Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **May/June 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.

This document consists of **4** printed pages and **1** Insert.

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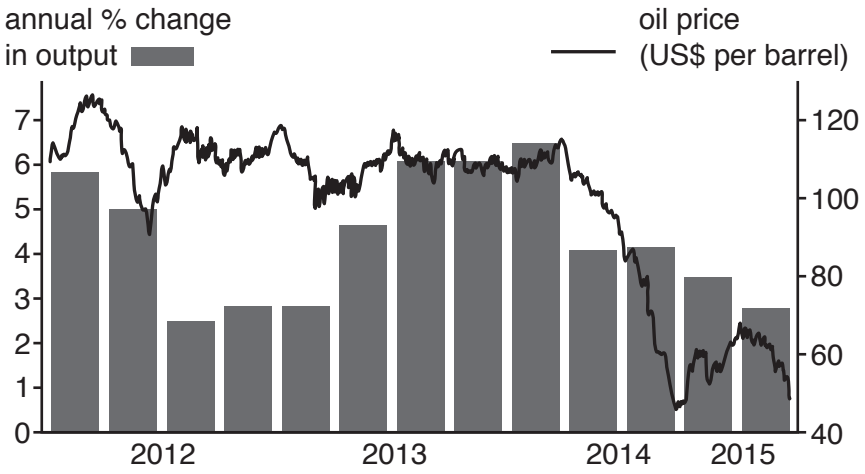
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Section A

Answer this question.

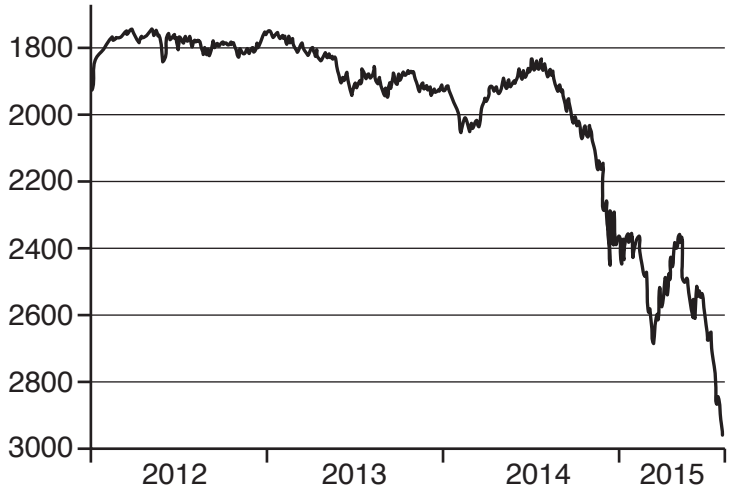
1 **Fall in price of oil but Colombia can look forward to growth**

Fig. 1: Colombia's growth and the oil price



Source: Thomson Reuters Datastream

Fig. 2: Colombian peso against the US dollar (peso per US$), inverted scale



Source: Thomson Reuters Datastream

Over the past year, the halving of crude oil prices has hit Colombia and much of South America hard. Venezuela's economy, for example, is expected to shrink by 7% this year. Colombia's national oil production was running at 1 million barrels a year, accounting for half of its exports and a fifth of government revenues. In Puerto Gaitan, which only a year ago was the centre of Colombia's oil industry, the town's population had tripled to 45 000 in just a few years. Property prices had soared and hotels overflowed. Today, though, business profits have fallen, leading to a fall in spending by entrepreneurs. "For Sale" signs now hang over Puerto Gaitan's closed stores, car parks in shopping malls are empty and 10 000 people have left the town. Towns throughout Colombia are experiencing similar problems.

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Colombia's government is feeling the effects as well. Every US$1 drop in the oil price per barrel cuts an estimated US$200 million from government revenues. As a result, the government has cut spending and raised taxes to keep its budget deficit down. More worryingly, the collapse in the price of oil has opened a large current account deficit equivalent to 7% of national income. Yet not all is bleak. Colombia's economy is forecast to grow this year. And unlike in neighbouring Venezuela, where oil accounts for more than 90% of exports, there is concern but no panic.

Firstly, the peso's depreciation could reverse Colombia's current account problems, boosting traditional exports such as coffee, textiles, car parts and flowers — if not to its immediate neighbours, then to the United States. Colombia produces oil, but it is not only an oil-producing country. Secondly, Colombia's government is having peace talks with Marxist rebels to end the country's five decades of unrest. The government's military expenditure will be reduced and estimates suggest that this 'peace dividend' could add as much as 2 percentage points to growth.

Source: The Financial Times, 2015

(a) **(i)** With the help of a diagram, explain **one** possible cause of the fall in the price of oil shown in Fig. 1. [2]

(ii) Explain how the fall in the price of oil has resulted in the fall in the value of the peso shown in Fig. 2. [2]

(b) With the help of production possibility curve diagram(s), explain how the 'peace dividend' might lead to the growth of Colombia's economy. [4]

(c) Use the information to explain how each of the components of aggregate demand in Colombia has been affected by the fall in the price of oil. [6]

(d) The fall in the value of the Colombian peso shown in Fig. 2 is expected to reduce Colombia's current account deficit.

Discuss any factors that will determine whether the fall in the value of the peso will have this effect. [6]

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[Turn over

Section B

Answer **one** question.

2 **(a)** Using examples, explain the difference between a merit good and a public good. Explain why a profit can be made from the provision of one of these types of good, but not the other. [8]

(b) Discuss whether it is better to impose an indirect tax or conduct an awareness campaign to deal with the problem of demerit goods such as alcohol. [12]

3 **(a)** Explain how equilibrium price and equilibrium quantity change to allocate resources when there is a successful advertising campaign for a normal good. [8]

(b) Discuss the difficulties of introducing a widespread system of maximum prices for essential food to protect low-income families in a period of high inflation. Consider whether this system is likely to be successful. [12]

4 **(a)** Explain how a fall in an economy's foreign exchange rate can cause both cost-push and demand-pull inflation. [8]

(b) Discuss the use of supply side policy as a means of solving the problem of inflation. Consider whether this policy is likely to be effective. [12]

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