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 2015**

1 hour 30 minutes

No Additional Materials are required.

5637715340

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Section A
Answer this question.
Brief answers only are required.

Section B
Answer any **one** question.

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Section A

Answer this question.

1 Increased cereal supplies push down prices and boost world trade

The Food and Agriculture Organisation's (FAO) forecast for world cereal production in 2013 has been adjusted upward by 8.5%, a record level of output. Early prospects for crops to be harvested in 2014 are also favourable. Overall prospects for wheat production in the northern hemisphere remain good. In the southern hemisphere, maize output is likely to rise in Brazil and Argentina. The prospects for the 2014 rice crop are mixed, with Brazil expanding output, while in the rest of South America, insufficient rainfall is limiting the supply of rice. The lack of water for irrigation is also limiting rice output in Australia and Sri Lanka.

FAO's forecast for world consumption of cereals in 2013 is forecast to rise by 1.7%. This is slightly larger than the predicted population growth. Other uses of cereals, apart from food and animal feed, are expected to show a strong growth in 2013/14.

Source: adapted from Food and Agriculture Organisation

Table 1: selected FAO food price indices
(Base year 2002–2004 (average of prices) = 100)

	The Total Food Price Index (meat, cereals, dairy, vegetable oils & sugar)	Cereals Price Index (includes wheat, rice & maize)	Dairy Product Price Index
2011	229.9	240.9	229.5
2012	213.3	236.1	193.6
2013	209.8	219.2	242.7
2014 January	203.4	188.4	267.7

Source: adapted from Food and Agriculture Organisation

India grain subsidy may only cause hunger elsewhere

India's battle against hunger might cause problems for the world's poorest. The Indian Government has said that 67% of India's population, over 800 million people, will have the right to buy up to 5 kilogrammes (kg) of rice, wheat and other cereals from the state each month at subsidised prices. This substantial food subsidy will worsen public finances. The total food subsidy expenditure is estimated to be US$25 billion.

When the production of rice in India is insufficient, the subsidy may destabilise the global rice market. India will be forced to import rice, which will lead to higher prices and rice shortages in other importing countries such as Nigeria, Bangladesh, Indonesia and the Philippines. India's good intentions may just push its rice shortages on to the rest of the world.

Source: adapted from Reuters Breakingviews 2013

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(a) **(i)** Calculate the percentage change in the price of cereals between 2011 and January 2014. [2]

(ii) Explain **two** possible reasons why the world price of cereals and the world price of dairy products moved in opposite directions between 2012 and January 2014. [4]

(b) Explain how an economist would decide whether cereals and dairy products are substitutes. [3]

(c) Use a diagram to illustrate how a subsidy will affect the price and quantity of rice produced in India. [3]

(d) Explain a likely opportunity cost of the Indian Government's spending on the food subsidy. [2]

(e) Discuss whether food subsidies are likely to solve the world's food shortages in the long run. [6]

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Section B

Answer any **one** question.

2 **(a)** Explain, using the concept of income elasticity of demand, how a fall in incomes affects the demand for inferior goods and necessary goods. [8]

(b) Discuss the policies that businesses might adopt to maintain sales when incomes are falling and consider which is most likely to be successful. [12]

3 **(a)** With the help of diagrams, explain how both cost-push and demand-pull inflation can be caused by a falling exchange rate. [8]

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

4 Assume, in a two-country, two-product world, that one economy is more efficient at producing both products.

(a) Explain how the efficient economy can benefit from specialisation and trade with the less efficient economy. [8]

(b) Evaluate the economic reasons that the less efficient economy might offer to justify protection of its industries. [12]

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Section A

Answer this question.

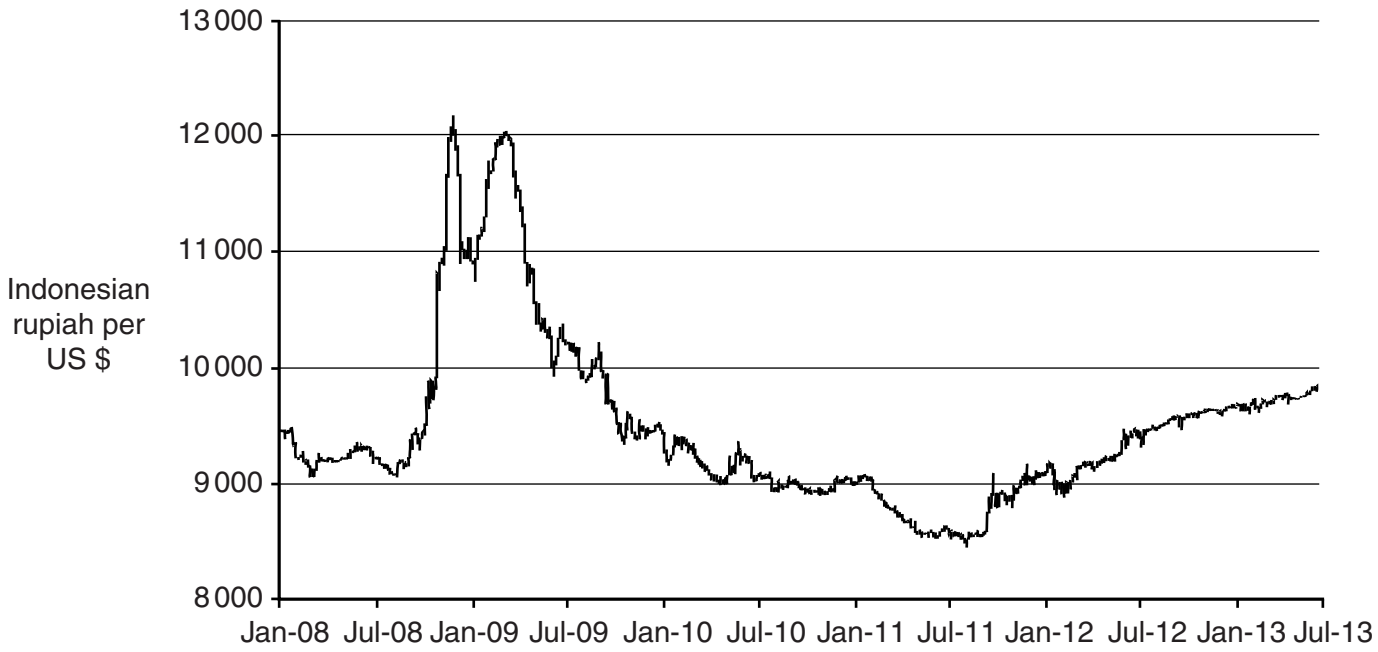
1 **The Indonesian Economy**

Extract 1: Indonesian rupiah weakens to lowest level in almost four years.

In 2012, the Indonesian rupiah's value against the United States (US) dollar fell to its lowest level since September 2009. This caused the cost of oil imports to rise, which resulted in a deficit on Indonesia's current account for the first time since 1997. However, recent developments might support the rupiah. In June, the 2013 Budget reduced fuel subsidies, which caused a price rise for fuel of 44%. Although this will put upward pressure on inflation, it is hoped that the reduction in fuel subsidies will have a positive impact on the Government Budget. Also, in June, Indonesia's Central Bank raised interest rates, which should take some pressure off the rupiah.

Source: Adapted from FocusEconomics 2013

Fig. 1: **Exchange rate of the Indonesian rupiah per US dollar**



Source: Thomson Reuters

Extract 2: Indonesia bans nickel exports.

Indonesia has started 2014 with a ban on exports of nickel, which is used to make stainless steel. Nickel prices increased as markets prepared themselves for a fall in global supply. It is hoped that the ban would mean that multinational companies would be forced to invest in factories in Indonesia so that the nickel is processed in Indonesia rather than just being mined and exported. This would create jobs in Indonesia and broaden Indonesia's manufacturing base.

Source: Sydney Morning Herald 2014

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Extract 3: Higher interest rates in the US cause concern in Indonesia.

Interest rates in the US look likely to increase and this will have an impact upon several emerging economies, including Indonesia.

Indonesia's central bank has resisted increasing interest rates but is monitoring events in the US. Inflation in Indonesia was stable at 8.4% in December 2013, but economic growth slowed to its lowest rate in four years. In addition, Indonesia's trade position is poor and there is a large outflow of foreign capital.

Source: The Observer 2014

(a) Describe the change in the value of the Indonesian rupiah between July 2009 and July 2013 shown in Fig.1. [2]

(b) Explain how the fall in the rupiah could cause the first current account deficit since 1997 as stated in Extract 1. [2]

(c) With the help of a diagram, explain how a cut in fuel subsidies would have contributed to the rise in the price of fuel by 44%. [4]

(d) **(i)** How could a rise in interest rates in the US affect Indonesia's balance of payments? [2]

(ii) With the help of a diagram, explain how this rise in US interest rates would be expected to cause a fall in the value of the Indonesian rupiah. [4]

(e) Discuss how any **two** changes described in the data might be expected to affect aggregate demand and aggregate supply in Indonesia and assess how prices and output might be affected. [6]

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Section B

Answer any **one** question.

2 **(a)** A study estimates that dark chocolate has a price elasticity of demand of (–)0.8 and that white chocolate has a price elasticity of demand of (–)1.4. Explain how chocolate producers could change price to increase total revenue for each type of chocolate. [8]

(b) Explain the factors that might cause a fall in demand for chocolate and discuss the extent to which chocolate producers have the power to stop this fall in demand happening. [12]

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

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

4 **(a)** In a two-country world, one country is more efficient at producing one product and the other country is more efficient at producing another product. Explain why specialisation and trade usually benefit both countries. [8]

(b) Suppose one country is more efficient at producing both products. Discuss whether it is the case that specialisation and trade will always benefit both countries. [12]

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Section A

Answer this question.

1 EU agreement 'biggest deal Canada has ever made'

Canada and the European Union (EU) signed the Comprehensive Economic and Trade Agreement (CETA), a free trade deal that will eliminate 98% of all tariffs, and many barriers on trade, investment and labour mobility. Canadian manufacturers, investors and service providers will have access to the 500 million people in the EU, where the total value of production approaches 17 trillion Canadian dollars (C$17 trillion) a year. A study estimates that the duty-free access of Canada's seafood, timber, manufacturing, agriculture and mineral industries to the EU will generate around C$12 billion in the Canadian economy and create about 80 000 new Canadian jobs.

Tariffs on imports from Europe of clothing, cheese, wine, dairy products and many other items would be removed. However, CETA could take two years to come into effect, as it requires the agreement of all EU members and the approval of Canada's provinces.

Canadian dairy farmers are against the agreement. They remain in favour of protection from foreign cheese producers and claim that European cheese will be dumped in the Canadian market. Canadian cheese producers argue that the industry is able to produce high-quality products for Canadian consumers but now this growing industry will face direct competition from cheaper, subsidised European cheese producers. Canadian cheese producers could indeed face difficulties, but the Government would provide compensation to address the negative effects of the agreement on the Canadian dairy industry.

But others are optimistic about the agreement, as it will allow Canadian beef and grain to gain new access to European markets. The vice-president of the Canadian Cattlemen's Association is also hopeful about the new agreement and believes that Canadian beef will be in 'strong demand' in the EU. Canadian producers will be able to sell an additional 50 000 tonnes of beef.

CETA's website claims that under the agreement 'Canada will now be one of the few developed countries in the world to have a guaranteed preferential access to more than 800 million consumers in the world's two largest economies, the EU and the United States'.

Source: CTV News 2013, with files adapted from The Canadian Press

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Table 1: Canada's current account of the balance of payments 2008–2012, C$millions

	2008	2009	2010	2011	2012
Total receipts	648 105	511 855	555 594	619 460	629 007
Total payments	646 197	557 605	614 013	667 926	691 222

Table 2: Canada's trade in goods: principal trading areas – seasonally adjusted, current C$millions

	December 2012	December 2013
Total exports	**38 619**	**39 722**
US	28 576	30 014
EU	3 028	2 640
Total imports	**38 635**	**41 381**
US	24 375	27 138
EU	3 257	3 385
Balance of trade in goods	**–16**	**–1 659**

(a) Compare Canada's current account balance in 2012 with its balance in 2008. [2]

(b) With the help of a diagram, explain how the removal of tariffs on EU goods imported into Canada would affect their price and quantity. [4]

(c) How would you decide whether Canada's cheese producers should be protected from competition from EU cheese producers? [4]

(d) Explain, using the theory of comparative advantage, how it is possible for consumers in both the EU and the Canadian economy to benefit from the movement towards free trade. [4]

(e) Evaluate any further information that would help you to assess the economic impact of Canada's trade agreement with the EU. [6]

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Section B

Answer any **one** question.

2 **(a)** Explain the functions of price, enterprise and profit in a free market economy. [8]

(b) Discuss whether an outward shift in an economy's production possibility curve is more likely to occur in a free market economy or a centrally planned economy. [12]

3 Most governments provide both defence and education services.

(a) Explain why defence and education services would not be provided in sufficient quantities if the government did not provide them. [8]

(b) Discuss how taxation and subsidies could improve the provision of defence and education services in an economy and consider the likely success of such policies. [12]

4 **(a)** Explain how an increase in the quantity of money in an economy and a decline in an economy's exchange rate can both cause inflation. [8]

(b) Discuss the impact of a high rate of inflation on an economy and consider whether reducing inflation should take priority over removing a deficit on the current account of the balance of payments. [12]

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