UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Subsidiary Level and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay (Core) **October/November 2013**

1 hour 30 minutes

Additional Materials: Answer Booklet/Paper

7830149354

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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.

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Section A

Answer this question.

Vietnam and inflation

1 In the mid 1980s, Vietnam started the process of moving from a command economy to one in which the market played a significant part. In September 2010 it experienced a sharp rise in inflation that meant that the annual rate rose to 8.9%. The Government's target rate was 8%. Details of some of the price changes are given in Table 1.

Table 1: Inflation rate and weighting in Vietnamese CPI of selected items, 2010.

Category	Annual inflation rate (%)	Weighting in CPI (%)
Foodstuffs	10.3	24.5
Education	15.6	5.7
Housing	12.8	10.0
Telecommunication	–5.9	2.7
Transport	6.7	8.9

Source: Vietnam Government data

The Government actions in 2009 included:
- devaluing the Vietnamese dong (VND) against the US$ by 10%
- raising the minimum wage and state pensions by 12%
- increasing the minimum price of exported rice
- encouraging banks to offer cheaper credit and to lend more.

To limit inflation the Government introduced price controls. These affected state-owned enterprises, foreign businesses and locally-owned private firms. The controls applied to 'abnormal' price changes on a wide range of goods, including fertilisers, animal feeds, animal vaccines, cement, steel, liquid petroleum gas, coal, salt, milk powder, rice and sugar.

(a) With reference to the data identify **two** features of a command economy in Vietnam. [2]

(b) Explain how the actions of the Vietnamese Government in 2009 might have caused any **two** different types of inflation to occur in the Vietnamese economy. [4]

(c) Suggest **two** reasons why an inflation rate of 8.9% might **not** be a cause of concern to a government. [2]

(d) **(i)** Compare the contribution to the change in the CPI of the changes in the price of housing with that of education. [2]

(ii) Analyse **two** possible reasons for the Government's selection of the items included for price control. [4]

(e) Discuss the desirability of a policy of widespread price controls. [6]

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Section B

Answer **one** question.

2 **(a)** Explain, using a diagram, how the social cost of consuming some goods can exceed the private cost of consuming them. [8]

(b) Discuss, using examples, whether cost-benefit analysis is an effective way of decision making when allocating an economy's resources. [12]

3 A firm that produces yoghurt is given the following information about the price elasticity of demand of various flavours: strawberry (–0.8), vanilla (–1.0), pineapple (–2.5).

(a) Explain the pricing policy that the firm should adopt for each of the flavours if it wants to increase total revenue. [8]

(b) Explain the factors that would lead to an increase in the demand for all types of yoghurt and discuss the extent to which the firm can influence these factors. [12]

4 **(a)** Use a diagram to explain how a fall in the rate of interest in a country can cause its foreign exchange rate to change. [8]

(b) Discuss whether a rise in its exchange rate or a fall in its exchange rate is more beneficial for an economy. [12]

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ECONOMICS **9708/22**

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Section A

Answer this question.

Zimbabwe and Inflation

1 When hyperinflation takes control numbers become enormous. This was Zimbabwe's experience in 2007 and 2008. Professor Steve H. Hanke of The Cato Institute calculated that in November 2008 Zimbabwe's annual inflation rate reached over 89 sextillion percent. This means 89 followed by 21 zeros.

There are many stories about the Zimbabwe dollar (Z$) in this period. In July 2008 an egg cost Z$50 billion, a bottle of beer rose in price from Z$100 billion to Z$150 billion in an hour and shopkeepers would only accept cheques (checks) if they were written to a value twice the amount owed by the customer. Prices of goods rose to trillions and quadrillions of Zimbabwe dollars. In six months the price of a loaf of bread rose from Z$200 000 to Z$1.6 trillion and the government introduced the Z$100 trillion banknote.

One way to make the figures more meaningful is to quote a daily rate of inflation or the time it takes prices to double. Table 1 gives this for three famous hyperinflations.

Table 1: Three famous hyperinflations

Hyperinflation	Daily inflation rate (%)	Time for prices to double
Hungary (July 1946)	195	15.6 hours
Zimbabwe (November 2008)	98	24.7 hours
Yugoslavia (January 1994)	64.6	33.6 hours

Source: Cato Institute

The international value of the Zimbabwe dollar also changed dramatically.
The exchange rate against the US dollar went from:
US$1 = Z$10 in 1997 to US$1 = Z$13 000 000 000 000 000 in November 2008.

Zimbabwe's trade performance changed between 2007 and 2008 as shown in Table 2.

Table 2: Zimbabwe's trade statistics (US$ millions)

	2007	2008
Exports of goods	1804	1651
Imports of goods	2113	2360
Current account balance	–383	–906

Source: EU statistics

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(a) **(i)** What is meant by hyperinflation? [2]

(ii) Describe what happened each day to the real value of money in Zimbabwe in November 2008. [2]

(b) Explain how a government may cause hyperinflation. [4]

(c) **(i)** Account for the shopkeepers' treatment of cheque (check) payments. [2]

(ii) Explain how workers and foreign investors might react to hyperinflation. [4]

(d) Discuss whether the change in Zimbabwe's current account is what would be expected when a country has the highest inflation rate in the world. [6]

Section B

Answer **one** question.

2 In September 2011 the Kenyan government reintroduced price controls to ensure that basic commodities were sold to the citizens at reasonable prices.

(a) With the help of a diagram(s), contrast the impact of a maximum price fixed below equilibrium market price with one that is fixed above it. [8]

(b) In view of the problems of allocation that might arise with effective maximum price legislation discuss how these problems might be overcome. [12]

3 **(a)** Use diagrams to explain the difference between merit goods and demerit goods. [8]

(b) Discuss whether it would be better if smoking were banned completely or whether it should be subject to an indirect tax. [12]

4 **(a)** Explain, with the help of a diagram, how a policy of expenditure dampening in an economy would affect aggregate demand, prices and output in that economy. [8]

(b) Discuss whether a policy of expenditure switching is more appropriate than a policy of expenditure dampening in an economy with a large balance of payments current account deficit and a high rate of inflation. [12]

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ECONOMICS **9708/23**

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Section A

Answer this question.

Tanzania and the East African Community (EAC)

1 Tanzania, Kenya and Uganda have long cooperated on economic matters as members of the East African Community (EAC). In 2005 EAC became a customs union. EAC then became a common market in 2010 and planned to become a monetary union in 2012.

The EAC Customs Union operates a common external tariff (CET) with a number of rates. The tariff includes rates of 0% on raw materials, capital goods and 'meritorious goods' (for example medicines); 25% on consumer goods, and higher rates on selected 'sensitive goods' (for example 100% on cane sugar, 75% on rice and 60% on wheat).

Officials have identified a number of problems facing the EAC Customs Union. These include the continuation of non-tariff barriers, language barriers, illegal cross-border trade and limited staff resources. These are thought to be reducing the effectiveness of the EAC Customs Union.

Some details of Tanzania's trade before and after the formation of the EAC Customs Union are given in Tables 1 and 2.

Table 1: Tanzania's trade with its EAC partners 2003 to 2008, US$ millions

	Before Customs Union		After Customs Union			
	2003	2004	2005	2006	2007	2008
Exports to Kenya	84.5	90.1	93.3	103.9	126.5	231.5
Imports from Kenya	117.8	131.5	174.7	156.9	113.6	197.9
Exports to Uganda	48.7	55.7	48.9	44.0	46.1	53.8
Imports from Uganda	8.3	7.7	6.5	5.4	6.5	6.4

Source: EAC

Table 2: Tanzania's trade balances 2003 to 2008, US$ millions

	Before Customs Union		After Customs Union			
Trade balance with:	2003	2004	2005	2006	2007	2008
EAC	7.1	6.6	–39.0	–14.4	52.5	81.0
Rest of world	–782.6	–1044.0	–1411.2	-2207.3	–3280.8	–3632.0

Source: EAC

(a) (i) Give **two** examples of non-tariff barriers to trade. [2]

(ii) State **two** changes that would have been necessary within the EAC when it moved from being a common market to being a monetary union. [2]

(b) Explain **two** possible reasons for the imposition of different CET rates by the EAC. [4]

(c) With reference to Tables 1 and 2, analyse the impact of the creation of the EAC Customs Union on the trade position of Tanzania. [6]

(d) Discuss the case for expanding the EAC after 2012 to include other neighbouring countries. [6]

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Section B

Answer **one** question.

2 **(a)** Explain the role of the enterprise factor of production in a free market economy, and compare this with the role of the other factors in the production process. [8]

(b) Explain the key differences between centrally planned and mixed economies, and discuss whether enterprise is a factor of production that is needed in a centrally planned economy. [12]

3 **(a)** Explain the relationship between the quantity of money in an economy and the value of money in that economy. [8]

(b) Explain the effects on the functions of money of a significant rise in the general price level and discuss which you consider to be most damaging for a modern economy. [12]

4 In October 2011, the Chinese Government said that they would not allow a further rise in the international value of China's currency, the yuan, because the Chinese economy would be damaged.

(a) Explain how exchange rates are determined in a free market and how some governments intervene to manage their exchange rate. [8]

(b) Explain the costs and benefits of a rising exchange rate and discuss whether on balance an economy 'would be damaged' by a rising exchange rate. [12]

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