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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 2012**

1 hour 30 minutes

Additional Materials: Answer Booklet/Paper

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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.

Inflation Targeting

1 Many central banks use 'inflation targeting'. Their principal aim is to achieve a particular annual rate of inflation within an acceptable range. For example, they might aim for a 2% rate of inflation but will accept a rate between 1% and 3%. Some economists claim that inflation targeting will help reduce the actual rate of inflation. The Central Bank of Turkey uses this approach and Table 1 shows how well it has worked.

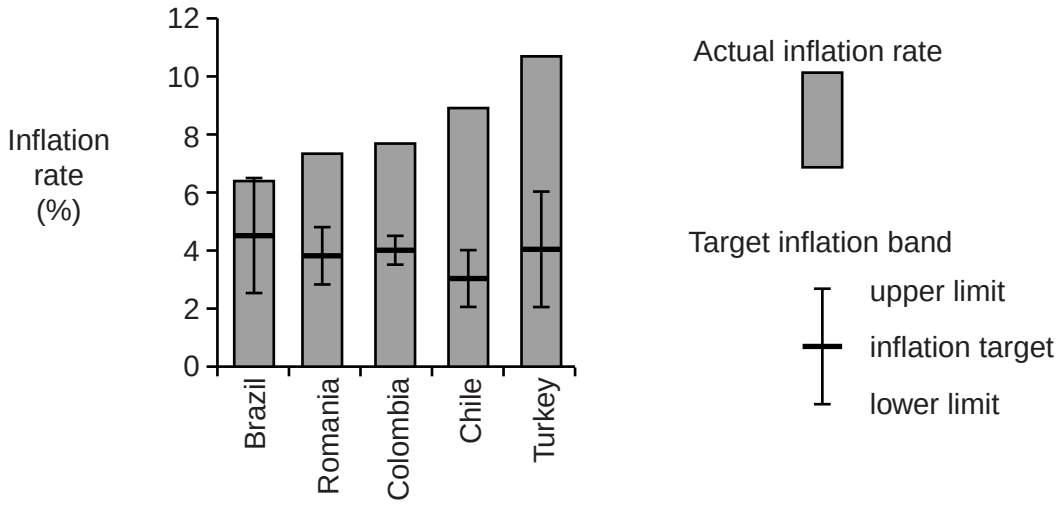
Table 1: Inflation in Turkey 2003–2008 (annual % rate)

	2003	2004	2005	2006	2007	2008
Target rate	20	12	8	5	4	4
Actual rate	18.4	9.3	7.7	9.7	8.4	10.8

In 2008 Turkey faced two particular difficulties. The New Turkish Lira (TRY) depreciated by 30% and food prices rose because of drought. Within the Turkish Consumer Price Index, food has a high weighting of 31%.

How successful five countries were in controlling inflation in 2008 is shown in Fig. 1.

Fig. 1 Target and actual inflation rates in five countries, 2008



(a) **(i)** In which year was Turkey most successful in meeting its inflation target? [1]

(ii) In which year was Turkey least successful in meeting its inflation target? [1]

(b) Explain the likely effect of the depreciation of the New Turkish Lira on Turkey's rate of inflation. [4]

(c) With reference to Fig. 1, how might differences between the inflation targets and actual inflation rates in Chile and Brazil in 2008 be explained? [4]

(d) How might having a target for inflation affect the causes of inflation? [4]

(e) Discuss the possible problems of constructing an accurate consumer price index. [6]

Section B

Answer **one** question.

2 **(a)** Explain how the loss of confidence in money will affect an economy's production possibility curve. [8]

(b) Discuss the difficulties involved in changing a planned economy to a successful market economy. [12]

3 **(a)** Explain, using elasticity of demand, the possible reasons why in some countries there has been an increased use of private transport instead of public transport. [8]

(b) Discuss the economic reasons for subsidising public transport and taxing private transport. [12]

4 **(a)** Use economic analysis to explain the benefits of international trade. [8]

(b) Discuss whether restrictions on international trade can ever be justified. [12]

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Section A

Answer this question.

1 **Current Account Balances 2006–2010**

The International Monetary Fund (IMF) supplies data on the balance of payments, particularly the current account balances, of its member countries. Table 1 was produced in October 2009 and shows balances for 2006 to 2008 and a forecast for the balances for 2009 and 2010 of several member countries.

Table 1: Current account balances in billions of US dollars (US$) 2006–2010

	2006	2007	2008	2009	2010
Brazil	13.6	1.6	–28.2	–18.8	–33.3
China	253.3	371.8	426.1	361.5	451.2
India	–9.3	–11.3	–26.6	–27.5	–33.6
Japan	170.4	211.0	157.1	96.9	105.6
Mexico	– 4.4	–8.3	–15.7	–10.8	–12.6
Russia	94.3	77.0	102.4	45.4	62.0
United States	–803.5	–726.6	–706.1	–369.8	–324.7

The start of a worldwide recession in 2009 had a major impact upon the level of international trade and affected different countries in different ways.

A country's current account balance is a key macroeconomic indicator. In some countries a current account surplus is an important economic objective. Other countries, however, need to decrease a current account deficit. One of the possible actions by a government facing such a deficit is to introduce an expenditure-reducing policy.

(a) Compare the changes shown in the current account balance of Russia and the United States between 2006 and 2010. [2]

(b) Explain **two** possible economic reasons why China's international trade performance was stronger than that of India. [4]

(c) Explain **two** likely economic effects of the 2009 recession on international trade. [4]

(d) Why might a current account surplus be an important economic objective for some countries? [4]

(e) Discuss the desirability of using an expenditure-reducing policy to decrease a current account deficit. [6]

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Section B

Answer **one** question.

2 **(a)** Explain why all types of economic system benefit from the existence and use of money. [8]

(b) Discuss whether an economy's production possibility curve is more likely to move inward or outward over time. [12]

3 **(a)** Explain, using elasticity of demand, why a train company might introduce a policy of raising fares at busy travel times and lowering fares at less busy travel times. [8]

(b) Discuss why some governments decide that it is undesirable to leave the provision of private goods, such as train travel, to the private sector. [12]

4 **(a)** Explain, with the help of a diagram, how a government can maintain a stable foreign exchange rate. [8]

(b) Discuss whether a government should be more concerned by an unstable foreign exchange rate or by an unstable domestic price level. [12]

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Section A

Answer this question.

1 **Economic Integration**

The world's two best known trade groups are probably the European Union (EU) and the North American Free Trade Area (NAFTA).

In 2005, a study examined the likely impact of the proposed formation of a third major trade group, JACIK. This would be an economic community comprising Japan, the Association of South East Asian Nations (ASEAN), China, India, and South Korea. ASEAN is a free trade area of ten countries including Indonesia, Malaysia and Singapore.

Exporting is an important activity for all three trade groups as shown in Table 1.

Table 1: Exports by value and world share, 2003

	EU	NAFTA	JACIK countries
Exports (US$ billions)	3523	1486	1657
% of world total	46.5	19.6	21.9

The 2005 study produced models of three levels of economic integration and the welfare gains with each were estimated. The results are shown in Table 2.

Table 2: Estimated welfare gains from the formation of JACIK in US$ million

	Model 1: Free trade of goods and services	Model 2: Free trade of goods and services and free movement of capital	Model 3: Free trade of goods and services and free movement of both capital and skilled workers
Japan	107 626	111 807	150 695
ASEAN	13 451	13 553	19 405
China	6 327	7 100	16 328
India	6 971	7 379	9 937
South Korea	13 043	13 317	14 076
JACIK total	147 418	153 156	210 441
Rest of World total	–27 293	–45 306	109 916
World total	120 125	107 850	320 357

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(a) **(i)** Use Table 1 to compare the export performance of the three trade groups in 2003. [2]

(ii) How might the differences you have identified be explained? [3]

(b) **(i)** State **three** ways in which an economic union differs from a free trade area. [3]

(ii) Explain **two** problems that might make economic integration difficult. [4]

(c) Use Table 2 to show whether the free movement of capital or the free movement of skilled workers is estimated to be more beneficial for JACIK. [2]

(d) Discuss how the rest of the world might view the formation of JACIK. [6]

Section B

Answer **one** question.

2 **(a)** Explain whether the factors of production are always of equal economic importance within and between economies. [8]

(b) Discuss whether planned economies should always be replaced by free market economies. [12]

3 **(a)** Explain how income elasticity of demand and cross elasticity of demand can be used to classify different types of goods. [8]

(b) Discuss the effectiveness of government use of maximum and minimum prices to help consumers and producers. [12]

4 **(a)** How does aggregate demand and aggregate supply analysis explain the existence of inflation in the short run? [8]

(b) Discuss whether a period of inflation or a period of deflation is more economically desirable. [12]

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