Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **October/November 2016**

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 **Raw sugar trade deal**

Mexico and the United States reach deal and avoid trade war

Mexico, the US and Canada are the three members of the North American Free Trade Agreement, which has given Mexico's sugar producers free access to the US market since 2008. In March 2014, however, the association that represents the US sugar industry accused Mexican sugar producers of dumping cheap, subsidised sugar into the heavily protected US market and costing US sugar producers nearly US$1 billion in income in 2013–14.

The US government threatened to impose duties on imports of sugar from Mexico, and Mexico was proposing to impose retaliatory duties on some US products imported into Mexico. A deal has now been reached to avoid these protectionist measures and thus prevent a possible trade war.

The deal would set a minimum price for sugar to guard against undercutting or keeping US prices artificially low, and limit the amount of sugar that may enter the US market. Mexico could export 1.4 million tonnes of sugar to the US in 2014. That compares with an estimated 1.9 million tonnes for the 2013 crop year. Companies such as chocolate producers and soft drink manufacturers may also be relieved they will not have to pay higher prices for Mexican sugar now that the large duties have been avoided. The US is a net importer of sugar and Mexico is one of its largest suppliers.

Under the agreement Mexican producers agreed to sell at a minimum price of US$0.21 per pound weight (about US$0.46 per kilo) for raw sugar, much lower than would have applied if the import duties had been imposed on the sugar.

Source: Reuters, 27 October 2014

Table 1: Price of raw sugar 2011–2013

	World sugar price (US$ per pound weight)	Sugar price in US (US$ per pound weight)
2011	0.27	0.38
2012	0.22	0.29
2013	0.18	0.21

Source: United States Department of Agriculture

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(a) (i) Explain **one** possible reason for the change in the world sugar price between 2011 and 2013. [3]

(ii) Explain **one** possible reason for the difference in the price of sugar in the US and the world price of sugar shown in Table 1. [2]

(b) (i) What is meant by 'dumping'? [2]

(ii) Explain why Mexican producers might choose to dump their sugar in the US market. [2]

(iii) Consider how an economist would decide whether the accusation that Mexican producers were dumping sugar in the US was justified. [2]

(c) With the help of a diagram, explain the likely impact on the US market for raw sugar if a minimum price higher than US$0.21 had been imposed in 2013. [3]

(d) Consider who, if anybody, in the US and Mexico might benefit from a trade war despite the advantages of free trade. [6]

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Section B

Answer any **one** question.

2 **(a)** With the help of a supply and demand diagram, explain how the introduction of an indirect tax on a good would affect the surplus enjoyed by the consumers of that good. [8]

(b) Discuss whether it is better to introduce an indirect tax or to adopt policies to improve consumers' knowledge and understanding to deal with the problem of demerit goods. [12]

3 **(a)** Explain, with the help of a diagram, what is meant by equilibrium national income, and show how this equilibrium changes when there is an increase in aggregate demand. [8]

(b) Discuss the factors that determine how much an increase in aggregate demand will affect prices, employment and the balance of payments of an economy. [12]

4 At the end of October 2014, the value of the US dollar on foreign exchange markets rose to a four-year high because it was believed that the US central bank was about to raise interest rates.

(a) With the help of a diagram, explain how exchange rates are determined in a free market and why an expected rise in interest rates in the US would cause the value of the US dollar to rise. [8]

(b) Discuss the probable impact of this exchange rate rise on the US economy and assess whether it is likely to benefit this economy overall. [12]

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Section A

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1 **Free Trade and Protectionism**

The US wins World Trade Organisation (WTO) trade enforcement disputes

The US has won a major victory at the WTO on behalf of the nation's farmers and the poultry industry. The WTO found in favour of the US in a dispute challenging India's ban on agricultural imports from the US such as poultry, meat, eggs and live pigs, allegedly to protect India from the spread of disease. The panel agreed that India's ban broke international trade rules and was imposed without sufficient scientific evidence.

This is the fourth major WTO victory that the US has announced this year. The US government is determined to extend economic opportunity for US workers, farmers and businesses.

Earlier US victories at the WTO in 2014 were:

- In June, the WTO found that China broke rules by imposing unjustified extra import duties on US cars. In 2013, an estimated US$5.1 billion of US car exports were covered by those duties.

- In August, the WTO found that China broke WTO rules by imposing quotas on Chinese exports of tungsten and molybdenum. These are important raw material inputs used by US manufacturers of products such as car batteries, wind turbines, energy-efficient lighting, steel, petroleum and chemicals.

- Also in August, the WTO agreed with the US that Argentina's import-licensing requirement and other import restrictions broke international trade rules. The Argentine measures unfairly restricted imports of US goods, potentially affecting billions of dollars of US exports, including computers, industrial and agricultural chemicals, transport equipment, machine tools, parts for oilfield rigs and refined fuel oil.

Source: The Prairie Star*, 19 October 2014*

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Table 1: US Trade in Goods with India 2009–2014

	2009	2010	2011	2012	2013	2014
Exports (US$ millions)	16 441	19 249	21 542	22 106	21 842	23 600
Imports (US$ millions)	21 166	29 533	36 155	40 513	41 845	45 228

Source: US Census Bureau

(a) (i) Compare the US balance of trade with India in 2009 with that in 2014. [2]

(ii) Explain **two** factors, other than India's ban on US agricultural products, that could explain the change in the US balance of trade that you have identified. [4]

(iii) In addition to the balance of trade in goods, what other balances would you require to calculate the US current account balance with India? [2]

(b) (i) Use a diagram to show how an import duty on a product affects its price. [2]

(ii) What is likely to determine the extent of the change in sales when an import duty is imposed on US cars in China? [2]

(iii) Explain a possible reason why China imposed export quotas on tungsten and molybdenum. [2]

(c) Consider whether the protectionist measures adopted by countries such as India, China and Argentina regarding trade with the US could ever be justified. [6]

Section B

Answer any **one** question.

2 **(a)** Explain, with the help of a diagram, what happens in the market for a product when the price of a substitute increases, and how economists would measure the relationship between these two products. [8]

(b) Discuss how habit-forming demerit goods and goods with lots of substitutes are each likely to respond to price rises, and consider the extent to which knowledge of their likely response would be useful to government policymakers. [12]

3 **(a)** Explain any **two** factors that cause the supply of a product to be price-inelastic. [8]

(b) Discuss the policies that a government might adopt to increase the price elasticity of supply of agricultural goods in an economy and consider which policy is likely to be most effective. [12]

4 **(a)** Explain what is used as money in a modern economy and how an increase in the quantity of money can cause prices to rise. [8]

(b) Discuss the policy options available to a government faced with inflation, and consider which is most likely to be effective. [12]

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Section A

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1 **Economic problems in Kyrgyzstan**

Rouble decline affects Kyrgyzstan

Kyrgyzstan is a developing economy which has a border with Russia. At the local market in the capital, Bishkek, the price of meat increased by 9% in six weeks in 2014. A local butcher said that as a result sales had fallen. 'I usually sell 400 kilos of meat every month, but in September I sold only 250 kilos,' she complained. In Bishkek, food prices increased by up to 25% over 12 months. Another shopkeeper increased what he charged for flour by 15%, but sales did not decline by very much. 'We all need flour because we all need to eat bread, macaroni, dough,' he said. 'It's not something people can cut back even if it becomes very expensive.'

Meanwhile, a sharp decline in the value of Russia's currency, the rouble, since early September is having an impact upon countries across Central Asia, where economies are dependent on remittances (transfers of income) from workers in Russia. By October 2014 the value of the rouble had fallen 20% against the US dollar since the start of the year. The fall had accelerated in September as the price of oil – Russia's main export – dropped to a four-year low. As local currencies followed the value of the rouble downward, the costs of imported essentials rose.

In Kyrgyzstan, remittances from the millions of workers in Russia have started to fall. In recent years, these cash transfers have contributed the equivalent of about 30% of national income to Kyrgyzstan's economy. As the rouble depreciates, however, it purchases fewer US dollars to send home. Any further drop may significantly reduce consumer demand.

This month the International Monetary Fund said it expects consumer prices in Kyrgyzstan to increase by 8.0% in 2014 and 8.9% in 2015, compared with 6.6% last year. One factor that could have an effect is a policy shift at Russia's central bank, which has already spent over US$50 billion this year attempting to protect the value of the rouble. Some people have condemned efforts to support the currency, arguing that a weaker rouble is good for exports.

In Kyrgyzstan the central bank has used some of its limited reserves to reduce the fall in the currency. Nevertheless, Kyrgyzstan's currency, the som, has fallen in value by 12% against the US dollar this year.

Source: Adapted from Asia Times Online, October 2014

(a) **(i)** Calculate the price elasticity of demand for meat in Bishkek. [2]

(ii) How does the price elasticity of demand for meat differ from the price elasticity of demand for flour in Bishkek? [2]

(iii) How might an economist explain this difference? [2]

(b) With the help of a supply and demand diagram, explain how the Russian central bank is 'attempting to protect the value of the rouble'. [3]

(c) Consider the extent to which the economic performance of Kyrgyzstan would be affected by the fall in remittances from Russia. [5]

(d) Discuss whether the actions of the Russian and Kyrgyzstan governments in protecting the value of their currencies are likely, on balance, to have benefited their economies. [6]

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Section B

Answer any **one** question.

2 **(a)** Distinguish between the concepts of market equilibrium and disequilibrium and show what happens in a free market for a good when disequilibrium exists. [8]

(b) Discuss whether subsidies or improved information is the more effective policy to deal with the problems raised by the under-consumption of merit goods. [12]

3 **(a)** Explain with the help of a diagram why production possibility curves are usually drawn with increasing opportunity costs, and show how they can be used to illustrate scarcity. [8]

(b) Discuss whether it is likely that economies that have an increase in labour and a high rate of technological innovation will come nearer to solving the economic problem. [12]

4 **(a)** Using diagrams, explain how rising raw material prices and a fall in the rate of interest might cause different types of inflation. [8]

(b) Discuss how the policy chosen to reduce the rate of inflation will be influenced by the cause of the inflation. Consider which type of inflation is most difficult to reduce and why. [12]

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