Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/21**

Paper 2 AS Level Data Response and Essays **May/June 2024**

2 hours

8737215146

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
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INFORMATION

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Section A

Answer all parts of Question 1.

1 Will an increase in exports lead Sri Lanka back into economic growth?

In May 2022, Sri Lanka had to admit that it was unable to pay its debts to other countries for the first time in its history. As a result, in February 2023 it was forced to obtain a loan of US$3bn from the International Monetary Fund (IMF). The question is now, can Sri Lanka trade its way out of trouble?

The main problem faced by Sri Lanka for many years has been a lack of international competitiveness. Despite a growth in exports between 2000 and 2018, over the same period, they fell as a share of the economy from 39% to 23% of Gross Domestic Product (GDP). As a result, the country has found itself unable to earn enough foreign currency to pay for essential imports of food and fuel.

Table 1.1: Sri Lanka balance of trade in goods and services, US$ million, January 2022 to January 2023.

January 2022	March 2022	May 2022	July 2022	September 2022	November 2022	January 2023
–858	–762	–404	–123	–205	–450	–410

For many years, Sri Lanka has enjoyed a comparative advantage in growing and exporting tea. However, the ban on imports of fertilisers in 2021 which cut yields by a fifth and an overreliance on outdated methods of production have had a disastrous impact. Another major export is textiles, but these rely heavily on imported raw materials that have rapidly increased in price following the COVID-19 pandemic and the conflict in Ukraine. So, what alternatives exist for Sri Lanka?

Unlike in other Asian nations, Sri Lanka does not appear to have a plan to develop any new comparative advantage. Probably the most likely option would appear to be to take full use of its position at the centre of Indian Ocean shipping lanes by developing its ports. Sri Lanka could become a major shipping hub which would extend opportunities for exports. For example, approximately a third of the world's oil is transported across the Indian Ocean.

Other options include allowing the Sri Lankan rupee to depreciate to boost exports because it is felt that the currency is overvalued. There are also suggestions that all import tariffs should be removed. Sri Lanka is currently one of the most protected economies in the World and removing tariffs may help attract much needed foreign investment and encourage local industries to become more efficient.

The question now is, could the introduction of these options lead Sri Lanka back into economic growth?

Source: Adapted from Ben Chu, Economics Editor, BBC Newsnight article and tradingeconomics.com, February 2023

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(a) Using Table 1.1:

(i) Identify the overall trend in Sri Lanka's balance of trade in goods and services between January 2022 and January 2023. [1]

(ii) Calculate the percentage change in Sri Lanka's balance of trade in goods and services between January 2022 and January 2023. [1]

(b) Explain what is meant by 'Sri Lanka has enjoyed a comparative advantage in growing and exporting tea.'. [2]

(c) Consider the extent to which depreciation of the Sri Lankan rupee could improve the country's balance of trade in goods and services. [4]

(d) Assess whether the removal of all protectionism is likely to reduce the balance of trade deficit. [6]

(e) Assess the extent to which supply-side policies will be able to 'lead Sri Lanka back into economic growth'. [6]

Section B

Answer **one** question.

EITHER

2 **(a)** With the use of examples, explain the difference between public goods and merit goods and consider whether markets will always provide enough of both goods. [8]

(b) Assess whether a planned economic system should always switch to a mixed economy. [12]

OR

3 **(a)** With the help of a formula, explain what is meant by the income elasticity of demand for a product and consider the extent to which demand for the product will always rise at the same rate as the income of its consumers. [8]

(b) Assess the extent to which price elasticity of supply or cross elasticity of demand is more useful to businesses. [12]

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Section C

Answer **one** question.

EITHER

4 **(a)** Explain **three** of the components of aggregate demand and consider the extent to which they may be increased without leading to inflation. [8]

(b) The Chinese government has re-emphasised its commitment to rebalancing the economy from one focused mainly on investment and exports to one aiming to increase the proportion spent on domestic consumption.

Assess the extent to which it would be possible to achieve this by fiscal policy alone. [12]

OR

5 **(a)** Explain **three** causes of unemployment and consider which cause is likely to be most damaging to a high-income economy. [8]

(b) Assess which expansionary macroeconomic policy would be most likely to enable a government to meet its economic objective of a low rate of unemployment. [12]

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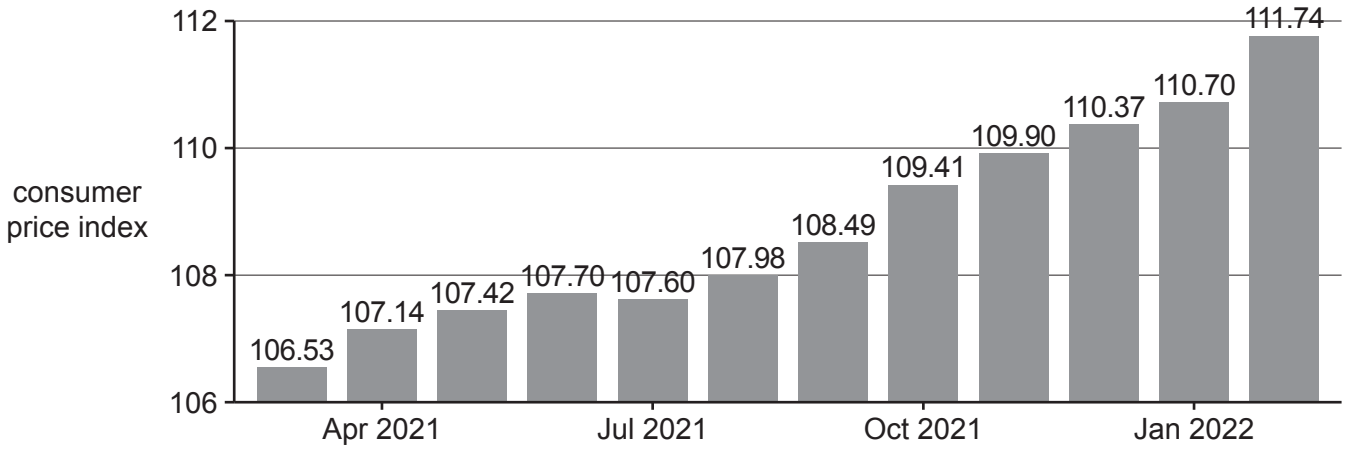
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Section A

Answer all parts of this question.

1 Dilemma for the European Central Bank (ECB)

The Eurozone consists of 19 European Union (EU) states that have agreed to use a common currency (the euro) and monetary policy, both of which are governed by the ECB. The ECB sets interest rates for all 19 members of the Eurozone and since July 2021 has aimed to maintain the rate of inflation at 2% in the medium term. Interest rates have been held at 0% since March 2016.



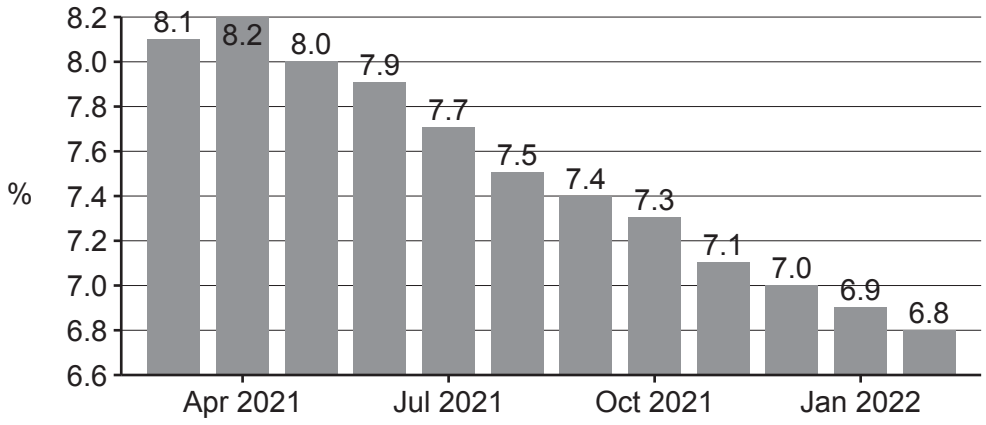
source: Tradingeconomics.com

Fig 1.1: Eurozone Consumer Prices Index (CPI) March 2021 – February 2022

In March 2022, the annual rate of inflation hit a record high for the Eurozone of 7.5% and is forecast to continue to rise throughout 2022. Additionally, according to the ECB vice president, annual economic growth is expected to fall from 4.6% at the end of 2021 to around 0% at the end of 2022. Most of the impact of these changes is expected to fall on consumers. Much higher energy costs and rising food prices tend to have a more severe effect on poorer households and those on fixed incomes.

The main causes of the rapid increase in the inflation rate are supply-side factors. The rise in energy prices result from a combination of the Covid-19 pandemic and the conflict between Russia and Ukraine which have reduced supplies of oil and gas. Additionally, the Eurozone labour market is increasingly suffering from a shortage of supply as unemployment has fallen to a record low of 6.8% in February 2022 with further falls predicted. Because the rise in the rate of inflation is almost exclusively supply-side driven, the ECB fears that this will lead to further falls in economic growth leading to a period of 'stagflation', where an economy experiences high inflation and low economic growth at the same time.

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source: Tradingeconomics.com

Fig 1.2: Eurozone % unemployment rate March 2021 – February 2022

All this leaves the ECB with a dilemma. Should it:

- increase interest rates substantially now to control the increasing rate of inflation and risk weakening economic growth even further, or
- increase them slightly in the hope that supply pressure will ease soon (this runs the risk of making high inflation more permanent if the pressure does not ease), or
- leave interest rates unchanged?

Sources, adapted from: reuters.com 31 March 2022
and reporting by Balazs Koranyi 1 April 2022

(a) Describe what has happened to consumer prices in the Eurozone between March 2021 and February 2022. [2]

(b) With the help of an aggregate demand and aggregate supply diagram, identify the main type of inflation in the Eurozone. [2]

(c) Consider the extent to which the shortage of supply of labour in the Eurozone may have contributed towards the increasing rate of inflation. [4]

(d) Using the concept of price elasticity of demand, assess the relative impact on poorer households, including those on fixed incomes, of rising prices of food and energy. [6]

(e) Assess the advantages and disadvantages of the ECB 'substantially' increasing the interest rate to control rising inflation. [6]

Section B

Answer **one** question.

EITHER

2 **(a)** Explain how the Gini coefficient is used to measure income inequality **and** consider the relative strength of **two** economic reasons suggested for such inequality in a low-income country. [8]

(b) Assess the extent to which government policies to redistribute income and wealth are likely to be successful. [12]

OR

3 **(a)** With the help of an example of each, explain the difference between a merit good and a demerit good **and** consider whether a subsidy given to a merit good will always be effective in increasing its consumption. [8]

(b) Assess whether fixing a minimum price is likely to be the best policy to reduce the consumption of a demerit good. [12]

Section C

Answer **one** question.

EITHER

4 **(a)** With the help of a diagram, explain what is meant by the circular flow of income in an open economy **and** consider the extent to which it can explain economic growth in such an economy. [8]

(b) Assess whether supply-side policy is the most effective way to achieve long-run economic growth. [12]

OR

5 **(a)** Explain what is meant by protectionism **and** consider the effectiveness of using tariffs as a method of protectionism. [8]

(b) Assess whether free trade is always better than a policy of protectionism for a developing economy that wishes to trade internationally. [12]

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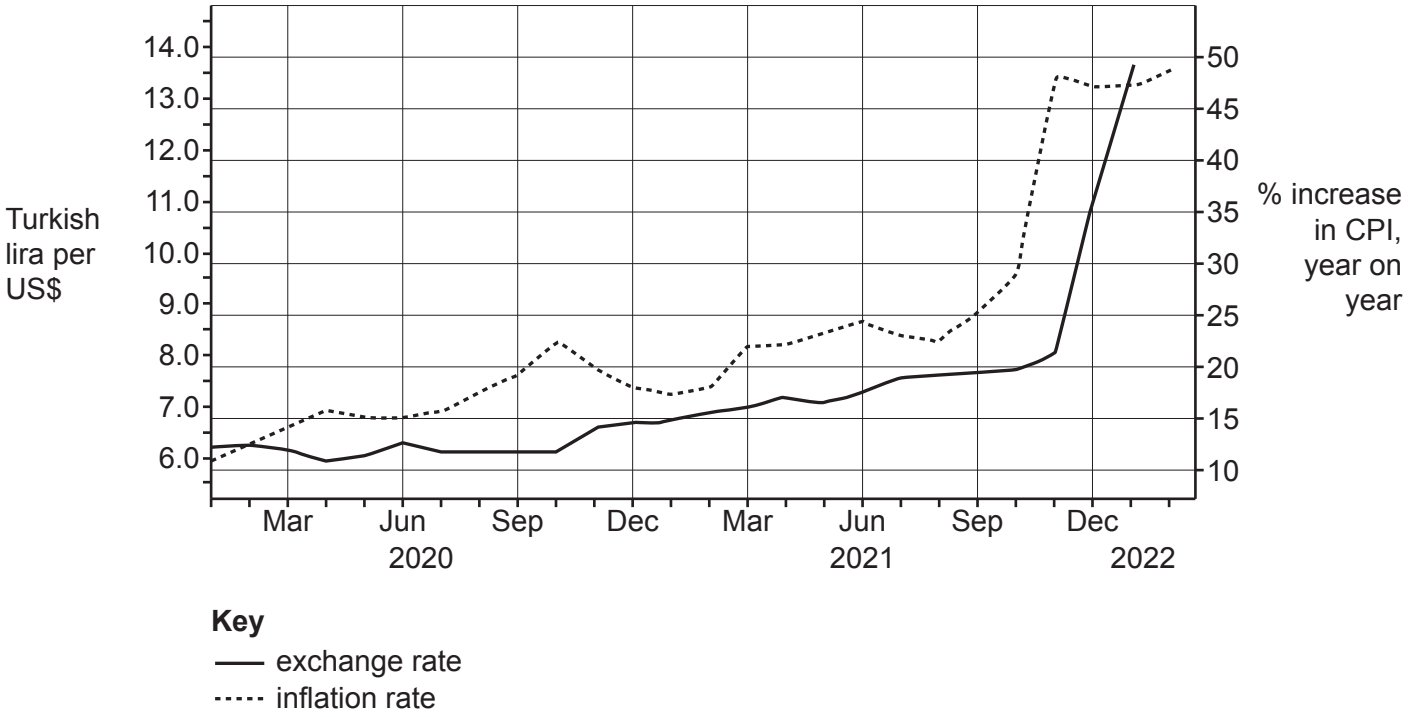
Section A

Answer all parts of Question 1.

1 Turkey's unconventional way of managing its economy

The relationship between interest rates and the general price level is one that is central to macroeconomic theory; namely that an increase in the rate of interest produces a reduction in the rate of inflation in an economy. Most economists agree on this relationship. Not so, according to President Erdoğan of Turkey, who has defied conventional economic theory in tackling his country's fundamental economic challenges.

Two economic challenges stand out. There is spiralling inflation and a collapse in the external value of Turkey's currency (the lira) in the foreign exchange market, as shown in Fig. 1.1.



Source: Turkstat, Bloomberg, February 2022

Fig. 1.1 Inflation and the exchange rate of Turkey, January 2020 to February 2022

In January 2022, the year-on-year rise in consumer prices was 48.7%, against a 36.1% year-on-year increase for December 2021. Much higher food prices and transport and energy costs accounted for most of the increase. Despite this rise, the country's Monetary Policy Committee (MPC) held the short-term interest rate at 14%. This was the rate set in September 2021 when the MPC cut the rate substantially from 19%. In short, the President had used his influence over the MPC to reduce interest rates in an attempt to reduce the increasing rate of inflation.

The President's unconventional approach has had a dramatic effect on the external value of the lira. The rapid depreciation in the value of the lira from September 2021 has had serious repercussions for Turkey's economy as Mr Erdoğan has sought to prioritise exports over currency stability. Consumer and producer confidence are low; many who can, have converted their lira deposits into US dollars or euros, fearing a collapse of the banking system.

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Despite these problems, the President remains adamant that his economics is right for Turkey. Moreover, he is convinced that when exports increase and international tourists return after the COVID-19 pandemic, employment will increase and the current account deficit on the balance of payments will be reduced. If true, this unconventional approach to Turkey's economic problems will be proved to be a success.

(a) Use the information provided to calculate the real interest rate for Turkey in January 2022. [2]

(b) **(i)** Explain why the Turkish lira depreciated from September 2021. [2]

(ii) Consider the extent to which producers in Turkey are likely to have been affected by the depreciation of the lira on the foreign exchange market from September 2021. [4]

(c) Assess whether Mr Erdoğan's economic policies have had a beneficial impact on Turkey's economy since 2020. [6]

(d) Excluding interest rate changes, assess what alternative policies might be used to reduce Turkey's rate of inflation. [6]

Section B

Answer **one** question.

EITHER

2 **(a)** From 2030, most new car production in the United Kingdom (UK) will be of electric cars.

Excluding the price of electric cars, explain the determinants of demand for electric cars **and** consider which of these determinants is likely to be of greatest significance at the present time. [8]

(b) Assess whether cross elasticity of demand is likely to be more important in determining the demand for electric cars than income elasticity of demand. [12]

OR

3 **(a)** Use a production possibility curve (PPC) diagram to explain how a government in a mixed economy might allocate more resources to consumption and fewer resources to investment **and** consider a limitation of this approach to resource allocation. [8]

(b) Assess whether producers are the only ones to benefit when an economy decides to allocate additional resources to investment. [12]

Section C

Answer **one** question.

EITHER

4 **(a)** With the help of a diagram, explain how increases in aggregate demand affect the level of real output and the price level in an economy **and** consider when such increases may become a problem. [8]

(b) Assess whether increases in aggregate demand are the best way of reducing unemployment in a high-income country. [12]

OR

5 **(a)** Explain **two** possible causes of a change in the terms of trade in an economy **and** consider which of these causes is likely to be more important for low-income countries. [8]

(b) Assess the extent to which different tools of protection can impact on the terms of trade in an economy. [12]

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