Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **May/June 2016**

1 hour 30 minutes

No Additional Materials are required.

5514292096

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.

1 **The Fiji economy: a positive outlook**

Fiji is a small island country in the Pacific with a population of 860 000. In 2014 its economy was reported to be continuing to grow steadily. It remained on course for a fifth consecutive year of expansion, boosted by high tourist arrivals and visible export earnings, particularly from sugar. The factors that were expected to restrict growth in 2015 included ongoing dry weather conditions causing lower output of agricultural goods, with the exception of sugar.

Table 1: Selected economic indicators for Fiji

	2014 estimate	2015 forecast
Economic growth rate %	3.3	3.0
Inflation rate %	3.0	3.5
Current account balance as % share of GDP	–6.0	–7.0

Source: *Asian Development Bank, 2014*

Consumption remained strong in the first five months of 2014, and imports of consumer goods, mainly vehicles, rose by 15.6%. Personal remittances increased, boosting consumption expenditure.

The tourism sector – Fiji's main source of foreign exchange – continued to perform strongly. Visitor arrivals increased by 4.0% year-on-year, with 4.6% more visitors from Australia and 11.6% more from New Zealand, but there was a significant fall in visitor arrivals from Japan.

Sugar production increased, aided by government investments in new technology that improved efficiency of production and reduced price.

Despite higher growth, inflationary pressures were eased by declining international commodity prices. However, annual average inflation in 2014 was not expected to fall below 3.0%, as economic activity was expected to revive. In addition, continuing dry weather was affecting the food supply.

Despite the positive growth outlook, increased investment is needed to improve productivity and address supply-side capacity constraints.

Source: *Asian Development Outlook 2014 Update*

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(a) How and where would revenue from tourist arrivals in Fiji be recorded in Fiji's balance of payments? [2]

(b) Use a supply and demand diagram to show how the government investment referred to in the article affected the price of sugar produced in Fiji. [2]

(c) Explain what the changes in sugar's contribution to visible export earnings and in the price of sugar might suggest about the price elasticity of demand for sugar. [3]

(d) Using aggregate demand and aggregate supply analysis, explain why inflationary pressures remained subdued in Fiji despite higher growth. [3]

(e) Explain how increased investment could address supply-side capacity constraints in the Fiji economy. [4]

(f) Discuss any economic factors that might help to explain the changes in visitor arrivals to Fiji from Australia and Japan. [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 position is established when there is a decrease in demand. [8]

(b) Discuss whether attempts to help poorer consumers through the introduction of a maximum price for necessities can ever be successful. [12]

3 **(a)** Outline the functions of the factor enterprise in a modern economy, and explain how enterprise responds to a rise in the demand for a good. [8]

(b) Discuss why some goods and services are provided by private enterprise and others are provided by the government in a mixed economy. [12]

4 **(a)** Explain what might cause a favourable movement in an economy's terms of trade. [8]

(b) Discuss whether overall a favourable movement in an economy's terms of trade would be likely to have positive or negative effects on the economy. [12]

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Section A

Answer this question.

1 **Turkey's economic policies**

Extract 1: Turkey's medium-term programme

In a press statement in 2014, Turkey's minister in charge of the economy, Ali Babacan, introduced Turkey's medium-term programme (MTP) for the period 2015–2017. He stated that the first priority of the MTP is solving the problem of inflation, second is the current account deficit and third is structural reforms.

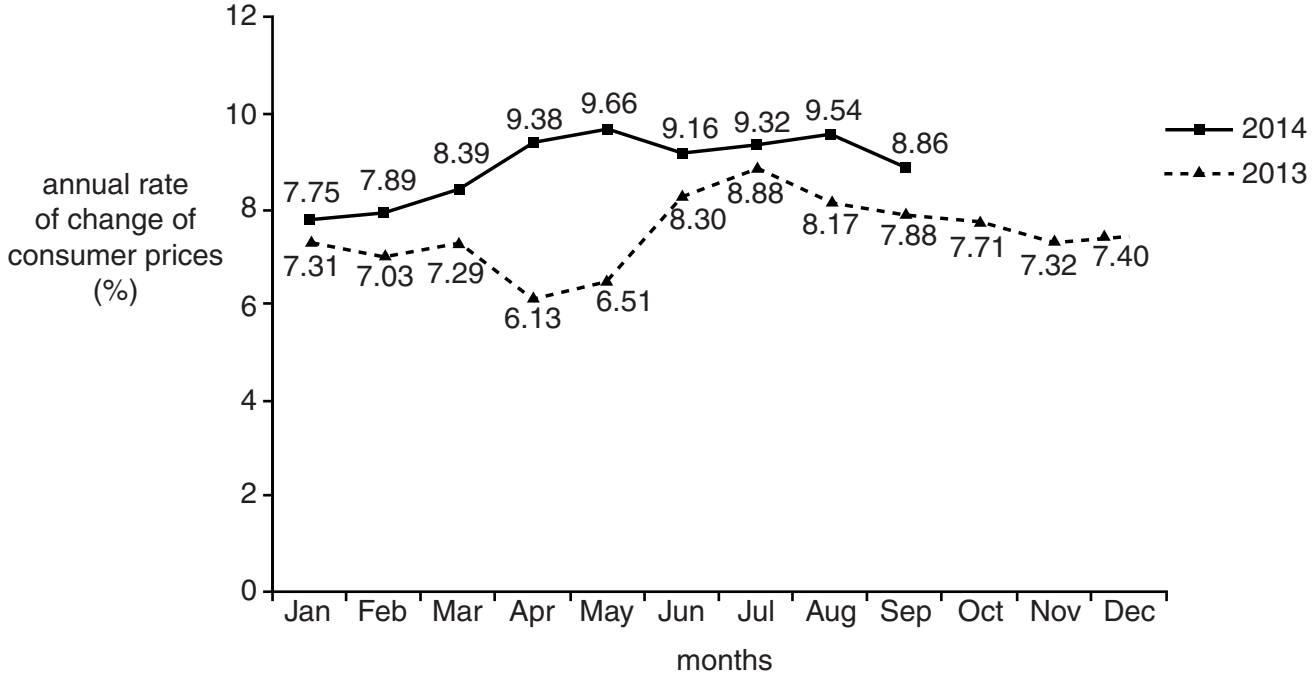
Tight fiscal policy will be pursued in order to reach Turkey's goals of lower inflation and a reduced current account deficit. Structural reforms are important to increase Turkey's potential growth, the minister said.

He announced that the inflation rate is expected to fall from 9.4% in 2014 to 6.3% in 2015 and 5.0% by 2017. The minister also stated that the unemployment rate is expected to drop from 9.6% in 2014 to 9.1% by 2017.

As the United States (US) economy recovers, the US central bank is expected to increase interest rates, causing the US dollar to continue to rise. The outcome of these policies might be harmful for Turkey's economy.

The minister claimed that Turkey's macroeconomic policies were already increasing saving in the economy and reducing consumer credit. By 2017 domestic savings are expected to rise to 15% of national income.

Fig. 1: Turkey's consumer price inflation rate, January 2013–September 2014



Source: *Daily Sabah*, 8 October 2014

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Table 1: Turkey's balance of payments current account, 2012–2013 (US$ million)

	2012	2013
Exports of goods	163 221	163 371
Imports of goods	–228 552	–243 394
Services	22 562	23 131
Income	–7 161	–9 355
Current transfers	1 433	1 181

Source: *www.turkstat.gov.tr*

(a) What happened to the balance on Turkey's current account between 2012 and 2013? [2]

(b) Use a production possibility curve diagram to show the intended outcome of the structural reforms in Turkey. [2]

(c) With the help of a demand and supply diagram, show how the expected change in US interest rates was likely to cause the US dollar 'to continue to rise'. [2]

(d) Consider whether the outcome of the interest rate changes in the US was likely to be 'harmful for Turkey's economy'. [4]

(e) Explain **two** factors that determine how the increase in consumer prices between 2013 and 2014 shown in Fig. 1 might affect the total value of Turkey's exports. [4]

(f) Discuss how 'tight fiscal policy' could be expected to help Turkey achieve the first priority of the MTP, and consider how effective this is likely to be. [6]

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Section B

Answer **one** question.

2 **(a)** Use examples to illustrate the difference between private goods and public goods, and explain why only private goods will be supplied in a free market economy. [8]

(b) 'The factor enterprise and the free working of the price mechanism always ensure a satisfactory outcome for consumers even when imperfect information exists.'

Discuss this view. [12]

3 **(a)** Explain the meaning of 'price elasticity of demand' and, using examples, outline the factors that would cause the demand for a good to be relatively price-elastic. [8]

(b) Discuss why entrepreneurs might want to change the price elasticity of demand for their products, and consider the extent to which this is achievable. [12]

4 **(a)** Using examples, explain the instruments of monetary policy and supply-side policy. [8]

(b) Discuss the advantages and disadvantages of supply-side policy and consider its effectiveness in an economy that is facing a labour shortage. [12]

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Section A

Answer this question.

1 China's economy and Australia's trade

Extract 1: China's record trade surplus is bad news for Australian miners

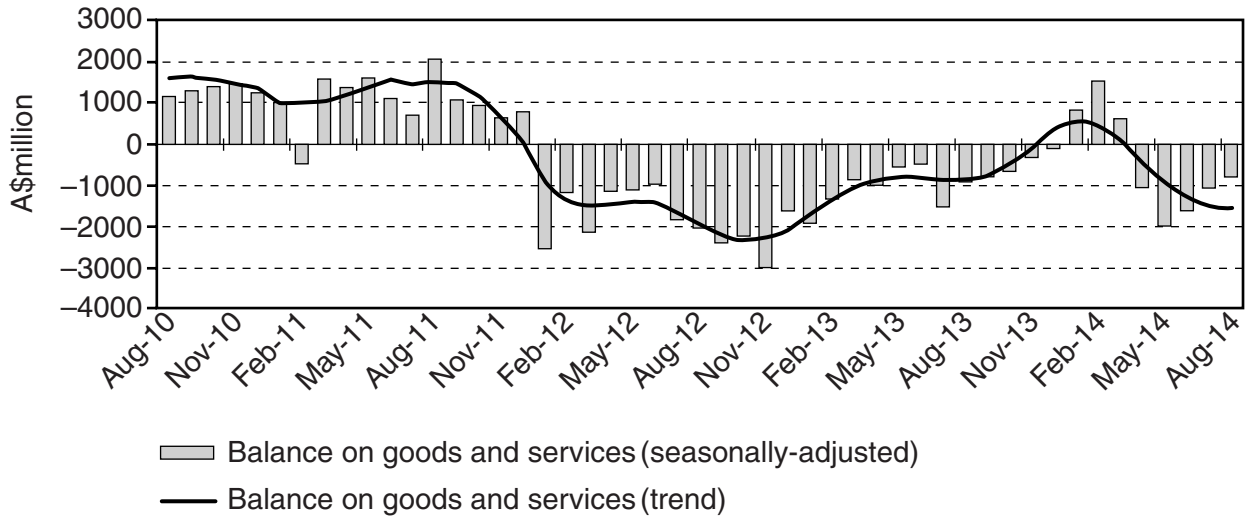
China had an overall trade surplus of almost US$50 billion in August 2014, a record balance. However, that is bad news for countries such as Australia, which exports large amounts of raw materials and whose biggest trading partner is China. China's surplus came not only from a 9.4% annual rise in exports, but also from a 2.4% fall in its imports. This has created a problem for Australia's balance of payments.

Of particular relevance to Australia, the fall in China's imports was a cause of a steep decline in iron ore prices, with the price hitting a five-year low of US$83.60 a tonne. Australia's iron ore exports dropped 9.3% in August compared with July. There was also an 18.1% slump in China's imports of coal between July and August.

Meanwhile, a construction industry slowdown in China is starting to reduce demand for building materials such as steel, and this is reducing the demand for iron ore and hence its price. It is not expected that the situation will change soon, but some analysts are hopeful that China will introduce some stimulus to maintain growth near its 7.5% target.

This represents an interesting dilemma for China's policymakers: the situation calls for more expansionary policies, for example lower interest rates, but, at the same time, strong exports and a record current account surplus will put pressure on policymakers to let the currency rise.

Fig. 1: Australia's trade balance, August 2010 – August 2014



Source: Australian Broadcasting Corporation, 8 September 2014

Table 1: Australia's terms of trade, July 2011 – July 2014

Year	Terms of Trade Index
2011 qtr* 3	106.5
qtr 4	102.0
2012 qtr 1	96.8
qtr 2	96.3
qtr 3	91.1
qtr 4	88.5
2013 qtr 1	91.3
qtr 2	90.4
qtr 3	87.5
qtr 4	88.2
2014 qtr 1	87.0
qtr 2	83.4

*quarter

Source: Australian Bureau of Statistics

(a) (i) Calculate the approximate change in Australia's trade balance between August 2010 and August 2014. [2]

(ii) Use a supply and demand diagram to show how the trend in Australia's trade balance over this period would be expected to influence the value of Australia's exchange rate. [2]

(iii) What other information would be required to measure the change in Australia's current account on the balance of payments over this period? [2]

(b) Suggest a change in the prices of exports and imports that might account for the change in the Australian terms of trade between 2011 quarter 3 and 2014 quarter 2. [2]

(c) Explain who in China would lose and who in China would benefit if China's exchange rate were allowed to rise. [6]

(d) Discuss whether lower interest rates in China or a rise in China's exchange rate is more likely to help solve Australia's balance of payments problems. [6]

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Section B

Answer **one** question.

2 **(a)** Explain how economists use the concept of elasticity to distinguish between normal and inferior goods and between substitutes and complements. [8]

(b) Discuss how knowledge of the differences between these types of goods would help government policy makers and entrepreneurs to make decisions. [12]

3 **(a)** Use aggregate demand and aggregate supply analysis to distinguish between cost-push and demand-pull causes of inflation. [8]

(b) Distinguish between the domestic and the external consequences of inflation, and consider which you think is more serious for an economy. [12]

4 **(a)** Use production possibility diagrams to explain how specialisation and international trade can improve the standard of living of consumers in a country. [8]

(b) Discuss whether protection of domestic industries can ever be justified, given the benefits of specialisation and trade. [12]

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