Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **October/November 2022**

1 hour 30 minutes

5459822026

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **two** questions in total:
  - Section A: answer Question 1.
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- Follow the instructions on the front cover of the answer booklet. If you need additional answer paper, ask the invigilator for a continuation booklet.
- You may use a calculator.
- You may answer with reference to any economy you have studied where relevant to the question.

INFORMATION

- The total mark for this paper is 40.
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Section A

Answer this question.

1 Governments and markets

Prices, according to economists, are determined by supply and demand. In many times and places, however, prices have been set by governments. For example, in January 2020, the government of Argentina updated its list of maximum prices, setting guidelines for over 300 products. Consumers, via a smartphone app, can report any prices of these products that are above the maximum.

The World Bank has collected data on the extent to which the governments of developing economies have intervened in markets to set prices. Table 1.1 shows the results of this research.

Table 1.1: Government intervention in product markets to influence prices in developing economies

Product market	Percentage of governments intervening in the market to influence price	Examples
Energy	89	Petrol in Iran
Food	76	Bread in Benin Rice in Haiti
Building materials	13	Cement in Burkina Faso

Source: Adapted from 'In a fix', The Economist, 11 January 2020

Governments generally impose price controls for one of three reasons:

- to redistribute income in an economy: maximum prices help the poor afford the necessities of life, whereas minimum prices support the livelihoods of farmers
- to stabilise a market: governments use stocks to smooth fluctuations in the price of a commodity like cocoa, buying when there is excess supply in the market and selling when there is excess demand
- to control inflation: maximum prices have been used in many countries

Many economists have been critical of the use of price controls by governments. In a market without government intervention, a product's price acts as a signal of its scarcity and an incentive to overcome scarcity. However, minimum prices can lead to food rotting in warehouses while maximum prices can lead to hoarding and black markets.

Another reason not to impose price controls in an economy is that they can be very unpopular. For example, in Santiago, the capital city of Chile, an increase in the minimum price on the public transport system led to widespread unrest in 2019. In the same year, the government of Iran decided to raise the minimum price of fuel sharply and suddenly, leading to a great deal of protest.

A representative of the World Bank has stated that one reason not to impose price controls in an economy is that they can be hard to remove, expressing the view that 'it is better not to have them in the first place.'

Source: Adapted from 'In a fix', The Economist, 11 January 2020

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(a) Explain how 'a product's price acts as a signal of its scarcity'. [2]

(b) Explain **one** possible reason why the Government of Iran may have decided to raise the minimum price of fuel in 2019. [2]

(c) Explain, with the help of a diagram, how an effective minimum price would affect the market for a basic food, such as rice in Haiti. [4]

(d) 'Governments use stocks to smooth fluctuations in the price of a commodity like cocoa.'

Consider whether government action to smooth fluctuations helps the workings of the price mechanism. [6]

(e) Discuss whether maximum price controls will always be effective in controlling inflation. [6]

Section B

Answer **one** question.

2 **(a)** Explain **two** factors that will determine the price elasticity of demand for a particular brand of car and how this price elasticity of demand may change over time. [8]

(b) Discuss whether knowledge of price elasticity of demand or income elasticity of demand would be of greater use to a business that produces cars. [12]

3 **(a)** Explain, with the use of a diagram(s), how the production possibility curve of an economy could be affected by a decrease in the quantity of labour available, but an increase in its quality. [8]

(b) Discuss whether supply side policies will be successful in increasing the quantity and quality of the factor enterprise in a modern economy. [12]

4 **(a)** Explain, with the use of a diagram(s), **two** factors that could bring about a depreciation in the value of a country's exchange rate in a freely floating exchange rate system. [8]

(b) Discuss whether protectionist policies would be the most effective way to correct a current account deficit on the balance of payments in an economy. [12]

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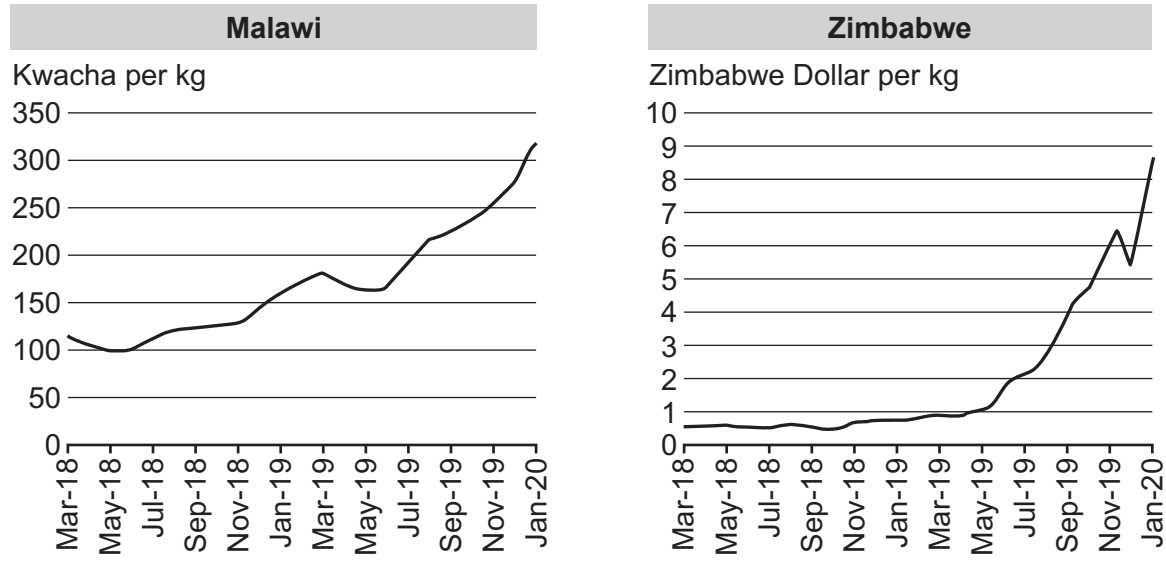
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Section A

Answer this question.

1 **Variations in the price of maize**



Source: FAO/GIEWS Food Price Monitoring and Analysis Tool.

Fig. 1.1: The price of maize in Malawi and Zimbabwe, March 2018 to January 2020

Table 1.1: Maize production in Malawi and Zimbabwe

	2015–2019 average (000 tonnes)	2019 (000 tonnes)	2020 forecast (000 tonnes)	Change 2019–2020 %
Malawi	2959	3392	3600	6.1
Zimbabwe	1313	1701	777	–54.3

Source: Adapted from Food and Agriculture Organisation of the UN. Country Briefs: Malawi and Zimbabwe 01/06/20

Extract 1: World export prices of maize fall sharply

Export prices of maize declined further in April 2020, with the United States (US) maize price nearly 10% down from April 2019. It is now at the lowest value in more than ten years. Large global supplies and good harvest prospects in South America continue to reduce prices. In addition, lower demand for maize from the biofuel and animal feed industries is depressing the price further.

Source: Food and Agriculture Organization of the United Nations 12/05/2020

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Extract 2: Zimbabwe takes steps to curb the rise in maize prices

Despite a falling world price for maize, the price of this staple food in Zimbabwe has continued to increase and is now at an exceptionally high level. The increased price mostly results from continued weakness in Zimbabwe's currency that has damaged the country's ability to import maize. In addition, the sharply reduced harvest of maize in Zimbabwe resulted in low domestic supplies. In an effort to tackle the soaring prices, the government has implemented several policies. To increase market supplies, the government removed a ban on imports of certain types of maize. It also increased producer subsidies on maize by 40%. Poorer households should benefit from access to this subsidised maize.

Source: Food and Agriculture Organization of the United Nations 17/02/2020

Extract 3: Malawi raises guaranteed minimum price for maize

Malawi's Ministry of Agriculture has released updated guaranteed prices for cereals produced on Malawi's farms in 2020. These are the minimum prices that farmers will receive for their crops. The guaranteed price for the food staple, maize, was raised by just over 10%. The government has begun purchasing maize at this increased price. This change in the minimum price is expected to increase the production of maize in 2020 and in the future to an average level of 3.7 million tonnes per year.

Source: Food and Agriculture Organization of the United Nations 10/04/2020

(a) Identify **one** possible cause of the decline in world export prices of maize. [1]

(b) Explain **one** change in a factor of demand that would lead to maize prices rising in Malawi despite the increase in domestic production. [2]

(c) With reference to Extract 2 explain **two** reasons why maize prices are rising in Zimbabwe despite the fall in the world export price of maize. [4]

(d) Explain, with the help of a diagram, how a rise in the minimum price of maize in Malawi will encourage production. [3]

(e) Consider, with the help of a diagram, whether a subsidy on maize production will benefit both the producers of maize and poorer households in Zimbabwe equally. [4]

(f) Discuss whether maximum prices on staple foods such as maize are likely to be effective in providing food for poorer households in Zimbabwe. [6]

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Section B

Answer **one** question.

2 In many economies, the use of cash is declining as people use contactless payments that transfer funds directly between bank deposits.

(a) Explain what represents money in a modern economy and how the use of contactless payments without the use of cash will affect the functions of money. [8]

(b) Discuss whether an expansionary monetary policy will be successful in correcting deflation. [12]

3 **(a)** Explain how a production possibility curve can be used to demonstrate scarcity, choice and opportunity cost. [8]

(b) Discuss the difficulties that might be encountered when adopting supply side policies to expand the productive capacity of an economy and consider whether these difficulties can be overcome. [12]

4 An economy adopts a freely floating exchange rate.

(a) Explain how this economy's exchange rate is likely to be affected when its inflation rate is much higher than inflation rates in its trading partners. [8]

(b) Discuss the advantages and disadvantages that result from a rise in an economy's terms of trade and consider whether a rise is likely to be of overall benefit to an economy. [12]

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Section A

Answer this question.

1 Pakistan's agriculture survives on subsidies

As in most developing countries, the agricultural sector in Pakistan is heavily dependent on subsidies. Agriculture is an important activity, employing 45% of the population. Domestic production is vital in providing food for its growing population. Farming in Pakistan is not very profitable and without subsidies, many farmers would be forced to leave their farms.

Despite subsidies, as shown in Table 1.1, the cost of production in Pakistan is much greater for a range of staple products than it is in India where farmers are more heavily subsidised.

Table 1.1: Cost of production after subsidies of selected products in Pakistan and India, 2018 (Pakistan Rupees per unit)

	Pakistan	India
Wheat	76	51
Cotton	127	88
Rice	124	68
Sugar cane	222	142
Maize	119	53

The higher cost of production in Pakistan has serious implications for Pakistan's participation in global trade in agricultural products. This problem is particularly critical as Pakistan seeks to increase exports to reduce a deficit on the current account of the balance of payments.

A complaint of farmers is that GST, a sales tax, is charged when they purchase fertilisers. In May, the government gave in to pressure and cut GST on fertilisers from 17% to 2%. Farmers' leaders want the tax to be completely removed from fertiliser sales. Their priority, however, is for a large increase in the subsidy paid to farmers to a level comparable to that paid to farmers in India. In Pakistan's current economic position this prospect appears to be remote.

Pakistan's farmers also complain about the subsidies that are paid to farmers in richer neighbouring countries. They strongly argue that these subsidies are unfair on farmers from developing countries and are holding back their economic development.

Source: Agriculture survives on subsidies, Amjad Mahmood, Dawn, 27 May 2019

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(a) Explain what might be the opportunity cost if the Pakistan government agreed to pay subsidies to Pakistan's farmers comparable to those paid to India's farmers. [2]

(b) **(i)** With reference to Table 1.1, state in which product group Pakistan's farmers are most disadvantaged. [1]

(ii) Explain how the lower level of subsidy currently paid to Pakistan's farmers is likely to affect Pakistan's trade in agricultural goods when competing with India in international markets. [3]

(c) Analyse, with the help of a diagram, how the sales tax on fertilisers affects the market for fertilisers in Pakistan. [4]

(d) Explain **two** other ways, apart from subsidies and reductions in sales tax, in which the government might support Pakistan's farmers. [4]

(e) Discuss whether agricultural subsidies should **not** be paid to farmers in countries which have lower opportunity costs in other areas of production. [6]

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Section B

Answer **one** question.

2 **(a)** Explain why demerit goods are over-consumed and merit goods are under-consumed. [8]

(b) Discuss the extent to which the introduction of a maximum price in a market will benefit consumers. [12]

3 **(a)** Explain the difference between a progressive direct tax and a regressive indirect tax, with an example of each. [8]

(b) Discuss whether an increase in direct taxes or an increase in interest rates is the more effective way of reducing inflation. [12]

4 **(a)** Explain how a higher rate of inflation in an economy compared to its trading partners and a decline in the exchange rate will each affect the terms of trade in an economy. [8]

(b) Since 2018, China and the United States (US) have been imposing tariffs on trade with each other.

Discuss the view that some will benefit and some will lose but the overall impact of these tariffs will be negative. [12]

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