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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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READ THESE INSTRUCTIONS FIRST

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.

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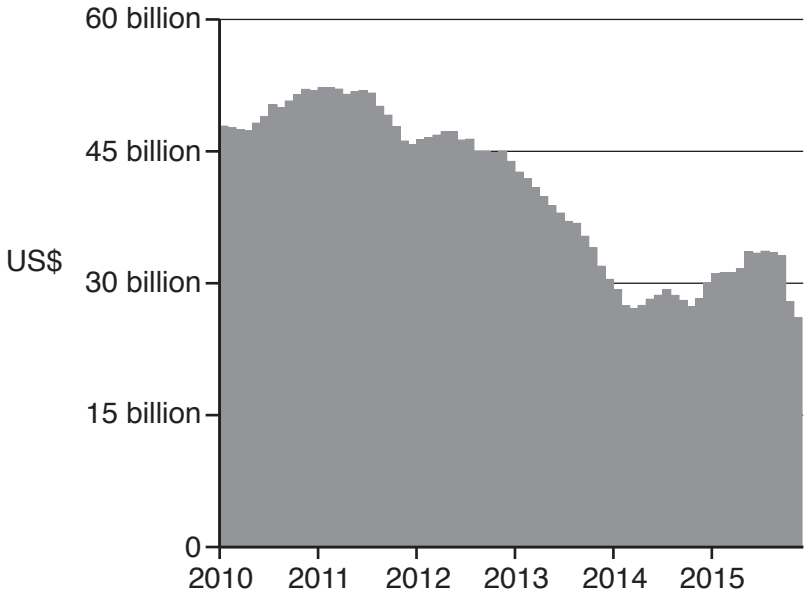
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Section A

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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