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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Subsidiary Level and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay (Core) **May/June 2010**

1 hour 30 minutes

Additional Materials: Answer Booklet/Paper

0932100310

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Section A
Answer this question.
Brief answers only are required.
Section B
Answer any **one** question.

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

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Section A

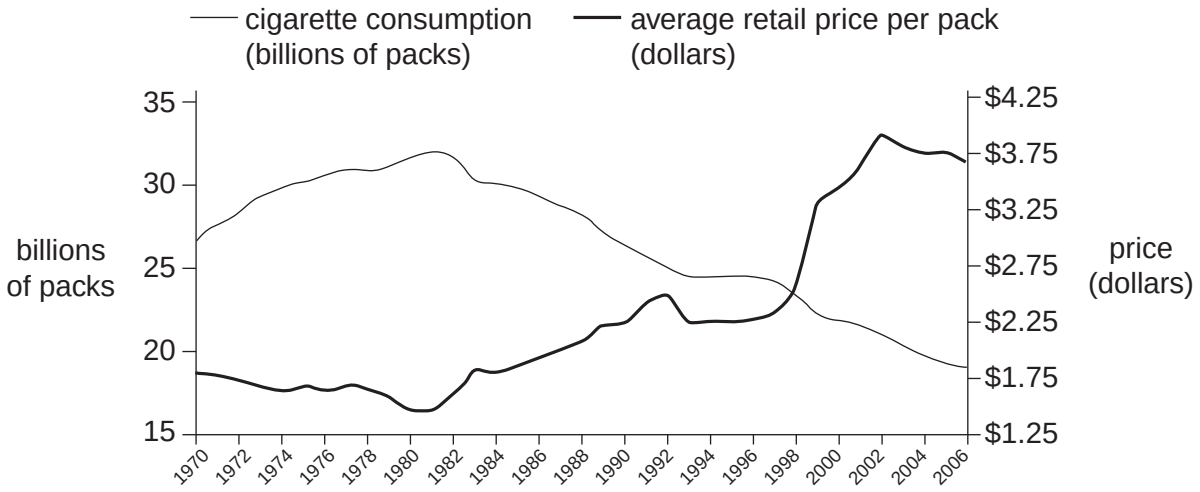
Answer this question.

1 **Economic Aspects of Cigarette Smoking**

Smoking cigarettes is a controversial matter that illustrates a number of economic issues. As with most products, the key influence on the level of consumption is the product's price.

United States

Fig. 1 US cigarette consumption and cigarette prices 1970–2006



Malaysia

A study of cigarette smoking in Malaysia estimated the short-run and long-run price elasticity of demand (PED) and the income elasticity of demand (YED) for cigarettes between 1990 and 2004. The results are shown in Table 1.

Table 1: Demand elasticities for cigarettes in Malaysia

Short-run PED	Long-run PED	YED
−0.08	−0.57	+1.46

Europe

In Europe, taxation of cigarettes is particularly heavy. In 2006 it was 76.4% of the final selling price in Germany, 77.1% in the UK and 80.4% in France. European countries are increasingly banning smoking in enclosed public areas and workplaces. Some anti-smoking campaigners are calling for the smoking of cigarettes anywhere to be made illegal.

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(a) How far does the data in Fig. 1 confirm that the normal demand curve relationship exists between the price and the quantity demanded of cigarettes? [3]

(b) **(i)** What do the three elasticity values in Table 1 tell us about the elasticity of demand for cigarettes? [3]

(ii) What might explain these different elasticity values? [4]

(c) Explain **two** possible economic reasons why cigarettes are heavily taxed. [4]

(d) Discuss the possible economic consequences of making cigarette smoking illegal. [6]

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Section B

Answer **one** question.

2 **(a)** Explain how division of labour can affect labour productivity. [8]

(b) Discuss how the operation of a barter economy would be affected by the introduction of money. [12]

3 **(a)** 'A free market price operates as a rationing and allocating mechanism.' Explain how it does this. [8]

(b) Discuss why certain goods and services are usually supplied directly by the government rather than through the market. [12]

4 **(a)** With the aid of a diagram, explain why an economy's floating exchange rate may depreciate. [8]

(b) Discuss whether a current account deficit is always a serious economic problem for a country. [12]

Copyright Acknowledgements:

Question 1 © Raising cigarette taxes reduces smoking especially among kids and the cigarette companies know it; http://tobaccofreekids.org; 2/01/2008.
Question 1 © Ross & Al Sadat; Demand analysis of tobacco consumption in Malaysia; Nicotine and Tobacco Research; Vol. 9, Issue 11, November 2007.

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Section A

Answer this question.

1 **Inflation in Paraguay**

Paraguay is a small South American country with few of the advantages that bigger, better known economies such as Venezuela and Brazil enjoy.

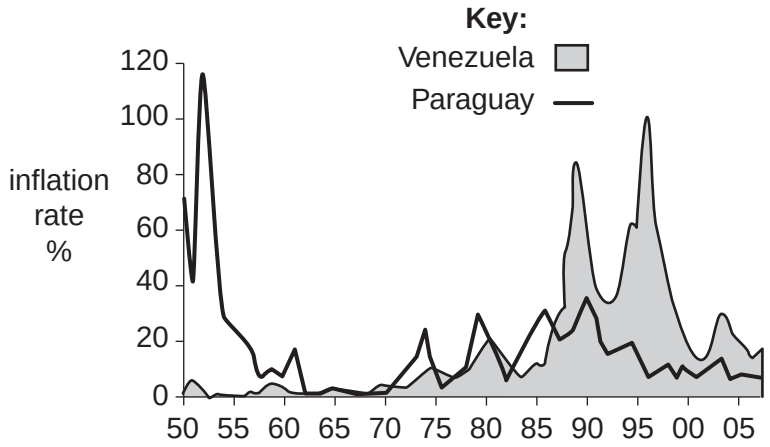
In January 2008 Paraguay updated its Consumer Price Index (CPI) with new weights based on the latest household budget survey. Table 1 shows the changes in the weights.

Table 1 Weights in the Paraguayan CPI, 1992 and 2008

	1992	2008
Food	35.1	32.1
Clothing	8.6	4.9
Alcohol and tobacco	2.1	1.2
Furniture	8.0	7.7
Transport	7.4	14.8
Communication	0.7	3.4
Housing	10.4	8.9
Health	4.8	4.1
Entertainment	5.1	6.1
Education	2.7	4.0
Restaurants and hotels	4.8	5.5
Miscellaneous goods and services	10.3	7.3

Paraguay's performance and that of Venezuela in controlling inflation are shown in Fig. 1.

Fig. 1 Inflation in Paraguay and Venezuela 1950–2005



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(a) **(i)** Why are weights used in constructing a CPI? [2]

(ii) Explain possible reasons why the weights for alcohol and tobacco and transport changed between 1992 and 2008. [4]

(b) **(i)** What is meant by inflation? [2]

(ii) Using Fig. 1 compare Paraguay's inflation between 1950 and 2005 with that of Venezuela. [2]

(iii) To what extent did Paraguay achieve a low and stable rate of inflation between 1950 and 2005? [4]

(c) Discuss whether all countries should set annual inflation targets of around 3%. [6]

Section B

Answer **one** question.

2 **(a)** Explain how a country's production possibility curve depends upon its factors of production. [8]

(b) Discuss how well comparative advantage explains the pattern of international trade. [12]

3 **(a)** With the help of a diagram, explain why some goods are produced in quantities greater than is socially desirable. [8]

(b) Discuss whether national defence or a public park is the better example of a public good. [12]

4 **(a)** Using a normal demand curve, explain how consumer surplus occurs. [8]

(b) With the help of diagrams, discuss whether consumers will benefit from the introduction on a product of **(i)** an indirect tax, and **(ii)** an effective maximum price. [12]

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Section A

Answer this question.

1 **Chinese Bicycles**

China is famous for its bicycles. There has even been a song written about those in Beijing. China is the world's leading producer and exporter of bicycles. Table 1 gives its output for two years compared with other leading producers.

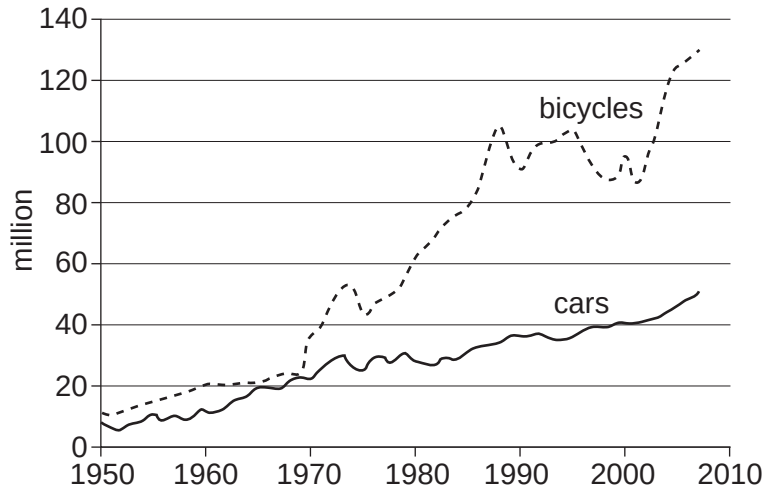
Table 1 Bicycle production (millions), selected producers

Year	China	Italy	Taiwan	Japan	US
1997	30.0	4.0	11.9	1.8	6.0
2007	87.0	2.5	4.9	1.1	0.3

In 2007, China exported 59 million bicycles, of which 17.3 million went to the US and 9.7 million to Japan. The European Union (EU) imported only 0.8 million, mainly because of a 48.5% anti-dumping import duty on Chinese bicycles. Taiwan, China's major competitor, concentrates on more expensive, higher quality products, and exported 4.7 million bicycles.

Fig. 1 shows the world output of bicycles and cars.

Fig. 1 World bicycle and car production, 1950 to 2007



In 2007 domestic sales of Chinese bicycles fell 3.8% to 28 million. Between 1995 and 2005 the number of bicycles owned in China fell from 670 million to 435 million, while car ownership rose from 4.2 million to 8.9 million.

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(a) **(i)** Summarise the main changes in bicycle production shown in Table 1. [2]

(ii) How might the changing pattern of production be explained? [3]

(b) Explain the likely effects for Chinese bicycle manufacturers of the anti-dumping import duty introduced by the EU. [3]

(c) **(i)** Use Fig.1 to compare the trend in the world production of bicycles with that of cars. [2]

(ii) How might the change in Chinese ownership of bicycles and cars between 1995 and 2005 be explained? [4]

(d) Discuss the externalities that might arise from the use of bicycles and cars. [6]

Section B

Answer **one** question.

2 **(a)** With the help of examples, explain why different economic decision makers face the problem of scarcity. [8]

(b) Discuss why the mixed economy is the most common economic system. [12]

3 **(a)** Explain why unanticipated inflation is often considered more of a problem than anticipated inflation. [8]

(b) Discuss whether inflation is more likely to be caused by domestic or international influences. [12]

4 **(a)** Explain the relevance of the Marshall-Lerner condition and the J-curve effect to the success of a currency devaluation. [8]

(b) There are various influences on the international value of a currency in a floating exchange rate system. Discuss their relative importance in different economies. [12]

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