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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) **October/November 2009**

1 hour 30 minutes

Additional Materials: Answer Booklet/Paper

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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.
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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.

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.

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Section A

Answer this question.

1 **Elasticity of demand for air travel**

The Department of Finance of Canada examined 21 studies of elasticity of demand for air travel. These were mainly based on behaviour in the USA. It produced a summary of what it thought were the most accurate estimates of elasticity for different segments of the market. Some of these findings are given in Fig.1 and Fig. 2.

Fig.1 Income elasticity of demand (YED) for air travel

	YED value
Total market	+1.1

Fig. 2 Price elasticity of demand (PED) for air travel

market segment	*PED value*
Long-distance international business flights	-0.3
Long-distance international leisure flights	-1.0
Short-distance business flights	-0.7
Short-distance leisure flights	-1.5

(a) **(i)** State the formula used to calculate income elasticity of demand. [2]

(ii) What can be concluded about air travel from Fig. 1? [2]

(b) Using Fig. 2, explain a likely reason for the different price elasticity values for

(i) business flights compared with leisure flights [3]

(ii) long-distance flights compared with short-distance flights. [3]

(c) Explain the significance of the price elasticity values in Fig. 2 for an airline considering a policy of fare cutting. [4]

(d) Discuss the costs and benefits of an increased demand for air travel. [6]

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Section B

Answer **one** question.

2 **(a)** Explain, with the help of a diagram, how the price of a product moves to a new equilibrium following a decrease in its supply. [8]

(b) Discuss whether government intervention always improves the operation of the market. [12]

3 **(a)** Explain why it is usually more difficult to trade internationally than domestically. [8]

(b) Discuss, with examples, how far the global distribution of factors of production determines what a country imports and exports. [12]

4 **(a)** Explain how a rapid rate of inflation in a country will affect its floating exchange rate. [8]

(b) Discuss whether a government should operate a fixed exchange rate system. [12]

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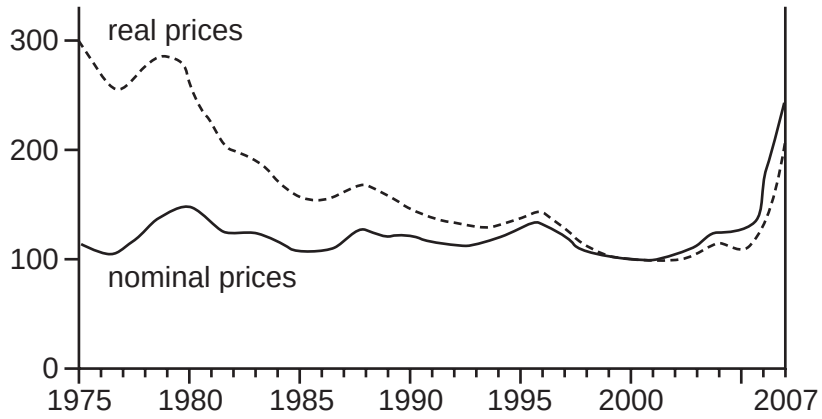
Section A

Answer this question.

1 World Food Prices

Between 1975 and 2007 the trend in world food prices changed significantly. Fig.1 shows indices of nominal and real food prices as measured by the International Monetary Fund (IMF).

Fig. 1 IMF World Food Prices Indices 1975-2007 (2000=100)



The importance of food within consumer spending patterns varies between countries. This is reflected in the weight given to food within a country's consumer prices index (CPI). Table 1 shows the CPI food weight for selected countries.

Table 1: Weight given to food (%) in CPI for selected countries

Country	Weight given to food in CPI (%)
UK	10
Australia	15
China	34
Kenya	50
Bangladesh	65

The International Food Policy Research Institute (IFPRI) calculated that a 10% rise in world food prices results in a 1% to 2% increase in world food supply. The effects of higher world food prices can benefit some countries and individuals but harm others.

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(a) (i) What is meant by nominal prices and real prices? [2]

(ii) Compare what happened to nominal food prices and real food prices before and after the year 2000. [3]

(b) (i) How might the differences in food weights shown in Table 1 be explained? [3]

(ii) Contrast the effect on the rate of inflation in Kenya and in the UK if there were a 20% rise in food prices in each country. [2]

(c) Explain **one** possible reason for the responsiveness of world food supply to changes in price reported by the IFPRI. [4]

(d) Discuss the benefits and drawbacks of rising world food prices. [6]

Section B

Answer **one** question.

2 (a) With the aid of a diagram, explain how a government subsidy to producers of fuel will affect the producers and government expenditure. [8]

(b) Discuss how reduced air fares on low-cost budget airlines might affect the air travel market and the markets for related goods and services. [12]

3 (a) Explain why a lighthouse is often given as an example of a public good while a light bulb is not. [8]

(b) Discuss whether it is likely that the private costs and the social costs of production would be identical. [12]

4 (a) Compare the aims and features of a free trade area with those of an economic union. [8]

(b) Discuss whether an improvement in a country's terms of trade always works to its benefit. [12]

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Copyright Acknowledgements:

Fig. 1 © *Food Prices, Cheap No More*; The Economist; 8/12/2007.
Table 1 © Mercer-Blackman et al; *Biofuel demand pushes up food prices* - Chart 2; IMF Survey Magazine; 17/12/07.

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