Cambridge International AS & A Level

Cambridge Assessment International Education
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **May/June 2019**

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 **Question 1**.
Brief answers only are required.

Section B
Answer **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.

This document consists of **4** printed pages and **1** Insert.

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Section A

Answer this question.

1 Trade tensions between China and the United States

At a World Economic Forum meeting in Switzerland in 2017, the Chinese President re-affirmed his country's commitment to free trade and pledged never to start a protectionist 'trade war' or to benefit from a devaluation of its currency, the yuan. Meanwhile, the United States (US) President stated that the 'America First' doctrine means increased protectionism and he repeatedly threatened to impose tariffs and import quotas on Chinese goods.

During 2016, the value of the US dollar rose against most currencies. In contrast, the Chinese yuan weakened significantly from 6.20 yuan per US dollar at the end of 2014 to 6.95 yuan at the end of 2016. The US President has accused China of intentionally devaluing the yuan in order to boost China's export competitiveness. Despite strong downward pressure on its currency, China has attempted to keep the yuan–US dollar exchange rate relatively stable, costing more than US$2 trillion of its official foreign exchange reserves. China has stated that it does not want the yuan to fall in value any more than the US does, but no country has complete control over its exchange rate.

China, like Japan and Germany, usually has a current account surplus on the balance of payments, but China's current account surplus as a percentage of GDP fell in 2016 and the International Monetary Fund expects it to decrease further, as exports continue to fall.

There are three policy paths that a country can follow with regard to its exchange rate: a completely free float, a managed float or a fixed (pegged) exchange rate. Each of these has various advantages and disadvantages. At present, China's policy is a managed float, but some economists have argued that it is the yuan–US dollar exchange rate that is regarded as being especially important and so it might be better if China decided to fix (peg) the yuan to the dollar. Fig. 1.1 shows the yuan–US dollar exchange rate over three years.

Source: Adapted from China Daily, 10–12 February 2017

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Fig. 1.1: Yuan–US dollar exchange rate, 2014–2017



Source: Trading Economics

(a) Describe, using Fig. 1.1, how the value of the yuan against the US dollar has changed between 2014 and 2017. [2]

(b) The US President threatened to increase protectionism of the US economy.

Explain, using a diagram, how **one** of the methods of protection mentioned in the article can work. [4]

(c) Explain **two** effects of the fall in China's current account surplus for China's economy. [4]

(d) Explain **two** likely reasons why China has opted for a managed float exchange rate system. [4]

(e) Discuss who would be the winners and the losers from a protectionist 'trade war' between the US and China. [6]

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Section B

Answer **one** question.

2 **(a)** Explain, with the help of diagrams, how **(i)** constant and **(ii)** increasing opportunity costs determine the shape of an economy's production possibility curve. [8]

(b) Discuss what the most significant issues of transition are that a country will face as it moves from a planned economy to a mixed economy. [12]

3 **(a)** Explain, with the help of a diagram, the disadvantages to consumers of introducing a maximum price in a market for an essential food item. [8]

(b) Discuss whether the advantages of privatising an industry will always outweigh the disadvantages. [12]

4 **(a)** Explain, with the help of a diagram(s), how changes in aggregate demand and aggregate supply can cause inflation in an economy. [8]

(b) Discuss whether deflation is more of a problem in an economy than inflation. [12]

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Section A

Answer **all** questions.

1 **Egypt's economic difficulties**

Table 1.1: Egypt, selected economic indicators, 2014–2019

	Consumer Price Index (base year 2000)	Current account balance (US$ billion)	Unemployment rate (% of total labour force)
2014	304	–2.356	13.4
2015	337	–12.182	12.9
2016	371	–18.659	12.7
2017	453*	not available	12.6*
2018	530*	not available	11.8*
2019	587*	not available	10.7*

* International Monetary Fund (IMF) estimates

Source: International Monetary Fund, World Economic Outlook Database, April 2017

Egypt's Central Agency for Public Mobilization and Statistics (CAPMAS) reported that Egypt's annual inflation rate surged to 32.9% in April 2017, compared to 10.9% in 2016. This is considerably higher than the expected rate that was estimated by the IMF shown in Table 1.1.

Inflation had been rising in Egypt since the decision of the Central Bank of Egypt (CBE) in November 2016 to float Egypt's currency (the Egyptian pound) in a move that caused a 50% depreciation in its value against the US dollar. This came as part of the Egyptian government's reform programme, started in 2014, to reduce the budget deficit and acquire a US$12 billion loan from the IMF to ease the US dollar shortage that had restricted Egypt's business activity.

A macroeconomic research group has said that 'The sharp rise in inflation could largely be attributed to the effects of the weaker Egyptian pound. Inflation was also made worse by levying a new indirect tax called Value Added Tax (VAT), and cutting subsidies on energy in November 2016.' On the same day as the CBE floated the Egyptian pound it raised the interest rate by 3 percentage points to 14.75%.

Egypt's VAT replaced the previous sales tax, which economists said created market distortions. It was expected to broaden the tax base in a country where the government struggles to collect income tax because of a large informal economy and widespread tax avoidance. The VAT does not apply to basic goods and services to protect the poor.

Source: Islam Al Naggar, Egypt Today, 10 May 2017, and Reuters, 29 August 2016

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(a) **(i)** What happened to Egypt's current account balance between 2014 and 2016? [1]

(ii) With reference to Table 1.1 calculate the percentage rate of inflation in Egypt between 2016 and 2017 that was estimated by the IMF. [1]

(b) Identify **two** Canons of Taxation satisfied by Egypt's new VAT. [2]

(c) Explain how the decline in the value of the Egyptian pound could cause demand-pull inflation and cost-push inflation in Egypt. [4]

(d) Explain how the estimated changes in unemployment in Table 1.1 might be expected to affect the current account balance of Egypt after 2016. [6]

(e) Discuss whether the Egyptian government's fiscal and monetary policies in the article are likely to succeed in curing the inflation problem. [6]

Section B

Answer **one** question.

2 **(a)** Explain how economists use the concept of elasticity to distinguish between inferior goods and necessary goods when consumer incomes change. [8]

(b) Discuss how businesses might attempt to change the price elasticity of demand for their products and consider which approach is most likely to be successful. [12]

3 **(a)** Distinguish between regressive and progressive taxes and explain whether you would use an income tax or a specific indirect tax to make post-tax incomes more equal. [8]

(b) Discuss whether subsidies on the production of **all** types of good will lead to an improved allocation of resources. [12]

4 **(a)** Explain, using examples, what is meant by 'protectionism' and show with the help of a diagram how export subsidies can be considered as a form of protectionism. [8]

(b) Discuss the arguments that are used to justify protectionism and consider whether these arguments can ever be justified. [12]

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ECONOMICS **9708/23**

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Section A

Answer this question.

1 **Difficult times for OPEC and Nigeria**

The Organisation of Petroleum Exporting Countries (OPEC) has 13 members and produces over 30 million barrels of oil a day, responsible for half of global production. Its members, strongly influenced by Saudi Arabia, seek to limit the supply of oil in order to sustain stable prices to aid their own economic development.

OPEC members have become concerned about the increase in oil production in the United States (US) due to the use of fracking (a new technique for extracting oil) and its impact on world oil prices and OPEC's own market share. In 2014, OPEC decided to increase its own supply of oil in a bid to bankrupt higher-cost US producers. The effects were remarkable. A 12% increase in OPEC's production saw the world price fall by around 60% to less than US$30 per barrel. This was much lower than US producers' costs but it led to a 45% cut in OPEC's oil revenue.

In late 2016, it was clear that governments in OPEC countries were suffering from reduced oil revenues. There was also growing evidence that US oil producers had been able to cut costs to remain competitive with OPEC, even though the world price was still well below US$50 per barrel. This was thought to be the minimum price for producing oil in the US. In a surprising change of policy, OPEC decided to cut its oil production by 3%. The result was a 10% increase in the world price of oil.

Nigeria is the largest economy in Africa. It produces around 8% of OPEC's total oil supply which accounts for over 80% of Nigeria's export revenue. Nigeria's economy has been seriously affected by OPEC's decision to increase supply on the world market. Its Gross Domestic Product (GDP), a measure of total national output, has continued to fall along with oil output. The slowdown in the economy has affected taxation paid to the government. In addition import restrictions have been put in place to try to offset a severe shortage of foreign currency.

Source: Sunday Telegraph 4 December 2016

Fig. 1.1 and Fig. 1.2 show the changes in Nigeria's crude oil production and the relative changes in oil output from 2015 to 2016.

Fig. 1.1: Nigeria's oil output, 2015–2016

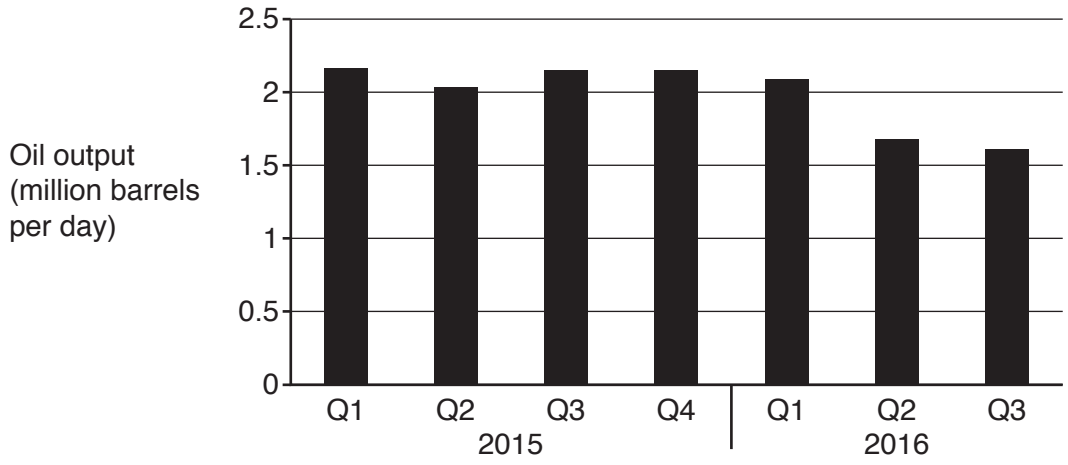
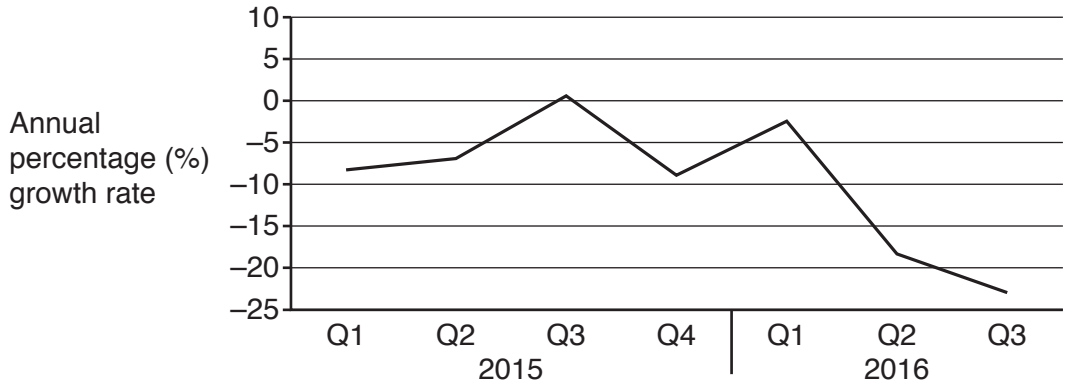


Fig. 1.2: Nigeria's annual growth rates for oil production



Source: Nigerian Bureau of Statistics, 2016

(a) Describe, using Fig. 1.1, the change in oil production in Nigeria between 2015 and 2016. [2]

(b) Compare, using supply and demand diagrams, how OPEC's decisions affected the world price of oil in 2014 and in 2016. [4]

(c) 'The demand for OPEC's oil is price inelastic.'

What evidence is there in the information to support this claim? [2]

(d) Fig. 1.2 shows that production in Nigeria's oil sector declined sharply from Q1 of 2016. During this period, total national output for Nigeria fell by an annual rate of only around 2%.

What can be inferred from this about the relative importance of the non-oil sectors in Nigeria? [2]

(e) Analyse, using aggregate demand and aggregate supply, **two** likely effects of OPEC's policies on the economy of Nigeria. [4]

(f) Discuss, with the help of the information, the extent to which OPEC will be able to control the world price of oil. [6]

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Section B

Answer **one** question.

2 **(a)** Using examples, explain why merit goods are said to be under-consumed and demerit goods are over-consumed. [8]

(b) Discuss whether merit goods should always be subsidised and demerit goods always taxed. [12]

3 **(a)** Explain the difference between the causes of cost-push inflation and demand-pull inflation. [8]

(b) Discuss the most serious problems faced by an economy with a high and increasing rate of inflation. [12]

4 **(a)** Explain the benefits of free trade as suggested by the principle of comparative advantage. [8]

(b) Despite the benefits of free trade, there has been a recent increase in protectionism by some developed and developing economies.

Discuss the possible reasons for this increase. [12]

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