate on the protection of domestic industry and investment in infrastructure. Do you agree that this is the best policy? [25]

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Question 1 © adapted from Eamonn Butler; *It's GCSE economics: high taxes don't work*; The Times; 7 May 2009.

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