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) **October/November 2014**

1 hour 30 minutes

No Additional Materials are required.

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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 world coffee market

Extract 1: Colombia losing ground in coffee market

Until the 1980s, Colombia was the second largest coffee producer in the world. Coffee cultivation contributed to a growth in incomes, a positive trade balance and employment. But at the end of the 1980s things started to change for the worse. Between 1989 and 2011, the country lost 7% of its share in the world coffee market, while Brazilian coffee producers increased exports. New producers entered the market and Colombia fell to fourth in the world in terms of the production of coffee.

Increased international competition is not the only reason that Colombian coffee producers are suffering. The harvest in 2011 was the smallest in 30 years, mostly due to heavy rains in the main coffee-producing regions. In addition, there are problems related to climate change, which cause increased coffee crop diseases that result in increased costs.

Source: All rights reserved © Worldcrunch – in partnership with AMERICA ECONOMIA

Extract 2: Nepalese farmers gain from global thirst for coffee

Nepal's hills are suitable for coffee growing and more farmers are turning to the crop, attracted by the high export prices. There is rapidly rising demand for coffee, especially in traditional tea-drinking countries such as China and India. Coffee growing in Nepal is booming. Total annual production is more than 30 times the crop in the early 1990s. Every year, 16% more land is being used for coffee and production is increasing by 20%. The industry now employs more than 25 000 people.

Coffee is one of the few industries in Nepal, other than tourism, that is thriving. Farmers are attracted to coffee as it is more profitable to grow than traditional crops such as maize and millet.

Most Nepalese coffee is exported. Coffee consumption is forecast to increase globally by about 3% per annum over the next decade, as it did over the past decade. Rising incomes, combined with advertising, is likely to encourage coffee drinking in countries such as China and India where coffee is not part of traditional culture.

Coffee exports are generating much-needed foreign reserves for the Nepalese government, and income for agricultural communities. In Nepal, too, demand is growing fast.

Source: The Guardian, newspaper 2012

Table 1: The annual average price of coffee (US cents per unit)

Year	Price
2007	107.68
2008	124.25
2009	115.67
2010	147.24
2011	210.39
2012	156.34

Source: International Coffee Organisation

(a) Describe the overall trend in coffee prices between 2007 and 2012 and identify **one** year in which supply was likely to have exceeded demand in the market for coffee. [2]

(b) Explain how coffee exports **and** a thriving tourism sector would contribute to Nepal's current account in the balance of payments. [4]

(c) With reference to Extract 2, explain how you would classify coffee using the concept of income elasticity of demand. [2]

(d) Using diagrams, explain how changes in demand and supply have affected the coffee market in Colombia and in Nepal. [6]

(e) Discuss the view that Nepal should specialise in the production of coffee and Colombia should specialise in some other product given the changes in costs that have occurred. [6]

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[Turn over

Section B

Answer **one** question.

2 **(a)** Using a supply and demand diagram, explain how the imposition of a subsidy on a good would affect the surplus enjoyed by the producers of that good. [8]

(b) Discuss whether minimum price legislation or the imposition of an indirect tax is more effective in improving resource allocation when the consumption of a good causes negative externalities. [12]

3 **(a)** Explain the factors that determine whether the price elasticity of demand for a product has a high value or a low value. [8]

(b) Discuss whether it is both possible and beneficial for a business to change the price elasticity of demand for its product. [12]

4 **(a)** Explain how tariffs and an undervalued exchange rate can operate to protect a domestic market from foreign competition. [8]

(b) Discuss whether protectionism disadvantages most people in the protected country. [12]

Copyright Acknowledgements:

Question 1 © Tamara Munoz; *Columbia Losing Edge in Coffee Market*; http://www.worldcrunch.com; 9 September 2012.
© Ishwar Rauniyar & Jason Burke; *Nepalese farmers tap into global thirst for coffee*; Guardian News & Media Ltd; 18 December 2012.
Question 1 Table © *Coffee Annual Average Price (US cents/lb)*; International Coffee Organisation; http://www.ico.org; 6 January 2013.

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Section A

Answer this question.

United States hints again 'China is a currency manipulator'

1 The US Treasury regularly reviews the exchange rate policies of nine economies that account for 70% of US foreign trade, with most of the focus on China, the world's second largest economy.

The Treasury welcomed gains in the value of the Chinese yuan, but said the currency remains 'significantly undervalued'. This undervaluation gives China a large advantage in its bilateral trade with the US. However, the Treasury declined to accuse China of currency manipulation because it could lead to Chinese trade sanctions against the US.

The Treasury argued that the Chinese authorities know that an appreciating currency is of overall benefit to China, and said the yuan had gained 9.3% against the US dollar between June 2010 and November 2012. It said that when inflation was taken into account, the value of the Chinese currency had increased 12.6% since June 2010, when the Chinese authorities agreed to allow the yuan to be bought and sold more freely on the foreign exchange market. Nevertheless, based on China's huge and rising stock of foreign exchange reserves, the US Treasury said that the yuan's appreciation had been insufficient.

These rising reserves, together with other factors, 'suggest that the real exchange rate of the yuan remains significantly undervalued and further appreciation of the yuan against the dollar and other major currencies is justified'.

Source: Straits Times, Singapore 2012

Table 1: Various economic indicators, China 2007 to 2013

	2007	2008	2009	2010	2011	2012	2013*
Inflation: average consumer price index (1995 = 100)	227	241	239	247	261	269	277
Current account balance $US billion	353	412	261	237	201	190	222
Exchange rate: yuan per $US	7.61	6.95	6.83	6.77	6.46	6.33	n/a

* forecast

Source: The World Bank and other international economic organisations

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(a) Compare the rate of inflation in China between 2007 and 2008 with that between 2010 and 2011. [2]

(b) Explain briefly how the foreign exchange value of a currency is determined in a free market. [3]

(c) The US Treasury report states that China's strong trade surplus has led to a 'huge and rising stock of foreign exchange reserves' in China.

Explain how this justifies the claim that China is manipulating the foreign exchange value of its own currency. [3]

(d) Explain why China's current account surplus is expected to increase in 2013, despite the rise in prices in China and the appreciation of the yuan. [6]

(e) Do you agree with the view of the US Treasury that an appreciating currency is 'of overall benefit' to China? [6]

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Section B

Answer **one** question.

2 **(a)** With the use of a diagram, explain how prices allocate scarce resources in a market economy. [8]

(b) Discuss whether prices are less important in allocating scarce resources in a mixed economy compared with a market economy. [12]

3 **(a)** Explain why the value of income elasticity of demand for a good can be positive, negative or zero, while the value of its price elasticity of demand is most likely to be negative. [8]

(b) Discuss whether price elasticity of demand is a more useful concept than income elasticity of demand for a business that is trying to increase its sales revenue. [12]

4 **(a)** Explain how a rise in the rate of interest might cause a shift in an economy's aggregate demand curve. [8]

(b) Discuss whether inflation is more likely to be caused by a shift in an economy's aggregate demand or a shift in its aggregate supply. [12]

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Section A

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UK Government plans to increase the price of alcohol to end 'excessive consumption'

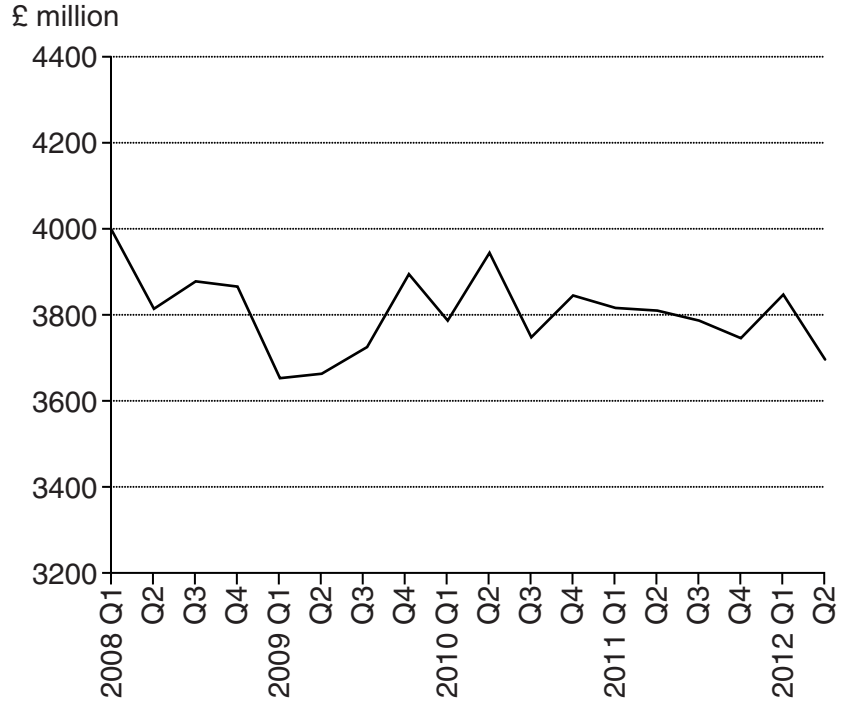
Plans for a minimum price for alcohol of 45 pence per unit were announced by the UK Government in an attempt to limit excessive consumption of alcohol. The Government hopes the policy, which would raise the price of the cheapest alcoholic drinks in shops, will reduce public disorder offences and cut the cost of alcohol-related ill health. It says that irresponsible drinking costs the UK taxpayer £21 billion a year, with nearly a million alcohol-related crimes and 1.2 million alcohol-related hospital admissions in 2011.

The Alcohol Health Alliance, an organisation of 32 medical, educational and counselling groups, welcomed the proposed policy. However, its chairman called for a higher minimum price of 50 pence per unit: 'According to the University of Sheffield, a minimum price of 50 pence per unit would reduce total alcohol consumption by 6.7%, reducing hospital admissions by approximately 20 000 in the first year alone.'

A minimum price of 45 pence per unit would cost the UK taxpayer about £200 million a year in lost revenue from taxes on alcohol.

Source: Adapted from The Independent, 2012

Fig. 1: Real expenditure in the UK on alcohol purchased in shops for consumption off the premises (£ million)



Source: Office for National Statistics

Table 1: UK average weekly alcohol consumption (units), by age: 2006–2010

Age (years)	2006	2008	2010
16–24	14.6	13.1	11.1
25–44	14.6	13.0	12.2
45–64	15.0	13.8	13.1
65 and over	8.7	8.9	8.1
Average for all age groups	13.5	12.3	11.5

Source: Office for National Statistics

1 (a) (i) What is the overall trend in UK real expenditure on alcohol purchased in shops for consumption off the premises between 2008 quarter 1 and 2012 quarter 2? [1]

(ii) Explain how a change in **one** demand factor might have caused the change in weekly alcohol consumption for the 'average for all age groups' shown in Table 1. [2]

(b) (i) Identify the age group that has shown the greatest change in average weekly alcohol consumption between 2006 and 2010. [1]

(ii) For the age group you have identified, explain **one** possible economic reason for the change in its average weekly alcohol consumption compared with the other age groups. [2]

(c) If the minimum price per unit were fixed at 50 pence rather than 45 pence, explain, with the help of a diagram, how the higher price would affect the consumer surplus in this market. [4]

(d) Explain, with reference to the data, how crime and hospital admissions arising from excessive alcohol consumption contribute to social costs. [4]

(e) Discuss whether the problems associated with excessive alcohol consumption are better dealt with through a minimum price per unit for alcohol rather than through an education campaign. [6]

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Section B

Answer **one** question.

2 **(a)** Show how the economic problem can be explained with the use of a production possibility curve. [8]

(b) Discuss whether an outward shift in a country's production possibility curve will always raise the welfare of the citizens of that country. [12]

3 **(a)** Explain why an increase in the money supply and rising world energy prices are categorised as different causes of inflation in an economy. [8]

(b) Discuss whether a floating exchange rate is consistent with the policy objective of a low and stable rate of inflation. [12]

4 **(a)** Explain how comparative advantage shows that specialisation and international trade can improve the welfare of consumers in an economy. [8]

(b) Discuss whether an economy would benefit more from an unfavourable rather than a favourable movement in its terms of trade. [12]

Copyright Acknowledgements:

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Question 1 Figure 1 © Office of National Statistics; www.ons.gov.uk; December 2012.

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