Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **May/June 2020**

1 hour 30 minutes

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.
  - Section B: answer **one** question.
- 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.
- The number of marks for each question or part question is shown in brackets [ ].

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Section A

Answer this question.

1 **The Lagos economy is working**

Nigeria discovered oil 50 years ago and is now the world's sixth biggest oil exporter. The recent increase in global oil prices has had a very large positive effect on the country's balance of trade and has also improved the country's terms of trade.

Lagos is the largest city in Nigeria, with a population of over 20 million, and has undergone a successful economic transformation in recent years. It has used the private sector to become the most productive and dynamic part of Nigeria's economy. The owner of one of Nigeria's largest companies has stressed the enormous economic progress that the country has made in recent years: "I'm a great believer in Nigeria because the opportunities here are enormous." His company's success shows what private enterprise can achieve in a mixed economy especially if it is provided with the right incentives by the government.

Most Nigerian entrepreneurs are operating in Lagos and entrepreneurship has certainly played a key role in the modern Lagos economy. Start-up initiatives have been encouraged and the need to be innovative has been increasingly recognised, leading to the development of new goods, services and markets. The city is the centre of thriving music, fashion, film and technology industries that have significant influence throughout Africa.

A 'free trade zone' on the edge of Lagos has been established where private sector firms pay no business taxes to the government and there are now numerous start-up enterprises that are thriving. The government aims to lower costs, reduce bureaucracy and make the economy more flexible and efficient with the hope of boosting trade. The zone is located next to a deep sea port and has good road connections with both the rest of Nigeria and other countries in the region.

Lagos is an important transport hub, with three major ports and West Africa's most important international airport. In 2016 the output of Lagos was valued at US$136 billion while Nigeria's total national output was valued at US$405 billion.

A former governor of the Nigerian central bank, has stated: "Since 2000, Lagos has been transformed. In terms of an improved infrastructure and a supportive economic environment, the government has given firms a greater opportunity to thrive."

Source: Adapted from The Financial Times, 26 March 2018

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(a) Calculate the percentage of Nigeria's national output that is accounted for by Lagos. [1]

(b) Distinguish between a country's balance of trade and its terms of trade. [3]

(c) Explain the contribution of the factor enterprise to the successful economic transformation of Lagos. [4]

(d) **(i)** Explain why 'free trade zones' (FTZ) can be considered a supply-side policy. [2]

(ii) Explain how measures to reduce protection through policies such as 'free trade zones' encourage specialisation and the development of comparative advantage in Nigeria. [4]

(e) Discuss whether government intervention to encourage private sector firms, in a mixed economy such as Nigeria, is always likely to be successful. [6]

Section B

Answer **one** question.

2 **(a)** Explain, with the aid of a production possibility curve (PPC) diagram, why scarcity makes choice inevitable for firms and how each choice has an opportunity cost. [8]

(b) Discuss the view that the only goods a government should produce are public goods. [12]

3 There is increasing concern about the impact of foreign holidays on the environment of the host country.

(a) Explain, with the aid of a demand and supply diagram, **two** factors that might cause an increase in the demand for foreign holidays. [8]

(b) Discuss whether an indirect tax on foreign holidays is likely to be effective in reducing the number of holidays taken. [12]

4 **(a)** Explain, with the aid of a diagram, **one** demand factor and **one** supply factor that can cause the depreciation of a foreign exchange rate. [8]

(b) Discuss whether an appreciation of a country's foreign exchange rate is likely to cause **both** a rise in inflation and a decrease in employment in its economy. [12]

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ECONOMICS **9708/22**

Paper 2 Data Response and Essay **May/June 2020**

1 hour 30 minutes

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Section A

Answer this question.

1 Argentina raises interest rates to 40 per cent

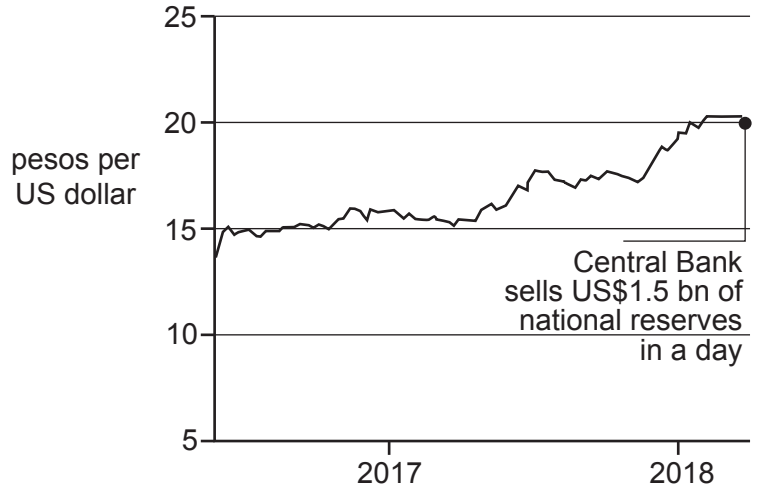


Fig. 1.1: Argentina's exchange rate (pesos per US dollar), May 2016 to May 2018

Source: BBC/Bloomberg

On 4 May 2018, Argentina's central bank raised interest rates to 40%. The day before this increase they were raised from 30.25% to 33.25%. A week earlier, they were raised from 27.25%. The rises were aimed at supporting Argentina's currency, the peso, which lost a quarter of its value over the previous year. Despite these rises, the peso, which before the economic turmoil in Argentina in 2001–2002 was fixed at parity with the US dollar, was trading at about 22 pesos to the US dollar. Risks to the peso had been developing for some time. These included large budget and current account deficits, a heavy government debt burden, persistent high inflation and an overvalued currency.

Inflation, a long-standing problem in Argentina, was 25% in 2017, the highest annual rate in South America except for Venezuela. The central bank has set an annual inflation target of 15% and has stated it will continue to take measures to achieve it.

Argentina's new president is pursuing a pro-market economic reform programme, seeking to reverse the protectionism and high government spending of previous governments. The president has pledged to reduce government spending drastically. The political opposition wants to stop him from removing subsidies on a range of basic household products, including gas and electricity. Removing the subsidies may bring more inflation in the short term but could help bring it down from its current high level to an annual rate of about 5% by 2020.

International and domestic investors still believe the president has a good plan for Argentina's economic recovery, but they are not convinced he has enough political support to achieve it.

Source: BBC News, 4 May 2018

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(a) State what the upward trend shown in Fig. 1.1 means has happened to the value of the peso between 2016 and 2018. [1]

(b) The central bank of Argentina sold US dollars from its foreign exchange reserves to a value of US$1.5 billion on one day in May 2018.

With the help of a supply and demand diagram, explain what effect you would expect this intervention to have on the value of the Argentine peso. [3]

(c) In the extract it is stated that risks to the peso have been developing for some time and that large budget and current account deficits are some of these risks.

(i) Distinguish between a budget deficit and a current account deficit. [2]

The extract also states that persistent high inflation represents a risk to the peso.

(ii) Explain **one** way in which persistent high inflation represents a risk to the peso. [2]

(d) Use aggregate demand and aggregate supply analysis to explain how the recent interest rate rises might help Argentina to reduce its annual rate of inflation and achieve its target. [6]

(e) Discuss whether the potential advantages outweigh the disadvantages to the Argentine economy if the president is successful in reversing protectionism. [6]

Section B

Answer **one** question.

2 **(a)** Use a production possibility curve diagram(s) to distinguish between the growth of an economy and a reduction in the number of unused resources in an economy and explain **one** reason that might cause each to occur. [8]

(b) Discuss whether the transition of an economy from one that is centrally planned to one in which resources are allocated through the free market is likely to be of overall benefit to the citizens of that economy. [12]

3 In summer 2018, many countries suffered a water shortage because of a long spell of very dry weather.

(a) Explain whether you would expect the price elasticity of supply of water to be relatively elastic or relatively inelastic. [8]

(b) Consider the short-term and long-term policies that could be adopted to deal with a water shortage in an economy and discuss whether these are likely to be successful. [12]

4 **(a)** Explain, using examples, the difference between private goods and public goods and why public goods will not be supplied by private enterprise. [8]

(b) Consider the problem of the provision of merit goods in a market economy and assess whether direct provision of such goods is the most effective way to deal with this problem. [12]

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ECONOMICS **9708/23**

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Section A

Answer this question.

1 The growing problem of plastic waste

It has been estimated that, globally, consumers buy a staggering one million plastic bottles every minute and that 91% of these are not recycled. There is now real and growing concern about the serious threat to marine life caused by the dumping of plastic waste in the sea.

There are an estimated 150 million tonnes of plastic waste in the world's oceans. Every year, millions of birds, mammals and fish die from eating or getting tangled in plastic waste. There is also growing evidence that humans could become ill when consuming fish that has eaten plastic waste. A recent study found that people who often consume seafood eat up to 11 000 tiny pieces of plastic each year. Those living in parts of South East Asia and around the Mediterranean sea are most at risk.

The scale of these problems is worst in Asia's developing economies. For example, a recent report from Pakistan stated that 'Continued dumping of plastic products has become a serious threat to animals and plants inhabiting coastal and offshore waters. People do not seem to understand how damaging plastic waste is for the oceans.' This is a typical concern; significantly, no solutions to these problems have been proposed by Pakistan's government.

One possible way to tackle the problem is to introduce a 'bottle tax' on drinks that are sold in plastic bottles. The amount of tax would ideally depend on the size of the bottle, for example being $0.10 for a one litre bottle and $0.20 for a two litre bottle.

The UK government is considering imposing a 'deposit return' scheme similar to those that are successfully operating in Denmark, Germany and Sweden. Customers would pay a deposit when buying drinks in plastic bottles and are refunded the deposit if they return the empty plastic bottles to a retailer.

In most developed countries the legal disposal of plastic waste is heavily regulated. The most common method of disposal is for plastic waste to be buried in landfill sites. Interestingly, in China and India, landfill sites often have very few plastic bottles because people collect bottles and sell them to gain a source of income.

Another solution to the problem of plastic waste is to create a new product by recycling the plastic; more research needs to be carried out to evaluate this option, but this research is expensive and beyond the reach of many developing economies.

The demand for plastic products is forecast to increase due to its widespread use in agriculture, manufacturing and retailing. Unless something is done about the problems of disposal, even more plastic rubbish will find its way into our oceans. The key issue for many of Asia's developing economies is that their options appear to be limited.

Sources: Dawn, 24 June 2017 and *Punjab Daily Times, 1 November 2017*

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(a) Explain why a plastic bottle can be classified as both a private good and a demerit good. [4]

(b) **(i)** Distinguish between an *ad valorem* tax and a specific tax. [2]

(ii) Explain whether the 'bottle tax' referred to in the extract is an ad valorem tax or a specific tax. [2]

(c) **(i)** With the help of a diagram, analyse the impact of the 'bottle tax' on the price and sales of plastic bottles. [2]

(ii) With the help of a diagram(s), explain what would determine the incidence of the 'bottle tax' on the consumers of plastic bottles. [4]

(d) Discuss whether taxing plastic bottles is the most effective way of reducing plastic waste in developing economies. [6]

Section B

Answer **one** question.

2 **(a)** The price elasticity of supply for a new smartphone is estimated at 0.8 in the short run and 1.5 in the long run.

Explain price elasticity of supply and suggest why the above estimates differ. [8]

(b) Discuss whether, for a manufacturer of smartphones, knowledge of their product's price elasticity of demand or its cross elasticity of demand with respect to other products is more useful. [12]

3 The annual rate of inflation in an economy increased sharply and unexpectedly.

(a) Explain the likely consequences of such an increase for consumers and firms. [8]

(b) Discuss whether a substantial rise in interest rates is the best way of correcting this increased rate of inflation. [12]

4 **(a)** Explain why the theory of comparative advantage may **not** give a true account of the benefits of free trade. [8]

(b) In April 2018, the United States (US) government threatened to impose tariffs of 25% on a wide range of imports from China including steel, technological products, medicines and household goods such as washing machines. In turn, China threatened to retaliate with the same proposed tariff on imports from the US of soya beans, cars and chemicals.

Discuss whether the US and China could both benefit from the imposition of tariffs on goods such as those identified. [12]

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