Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay (Core) **May/June 2014**

1 hour 30 minutes

No Additional Materials are required.

0205298623

READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

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.

The number of marks is given in brackets [ ] at the end of each question or part question.

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Section A

Answer this question.

Problems put the brakes on India's economic growth

1 With developed economies heavily in debt, the ability of the BRICs (Brazil, Russia, India and China) to drive the global economic engine is increasingly in doubt. China's growth has slowed to its lowest rate in three years. Brazil's growth has decreased and Russia is heavily dependent on oil and energy prices, which are falling. India's growth has slowed but is still high by the standards of developed countries, though well below the levels required to maintain economic momentum and improve the living standards of its citizens.

However, there are still positives in the Indian story. There is a youthful population, a large domestic demand and high savings. But India's economic difficulties, including its weak international position and inadequate infrastructure, threaten to overwhelm the country's potential. In critical sectors such as power, transport and utilities more investment is needed, and although its workforce is young and growing, there is a shortage of skills.

The country is running a current account deficit of more than 3% of GDP. The cause is slowing exports as a result of weakness in India's trading partners and higher imports, mainly purchases of commodities and oil (India imports around 75% of its crude oil).

In addition, India has a weak external position. It has around US$ 270bn in currency reserves. But foreign debts that must be repaid in the current year are about 40–45% of this amount.

Source: Adapted from The Independent

Table 1: Selected Economic Indicators for India 2007–2013

	2007	2008	2009	2010	2011	2012*	2013*
Gross Domestic Product % change	10.0	6.9	5.9	10.1	6.8	4.9	6.0
Inflation Index 2001=100	130.7	141.7	157.1	175.9	191.5	211.1	231.5
Current Account Balance US$ billion (bn)	–8.08	–30.97	–25.91	–52.22	–62.75	–74.54	–69.07
Exchange Rate: Indian Rupees per US$	41.3	43.5	48.3	45.7	46.6	52.1	52.9

*Forecast

Source: The World Bank and other international organisations

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(a) **(i)** Calculate the rate of inflation in India between 2001 and 2011. [1]

(ii) Calculate the expected rate of inflation in India between 2011 and 2013. [1]

(b) With the use of a production possibility curve explain the opportunity cost to India of choosing to produce transport facilities rather than education services. [4]

(c) Explain how the provision of improved transport facilities and education services might develop the productive potential of the economy in India. [4]

(d) India's exchange rate depreciated between 2010 and 2011.

With reference to the data explain, using supply and demand analysis, what might have contributed to this change in India's exchange rate. [4]

(e) Given the changes in the exchange rate shown in Table 1 between 2010 and 2013, discuss whether the changes in the current account balance over this period are what economic theory predicts. [6]

Section B

Answer **one** question.

2 **(a)** Explain whether you would expect the price elasticity of supply of an agricultural product, such as rice, in a market to be elastic or inelastic. [8]

(b) Discuss the extent to which a government can increase the supply of an agricultural product to an economy in the short-run and in the long-run. [12]

3 **(a)** Explain the difference between private goods and public goods, and why it is possible for a business to make a profit in the supply of private goods but not in the supply of a public good. [8]

(b) Discuss the view that a market economy is always preferable to a planned economy because of the existence of the price mechanism. [12]

4 **(a)** Explain what is meant by the term 'money' and outline its characteristics in a modern twenty-first century economy. [8]

(b) Discuss whether money is able to perform all of its functions in an economy that is experiencing a high rate of inflation. [12]

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ECONOMICS **9708/22**

Paper 2 Data Response and Essay (Core) **May/June 2014**

1 hour 30 minutes

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Section A

Answer this question.

Trade in New Zealand

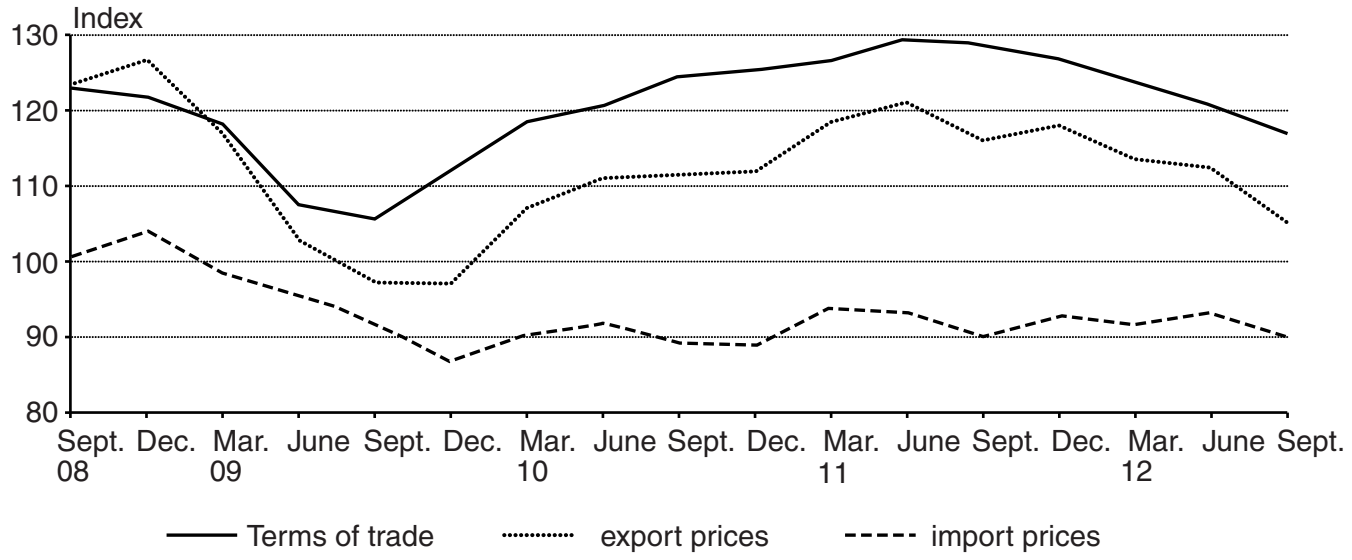
1 **Extract 1: Terms of trade down again but the view is positive**

New Zealand's terms of trade declined 3.2% from June to September 2012. There was a 13% drop in dairy prices which contributed to a 32% rise in the volumes of dairy products exported; the net effect on the total value of dairy exports was an increase of 16%. Meat prices fell 6%, but volumes were 15% higher, so that export receipts from the sector were 8.9% higher than June.

Exports of transport equipment fell 7.2% in volume terms, which was likely to reflect reduced economic activity in Australia and the United States, the key markets for New Zealand's manufactured exports. Demand in Australia is expected to recover in 2013, aided by interest rate cuts and renewed economic activity in China. Furthermore, prices for many of New Zealand's key export commodities were showing signs of improvement, and as international inflationary pressures remained weak, the terms of trade were expected to stabilise during 2013.

Source: Adapted from The New Zealand Herald 2012

Fig. 1 New Zealand's Terms of Trade Index, and Indices of Export Prices and Import Prices for Goods Traded
Quarterly
Base: June 2002 (=100)



Source: Statistics New Zealand

Extract 2: New Zealand's deficit above expectations

New Zealand's annual balance of trade deficit has increased to NZ$1.4 billion in October 2012, up from a deficit of NZ$875 million in the previous year. The total value of exports in October 2012 was 11% lower than in October the previous year. This can partially be explained by a 5.5% rise in the exchange rate of the New Zealand dollar over that period.

Dairy products accounted for nearly half the decline in exports, down 20% on October 2011. Imports at NZ$4.2 billion were up 1.7% on October 2011, due to higher imports of machinery and of consumer goods.

Source: Adapted from The New Zealand Herald 2012

(a) (i) Describe the change in New Zealand's terms of trade from June 2011 to September 2012. [1]

(ii) With reference to Fig. 1, account for the change that you have described. [2]

(b) (i) Given the information in Extract 1, calculate the price elasticity of demand for New Zealand meat from June to September 2012, if all other factors were equal. [2]

(ii) Explain why receipts from meat exports rose despite the fall in the price of meat. [2]

(c) Using the information provided in the extracts, explain why New Zealand's terms of trade were expected to 'stabilise during 2013'. [3]

(d) Use economic theory to explain why New Zealand specialises in exports of dairy products and meat and imports machinery and consumer goods. [4]

(e) Discuss whether the rising deficit in New Zealand's balance of trade is what would be expected, given the change in the terms of trade after June 2011. [6]

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Section B

Answer **one** question.

2 **(a)** Explain the meaning of the term 'equilibrium price and quantity' in the market for a good or service and show how a new equilibrium is established when there is an increase in demand. [8]

(b) Discuss the view that attempts to help poorer consumers through the imposition of a maximum price for food items will always fail. [12]

3 **(a)** Distinguish between income elasticity of demand and cross elasticity of demand and explain how each is used to identify different types of product. [8]

(b) Discuss which of these two types of elasticity would be more useful when predicting how a firm's revenues would change as demand factors change in a market economy. [12]

4 **(a)** Using diagrams, explain the difference between demand-pull and cost-push causes of inflation. [8]

(b) Distinguish between the domestic and external consequences of inflation and discuss which is most damaging to an economy. [12]

Copyright Acknowledgements:

Question 1 Extract 1 © Brian Fallow; Terms of Trade down again but the review is positive; The New Zealand Herald; 04 December 2012.
Question 1 Figure 1 © www.stats.gov.nz; The New Zealand's Terms of Trade Index; Statistics New Zealand; December 2012.
Question 1 Extract 2 © Brian Fallow; New Zealand's deficit above expectations; The New Zealand Herald; 28 November 2012.

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Section A

Answer this question.

1 European biofuel targets contribute to global hunger, says Oxfam

Governments throughout the world are under pressure to prevent global warming. One solution has been to adopt policies designed to switch from energy sources that rely upon fossil fuels, such as oil, and replace them with biofuels that are made from sugar and cereals. In the United States one policy introduced in 2006 was to subsidise biofuel production, but this was removed in 2011.

In 2009, European Union (EU) governments agreed to targets committing them to produce 10% of their transport energy from biofuels by 2020.

However, the targets designed to help fight climate change have become increasingly controversial. It is claimed by the charity Oxfam that the EU's biofuel policies are having a devastating impact on the world's poorest people through rapidly rising food prices and worsening hunger. It has calculated that the land required to meet the targets for one year could feed 127 million people.

Because of this increased demand for land to produce crops the adoption of targets to prevent global warming is being questioned. This demand for land to produce crops for biofuels is pushing food production on to land that is less suitable for agriculture, such as forests and grasslands. These had been acting as 'carbon sinks' absorbing greenhouse gases and as a result helping to prevent climate change. Estimates show that using this land to produce food crops could be as bad for the environment as putting an extra 26 million cars on Europe's roads.

The big problem is that the world's limited resources—land, water, soil—are being used to grow crops for biofuel production when they could be used to produce much-needed food.

Source: www.guardian.co.uk 2012

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(a) **(i)** Calculate the rate of food price inflation from 2003 to 2009. [1]

(ii) Calculate the rate of food price inflation from 2009 to 2012. [1]

(b) What evidence is contained in Table 1 to suggest that the adoption of biofuel targets in the EU had an impact on food prices? [2]

(c) Using diagrams, explain how the removal of the subsidy for biofuel production in the United States in 2011 would be likely to affect the market for:

(i) biofuels. [3]

(ii) fossil fuels. [3]

(d) **(i)** Use a production possibility curve to show the trade-off between the production of crops for biofuels and the production of food crops. [2]

(ii) Explain why the cost of food production is increasing as more land is used to grow crops for biofuels. [2]

(e) Carbon emissions are believed to contribute to global warming.

Discuss whether indirect taxes on fossil fuels might be a more effective way of preventing global warming than government commitments to biofuel targets. [6]

Section B

Answer **one** question.

2 **(a)** Explain the factors that might make the price elasticity of demand for a good highly inelastic. [8]

(b) Discuss why businesses might attempt to change the price elasticity of demand for their products and consider whether it is likely that they will be successful in their attempt. [12]

3 **(a)** Explain, using appropriate diagrams, the meaning of the term ‘externalities’. [8]

(b) Discuss the most appropriate policy that a government should adopt when the production of a good gives rise to a negative externality. [12]

4 **(a)** Explain the factors that might cause an economy to experience a current account deficit. [8]

(b) Discuss the policies available to a government faced with a current account deficit and consider which policy has the fewest disadvantages for the consumers in that economy. [12]

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Question 1 © www.fao.org; Table: 1 Food Price Index; Food and Agricultural Organization of the United Nations; 2012.
Question 1 © Felicity Lawrence; Extract: European biofuel targets contribute to global hunger; Guardian News & Media Ltd; 17 September 2012.

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