

UNIVERSITY OF CAMBRIDGE
INTERNATIONAL EXAMINATIONS General

ECONOMICS 9708/23 Paper 2 Data Response and Essay (Core) **May/June 2010 1 hour 30 minutes**

Additional Materials: Answer Booklet/Paper

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.

Do not use staples, paper clips, highlighters, glue or correction fluid.

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.

Section A

Answer this question.

1 Chinese Bicycles

China is famous for its bicycles. There has even been a song written about those in Beijing. China is the world's leading producer and exporter of bicycles. Table 1 gives its output for two years compared with other leading producers.

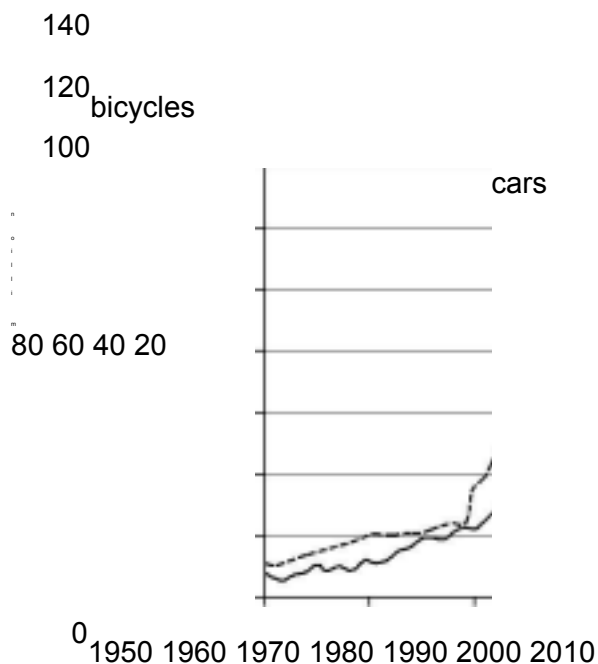
Table 1 Bicycle production (millions), selected producers

Year	China	Italy	Taiwan	Japan	US
1997	30.0	4.0	11.9	1.8	6.0
2007	87.0	2.5	4.9	1.1	0.3

In 2007, China exported 59 million bicycles, of which 17.3 million went to the US and 9.7 million to Japan. The European Union (EU) imported only 0.8 million, mainly because of a 48.5% anti dumping import duty on Chinese bicycles. Taiwan, China's major competitor, concentrates on more expensive, higher quality products, and exported 4.7 million bicycles.

Fig. 1 shows the world output of bicycles and cars.

Fig. 1 World bicycle and car production, 1950 to 2007



In 2007 domestic sales of Chinese bicycles fell 3.8% to 28 million. Between 1995 and 2005 the number of bicycles owned in China fell from 670 million to 435 million, while car ownership rose from 4.2 million to 8.9 million.

- (a) (i)** Summarise the main changes in bicycle production shown in Table 1. [2] **(ii)** How might the changing pattern of production be explained? [3]
- (b)** Explain the likely effects for Chinese bicycle manufacturers of the anti-dumping import duty introduced by the EU. [3]
- (c) (i)** Use Fig.1 to compare the trend in the world production of bicycles with that of cars. [2]
- (ii)** How might the change in Chinese ownership of bicycles and cars between 1995 and 2005 be explained? [4]
- (d)** Discuss the externalities that might arise from the use of bicycles and cars. [6]
- (a) (i) Overall during 1997 and 2007 world output of bicycles increased from 53.7 million to 95.8 million. This represents almost 78 percent increase. Most of this increase came from China whose production of bicycles more than doubled.
- (a) (ii) Except for China all other countries' bicycle production decreased during the period for which information has been provided in table 1. Lower bicycle production by countries like Italy, Taiwan, Japan and US might be because of their reduced domestic demand. This lower domestic demand be because of the fact that countries' average national income levels have increased over time and now citizens of these economies have better living standards and hence can afford improved means of transportation including private cars, public transport.
- Moreover increase cost competitiveness of Chinese bicycles might mean that it is cheaper for these economies to import from China than to locally manufacture bicycles. Moreover improved and efficient transportation mechanism, nowadays, mean that countries can afford to cheaply import products such as bicycles from far off countries.
- (b) Dumping is illicit competition practice that justifies use of protectionist tools by the economies

that consider themselves victim to this illegal competition practice. Dumping is when economies export certain products at prices below their cost of production. This marketing strategy aims at destroying local competition to help establish monopoly and therefore to ensure unlimited abnormal profits.

Hence Chinese producers are expected to destroy local industry of bicycles in EU and hence these products are subject to protectionist tools.

Such export constraints can adversely affect economies' export revenue and therefore will reduce their balance of trade balances. Moreover lower aggregate demand levels due to lower exports would mean lower national income and employment levels. Moreover if export demand for economies' certain products remain low for indefinite time period then resource reallocation will become necessary. Lower export earnings result in lower foreign exchange reserves which will limit economy's ability to intervene in currency markets to affect its exchange rates.

(c) (i) Except for 1970, in all other years world bicycle output was more than world's car production levels. Before 1970 the world bicycle levels were not too much higher than world car production but after 1970 the difference significantly increased because of much faster growth of in bicycle production as compared to car production.

(c) (ii) During 1995 and 2005 Chinese ownership of bicycles reduced from 670 million to 435 million. This represents 35 percent fall in Chinese ownership of bicycles. On the other hand, during the same time period Chinese ownership of cars doubled increasing from 4.2 million to 8.9 million. This represents almost 112 percent increase.

Increased average national income level of Chinese might have helped them to afford improved means of transportation like private cars. Cars being luxurious items are expected to have elastic income demand as opposed to bicycles that are expected to negative income elasticity of demand. This means that during rising income levels consumers will switch from inferior products to normal goods like from bicycles to cars. Moreover more price elastic demand for cars will result in increased demand for cars following decrease in private car usage. This might be due to cheaper fuel and cheaper cars.

(d) Externalities refer to positive or negative effects on third parties. Positive externalities are when

certain production or consumption activity is benefiting the people who are not directly involved in certain economic transaction. Similarly negative externalities are when certain production or consumption activity causes harmful effects on third party. For instance pollution caused by certain production process can be defined as negative externality. On the other hand, consumers benefitting from someone else's consumption or production are known to be experiencing external benefits. By someone getting vaccination will benefit other people who come into contact with them.

Unlike use of bicycles cars' usage involves negative externalities. Greater fuel consumption due to greater car usage will adversely affect environment due to increased air pollution. This is due to greater harmful gas emissions. As far as production externalities of bicycles and cars are concerned, both products might involve negative externalities. However since car is much more technologically sophisticated product than bicycle hence cars' production is expected to involve more negative externalities than bicycle manufacturing.

As far as positive externalities are concerned, there might be no benefits received by third parties through someone's usage of bicycles or cars.

However effective policy making will help economies achieve more efficient resource usage. Use of indirect taxation and subsidies are effective means of controlling negative and positive externalities respectively.

