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 **October/November 2019**

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.

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 **The impact of demonetisation in India**

India has a vast informal economy, where products and labour are exchanged for cash without official records, so that the authorities cannot easily trace the transactions. In November 2016, this informal economy was affected by a government decision to adopt a policy of 'demonetisation'. This involved the withdrawal from circulation of India's two most used bank notes, the 500 and 1000 rupee notes. This policy removed 14 trillion rupees of cash from the most cash-dependent major economy in the world. There were long queues outside banks as people tried to open bank accounts to deposit these notes before they were no longer valid.

The policy was intended to remove cash hoarded by the very rich elite, criminals and the large number of people who did not pay tax. The government later said that demonetisation was also the first step in a 'cashless' revolution to move the billions of transactions undertaken each day in India through the banking system so that the tax authorities could trace them. In 2016, only 1% of workers paid income tax.

India's Labour Minister announced that it would become compulsory for employers to pay their employees through bank accounts, a hugely ambitious step in a country where as many as 90% of workers were paid in cash. Many business owners were dreading the prospect of paying their employees through bank accounts. One factory owner in Delhi commented: "How do you think I can pay the workers with a cheque if they don't have a bank account? It takes three days to clear a cheque. What will they eat during those days?"

The Indian government's vision of a cashless economy does not seem to correspond to the reality of working life in India. Another factory owner stated that this would affect the production process: "Rickshaw pullers transfer goods from my factory to the shops. For one trip I pay a rickshaw puller 100 rupees. Does the government expect me to give them a cheque for such a small amount? How do I pay them if I am not allowed to use cash? If I have to write a cheque for every payment this will increase my costs considerably."

The workers are also concerned about the change to the law that will force them to have their wages paid directly into banks. Money performs a number of important functions in an economy and cash has an acceptability that still matters for many workers. One worker commented: "I am a daily wage worker and I am not sure if I will have a job tomorrow. If I receive cash in hand, I know I have the money".

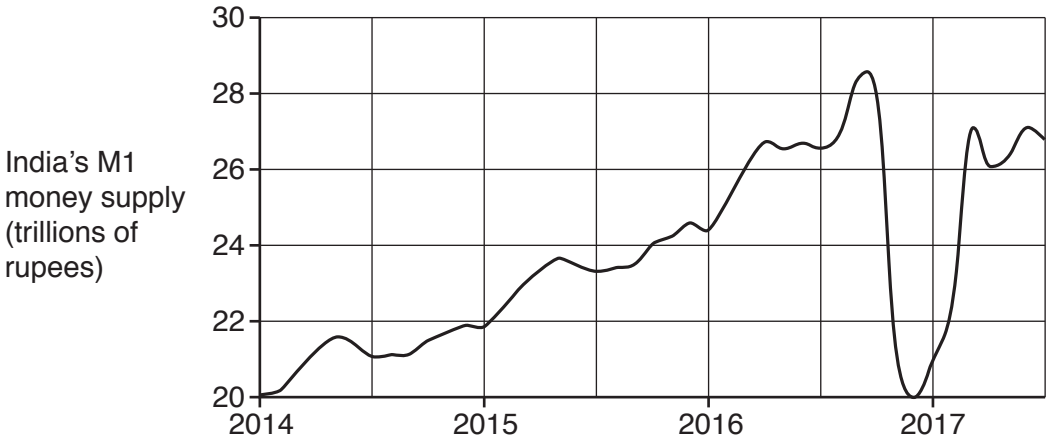
If demonetisation is to succeed, the Indian government will need to introduce incentives to persuade millions of people to open bank accounts. However, this will not be easy to achieve because around 30% of people in India still do not have bank accounts.

Fig. 1.1 shows India's money supply as measured by M1, which consists of notes and coins in circulation and balances in bank deposits that can be spent immediately e.g. through withdrawals, cheques or debit cards.

Source: Adapted from The Guardian, 21 December 2016

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Fig. 1.1: India's M1 money supply, 2014–2017



Source: Trading Economics

(a) **(i)** Describe, using Fig. 1.1, the immediate impact of demonetisation on India's M1 money supply. [2]

(ii) Explain a possible reason why India's M1 money supply increased early in 2017, as shown in Fig. 1.1, after the most used bank notes were withdrawn from circulation. [2]

(b) Explain whether a cheque should be regarded as money. [2]

(c) Explain how the Indian government's decision to withdraw the two most used bank notes is likely to affect the use of cash as a store of value in India over time. [4]

(d) Explain the possible impact of demonetisation on the Indian government's fiscal policy. [4]

(e) Discuss whether demonetisation in India is likely to be inflationary. [6]

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Section B

Answer **one** question.

2 **(a)** Explain, with the help of a diagram, how a free market would react if a minimum price which had been set above the equilibrium is removed. [8]

(b) Discuss, with the use of examples, the extent to which a supermarket could make use of the concept of income elasticity of demand in relation to the different types of goods being sold when there was an increase in consumer incomes. [12]

3 **(a)** Explain, with the help of a diagram, the effect and incidence of a subsidy in a market for essential transport. [8]

(b) Discuss, with the use of examples, whether a government should directly provide certain goods and services in an economy. [12]

4 **(a)** Explain, with the help of a diagram, the difference between what causes **(i)** a movement along an aggregate supply curve and **(ii)** a shift in an aggregate supply curve. [8]

(b) Discuss whether supply-side policies are likely to be effective in increasing employment in an economy. [12]

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Section A

Answer **this** question.

1 Ethiopia to develop through infrastructure investment

Extract 1: Ethiopia economic overview

With 99.4 million people, Ethiopia has the second largest population in Sub-Saharan Africa. Its annual population growth rate was 2.5% in 2015. It is also one of the world's poorest countries. The country's per capita income of US$590 is substantially lower than the regional average. In 2011, 33.5% of the population lived in extreme poverty.

The economy has experienced strong and broad-based growth over the past decade, averaging 10.8% per year between 2003 and 2015 compared to the regional average of 5.4% per year. Private consumption and public investment have been the main drivers of aggregate demand in recent years.

In 2017, the government was implementing the second phase of its Growth and Transformation Plan (GTP II), due to run from 2015 to 2020. Its aim was to continue improvements in physical infrastructure through public investment, transforming the country into a manufacturing hub. The goal was to reduce poverty in Ethiopia by 2025.

Developments in the balance of payments in Ethiopia have been largely driven by the implementation of major infrastructure projects in the country that contributed to higher current account deficits, balanced by growing foreign direct investment (FDI) and long-term foreign borrowings.

Source: World Bank, April 2017

Extract 2: Ethiopia plans US$90 million infrastructure spending spree

Despite Ethiopia being a landlocked country, the vast majority of its imports and exports are conveyed by sea. The ports in neighbouring country Djibouti are crucial to Ethiopia because they are used for 90% of its trade.

In January 2017, a US$4 billion railway project was officially completed linking Ethiopia's capital, Addis Ababa, to the main port in Djibouti, cutting the travel time along the route from three days to just 12 hours. It was expected to cut the cost of transporting freight by a third, having a huge impact on trade flow and the lives of Ethiopians.

The project was partially built and funded by Chinese companies with the assistance of the Chinese government. China Railway Group and the China Civil Engineering Construction Corporation built the railway line, while China loaned Ethiopia US$2.49 billion to build the new railway. Contracts were awarded to Chinese firms to build various sections of the railway. Chinese investment in Ethiopia's infrastructure provides opportunities for Chinese steel and construction industries. China has an overcapacity in steel and needs to find markets for its excess supply. China also has the technical expertise and companies available to assist in major foreign infrastructure projects.

Chinese infrastructure investment in Ethiopia is not just limited to the railway network. Chinese firms are also building more than 65% of the new roads in Ethiopia including the prominent Addis Ababa ring road. As part of its policy of investing in infrastructure, the Ethiopian government is spending US$89 million of its own revenue upgrading the national road network.

Source: Neil Ford, African Business, 21 March 2017

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Table 1.1: Ethiopia's current account of the balance of payments, 2015

Balance of trade in goods and services (US$ million)	Current account balance (US$ million)
–14 275	–7427

Table 1.2: Ethiopia's Foreign Direct Investment inflows, 2012–2015 (US$ millions)

Year	2012	2013	2014	2015
	279	1281	2132	2168

Source for tables: IMF World Economic Outlook, October 2016

(a) (i) Suggest **two** reasons that would explain why Ethiopia's current account balance differs from its balance of trade in goods and services in 2015 as shown in Table 1.1. [2]

(ii) Explain **one** possible impact on Ethiopia's balance of trade in goods and services of operating the new railway line to Djibouti. [2]

(b) Identify **two** ways in which China's economy would benefit from the building of infrastructure in Ethiopia. [2]

(c) Use a production possibility curve to explain the opportunity cost that Ethiopia would face if it did not have access to help from China in building new infrastructure. [4]

(d) Consider whether a road network, such as that upgraded in Ethiopia with government funds, should be classified as a public good. [4]

(e) Use aggregate demand and aggregate supply analysis to discuss how output, employment and prices might be affected by the development of infrastructure in Ethiopia. [6]

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Section B

Answer **one** question.

2 **(a)** Explain, with the help of a diagram, the process through which the equilibrium price and equilibrium quantity of a good changes when there is an improvement in the technology underlying the production of that good. [8]

(b) Discuss the problems in applying supply-side policies in an economy and assess whether these problems can be overcome. [12]

3 **(a)** Explain how knowledge of the price elasticity of demand for a good can help businesses to assess the impact of price changes upon their total revenue. [8]

(b) 'Since the demand for a demerit good such as cigarettes is price inelastic, a tax on the product is a waste of time. What is needed is better awareness amongst consumers of the negative effects of smoking cigarettes.'

Discuss this view. [12]

4 **(a)** Explain how the terms of trade of an economy will be affected by changes in that economy's exchange rate. [8]

(b) Discuss, using examples, whether an expenditure-reducing or an expenditure-switching policy is the more effective response in economies faced with a deficit on the current account of the balance of payments. [12]

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Section A

Answer **this** question.

1 **China and India: BRICS partners yet competitors**

BRIC is a term referring to the economies of Brazil, Russia, India and China. It originated from Jim O'Neill of Goldman Sachs who predicted that these four countries would be the fastest growing market economies in the twenty-first century and that by 2050 they would be amongst the wealthiest economic powers. South Africa was added to the group in 2010 resulting in them being known as BRICS economies.

It should be stressed that the five BRICS economies are not a formal trading organisation like the European Union, although their leaders do meet annually to discuss global economic issues of common concern and relevance.

Of the five countries, China and India in particular compete with each other in world markets. India is following China in embarking on a policy of growth in its manufacturing industries; it is also a major exporter of agricultural goods to neighbouring countries in south-east Asia.

Table 1.1 below shows that India has experienced the highest rate of consumer price inflation of all BRICS economies since 2008. It has also experienced a rapid deterioration of over 30% in its terms of trade. There are serious doubts over whether Indian products really can compete with those from China in world markets.

Table 1.1: Consumer Prices Index (CPI) for BRICS economies, 2012–15 *(2008=100)*

	2012	**2013**	**2014**	**2015**
Brazil	124.5	131.8	140.2	155.2
Russia	136.0	145.2	156.5	180.8
India	147.7	163.8	174.1	184.4
China	110.9	113.8	116.1	117.7
South Africa	123.9	131.0	130.0	145.4

Source: BRICS Joint Statistical Publications

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Fig. 1.2 below shows how China's terms of trade have changed from 2012 to 2016.

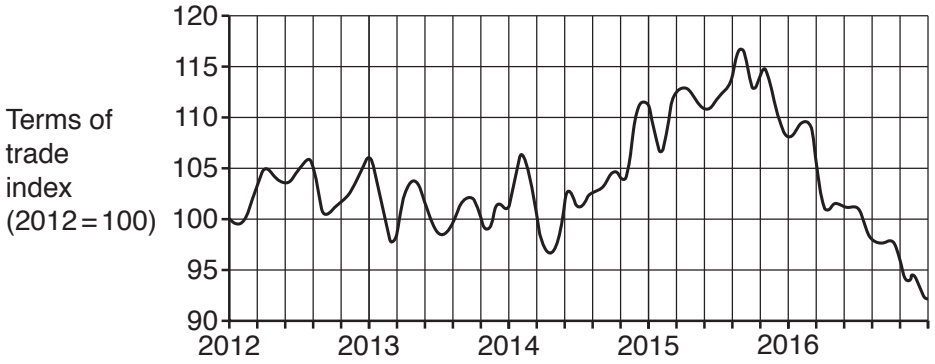


Fig. 1.2: China's terms of trade index, 2012–16

Source: Trading Economics

(a) (i) Using Table 1.1, compare the rate of inflation for China and India between 2012 and 2015. [2]

(ii) Explain **two** possible reasons why the CPI might **not** be an accurate measure of inflation in a BRICS economy such as India. [4]

(b) Explain **one** possible aggregate demand reason and **one** possible aggregate supply reason for the differing rates of inflation in the BRICS economies since 2012. [4]

(c) (i) Using Fig. 1.2, describe how China's terms of trade changed from the high point in 2015 to the end of 2016. [2]

(ii) Explain **one** possible reason for this change. [2]

(d) With the help of the information, discuss what is likely to be the most important factor that will determine how successfully India can compete with China when trading in world markets. [6]

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Section B

Answer **one** question.

2 **(a)** It has been reported that the world demand for chocolate is increasing at a time when the supply of cocoa beans, the raw ingredient required to produce chocolate, is not as large as expected.

Explain, with the help of a diagram, the likely effects of these changes on the world market for chocolate products. [8]

(b) Very high consumption of chocolate can lead to health problems such as obesity and diabetes, especially amongst young children in developed economies.

Discuss what is likely to be the most effective policy to reduce these problems. [12]

3 In March 2017, the Indian government announced a new five year programme of investment in the country's nationalised railway system.

(a) Explain, with the help of an aggregate demand and aggregate supply diagram, how this investment is likely to affect India's output, prices and employment. [8]

(b) Discuss whether a nationalised or a privatised railway system is likely to generate a better market for rail travel. [12]

4 **(a)** Explain the likely causes of a deficit on the current account of the balance of payments for an economy that relies heavily on agricultural products. [8]

(b) The largest economy in the world, the United States (US), records a persistent deficit on its current account of the balance of payments.

Discuss what is likely to be the most effective way to reduce this deficit. [12]

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