Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **October/November 2017**

1 hour 30 minutes

No Additional Materials are required.

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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.

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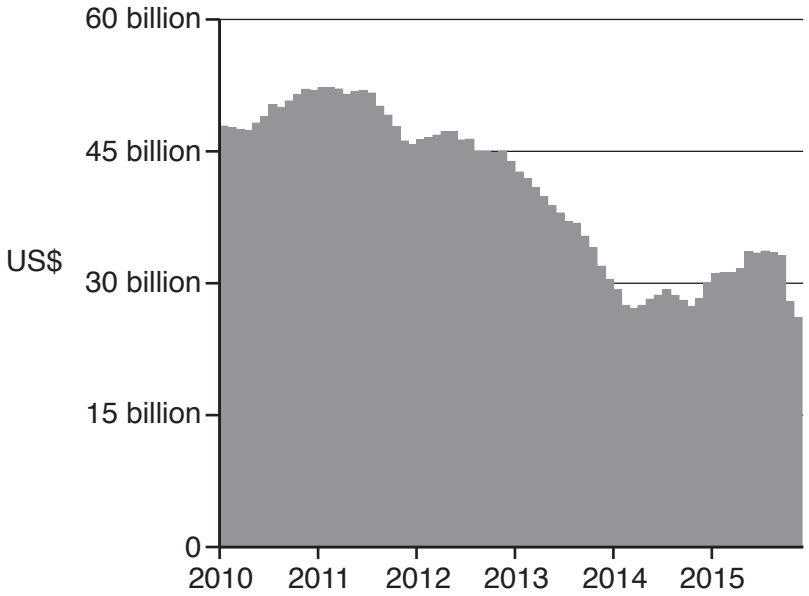
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Section A

Answer this question.

1 **Argentina announces lifting of currency controls**

Fig. 1 Argentina's foreign exchange reserves (monthly)



Source: CEIC

Argentina's new government has removed foreign currency controls, allowing its citizens to buy US dollars freely for the first time in four years. These currency controls have been in place as part of a fixed exchange rate system. The move, which officials hope will boost the faltering economy, is the strongest President Macri has yet made in his bid to reduce the government interference that marked the country's economy under the previous presidencies. Removing foreign currency controls was the latest in a series of moves President Macri has made since he took office. His administration has also eliminated most farm export taxes and cut personal income taxes.

The decision carries significant short term risks but equally big long term rewards if it leads to greater investment and lifts the country's failing export sector. In the short term, the move is likely to cause the biggest currency depreciation since Argentina's economic meltdown in 2002. Economists expect the Argentinian currency, the peso, to fall from its current official exchange rate of US$1 = 9.8 peso to something closer to the rate used in the black (illegal) market, about US$1 = 14.5 peso. This would be a fall of a third of its value.

Lifting foreign currency controls came on the same day the US central bank raised its interest rate for the first time since 2006, making it relatively harder for other countries, including Argentina, to attract funds. A weaker peso will add to the country's already high inflation rate of 25%. To try to control price rises and attract funds, Argentina's central bank raised its interest rate to 38%.

Amid rampant inflation and a lack of faith in the peso, Argentinian consumers and firms sought security in holding US dollars. Combined with rising demand from Argentina's government – which needed US dollars to make debt payments and pay for energy imports – this resulted in a shortage of US dollars in Argentina. To address this problem, former President Kirchner largely banned the sale of US dollars in 2011 but this led to the creation of a currency black market.

The ban failed to contain inflation, which was among the world's highest throughout President Kirchner's term of office. Firms, meanwhile, struggled to obtain US dollars to buy parts and

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equipment, stifling growth and sometimes causing critical shortages at places like hospitals, which depend on imported supplies and equipment.

Source: Wall Street Journal, 16 December 2015

(a) **(i)** Explain how Argentina's high rate of inflation could cause downward pressure upon the official exchange rate of the Argentinian peso. [3]

(ii) Explain how managing the peso to maintain an official exchange rate has resulted in the change in Argentina's foreign exchange reserves shown in Fig. 1. Use a diagram to support your answer. [4]

(b) Explain why fixing the price of the US dollar in terms of the Argentinian peso resulted in a black (illegal) market. [3]

(c) Explain the factors that will determine whether the rise in the interest rate to 38% will lower inflation and attract funds into Argentina. [4]

(d) Discuss the advantages of fixing the value of a currency at an official rate. Assess whether on balance a freely floating rate is more likely to be beneficial for Argentina. [6]

Section B

Answer **one** question.

2 **(a)** Explain the factors that determine whether the price elasticity of supply for a good is likely to be relatively elastic or relatively inelastic. [8]

(b) Discuss how governments might attempt to increase the elasticity of supply of an agricultural product. Consider whether they are likely to be successful. [12]

3 **(a)** Distinguish between equilibrium and disequilibrium in the market for a good. Explain how equilibrium price and equilibrium quantity will change when there is a decrease in the supply of a product. Use a diagram to support your answer. [8]

(b) Discuss how the imposition of an indirect tax on a product will affect consumers, the government and producers. Assess whether it will have an overall beneficial effect. [12]

4 **(a)** Use production possibility curves to explain the different impact on an economy of a rise in the unemployment rate and an increase in the working population. [8]

(b) Discuss the causes of an increase in aggregate demand. Assess whether such an increase will always cause inflation. Use diagrams to support your answer. [12]

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ECONOMICS **9708/22**

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Section A

Answer this question.

1 **Japan's Economic Difficulties**

Table 1: Japan Consumer Prices Index, June 2013–December 2015

	Consumer Prices Index 2010 June = 100
2013 June	99.8
2013 December	101.0
2014 June	103.4
2014 December	103.4
2015 June	103.7
2015 December	103.6

Source: MIAC, JMA

Table 2: Japan Consumer Prices Index, Categories of Spending

Category of Spending	Weighting	Year on Year % price change December 2015
Food	25.3	2.4
Housing	21.2	–0.1
Fuel, light and water charges	7.0	–6.6
Household goods	3.5	2.3
Clothing and footwear	4.1	1.8
Medical care	4.3	0.8
Transport and communication	14.2	–2.8
Education	3.3	1.5
Culture and recreation	11.5	2.2
Miscellaneous	5.6	0.7

Source: MIAC, JMA

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Japan's economy shrunk by 0.4% in the second quarter of 2015. This was as a result of weak domestic consumption and slow exports. Should the economy continue to contract for another quarter and inflation expectations start to fall, expansionary monetary policy is likely to be introduced.

Private consumption, which accounts for about 60% of Japan's national income, fell 0.8%, partly because of weak overall wage growth and partly because of bad weather. Household spending has struggled to recover following a sales tax rise last year, which was part of the government's aim to push up prices to achieve its 2% inflation target. Despite wage rises at some big firms and labour shortages, it has been a struggle to convince people to spend much more money on consumer goods after last year's sales tax rise. Increasing consumption is proving even more difficult given falling oil prices. Exports dropped 4.4% in the same quarter. The sharp plunge was partly due to disappointing demand for Japanese products, especially in the US and China. The slowdown in China, a major market for Japanese exporters, has further raised concerns.

It is now two years since Japan's prime minister, Shinzo Abe, introduced his policy, sometimes called 'Abenomics'. This aims to revive the economy, boosting growth and conquering years of deflation. The programme called for more government spending, large increases in the money supply and reforms to a highly regulated economy. But the pace of reforms has been slow, particularly in the protected agricultural sector. The poor figures on the economy resulted in the central bank stating it will not yet meet its 2% inflation target – a key part of Abenomics – although the bank insists that healthy price rises are around the corner.

Source: Agence France-Presse in the Guardian

(a) Use Table 1 to identify **two** periods when the Consumer Prices Index fell in Japan. [2]

(b) Explain how Table 2 could be used to support the view that falling oil prices have contributed to downward pressure on consumer prices. [2]

(c) With reference to the year on year price changes shown in Table 2, explain which category of spending had the greatest impact on the real income of the average household in Japan in 2015. [4]

(d) Explain whether expansionary monetary policy is likely to increase prices and help Japan to achieve its target inflation rate of 2%. [6]

(e) Discuss whether all individuals and firms in Japan would benefit from a rise in the rate of inflation. [6]

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Section B

Answer **one** question.

2 **(a)** Explain how economists use the concept of income elasticity of demand to distinguish between different types of goods. [8]

(b) Discuss whether an understanding of price elasticity of demand is of more benefit to a producer of agricultural goods than an understanding of income elasticity of demand. [12]

3 **(a)** Show the difference between a movement along, and a shift in, a production possibility curve. Explain what might cause each to occur. Use diagrams to support your answer. [8]

(b) Discuss the way in which resources are allocated in planned economies and free market economies. Consider which type of economic system is likely to have the more beneficial outcome. [12]

4 **(a)** Describe the four components of the current account of the balance of payments. Explain what might cause a deficit in this account. [8]

(b) Discuss the ways in which expenditure-reducing and expenditure-switching policies attempt to remove a current account deficit. Assess which approach is preferable. [12]

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Section A

Answer this question.

1 **The world market for rice**

Table 1: The World Price of Rice
(World average price index, 2004 = 100)

Year	Rice Price Index
2011	242
2012	231
2013	233
2014	235
2015	211

Source: F.A.O.

The market for rice is more distorted than that for any other basic food.

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Rice-exporting countries should encourage this by dismantling controls of their own.

Source: adapted from The Economist, 14 November 2015

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1 **(a)** Using Table 1, calculate the percentage change in the price of rice from 2014 to 2015. [2]

(b) Explain how rice farmers in Japan benefit from subsidies on fertilisers, power and water. Use a diagram to support your answer. [3]

(c) Explain how minimum prices will protect the interests of rice farmers. Consider whether the minimum price can be sustained in the long run. [5]

(d) Explain how the principle of comparative advantage might be used to justify Thailand and Vietnam specialising in rice production and Japan specialising in some other product. [4]

(e) Discuss the advantages and disadvantages of rice-importing countries removing their controls on the rice market. Consider whether on balance the controls should be kept. [6]

Section B

Answer **one** question.

2 **(a)** Explain the factors that determine whether the price elasticity of demand for a good is likely to be relatively inelastic. [8]

(b) Discuss if it is more useful for governments to have knowledge of the price elasticity of demand or the income elasticity of demand for certain products. [12]

3 **(a)** Explain how a production possibility curve with increasing opportunity costs illustrates the consequences of a government's choice to produce more military goods. Use a diagram to support your answer. [8]

(b) Discuss whether supply side policies are the most effective way to generate growth in an economy. [12]

4 **(a)** Show how exchange rates are determined in a freely floating system. Explain how a high rate of inflation in an economy can lead to depreciation in that economy's exchange rate. Use a diagram to support your answer. [8]

(b) Discuss the advantages and disadvantages of a freely floating exchange rate. Consider whether on balance it is preferable to a fixed rate system. [12]

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