Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **October/November 2021**

1 hour 30 minutes

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS
- Answer **two** questions in total:
  Section A: answer Question 1.
  Section B: answer **one** question.
- Follow the instructions on the front cover of the answer booklet. If you need additional answer paper, ask the invigilator for a continuation booklet.
- You may use a calculator.
- You may answer with reference to any economy you have studied where relevant to the question.

INFORMATION
- The total mark for this paper is 40.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages. Any blank pages are indicated.

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Section A

Answer this question.

1 **What is the 'right' level of inflation?**

Central banks aim to keep inflation under control, but what does 'under control' mean? How much inflation is too much? And, a question only an economist could ask, how much inflation is too little?

Hyperinflation, where the rate of inflation is extremely high, is an economic catastrophe for a country. Table 1.1 below gives details of four cases of hyperinflation.

Table 1.1

Country	Date	Highest monthly inflation rate (%)	Time taken for prices to double (hours)
Hungary	1945 to 1946	41900000000000000	15
Zimbabwe	2007 to 2008	79600000000	25
Germany	1922 to 1923	29500	89
Venezuela	2016 to 2018	219	430

Source: www.cato.org/research/world-inflation-and-hyperinflation-table, accessed October 2019

The consequences of hyperinflation are far-reaching. Inflation undermines the functions of money. Rapid price rises encourage panic-buying by consumers, creating shortages that further increase inflation. In the most extreme cases countries stop using money completely, and resort to barter. In Zimbabwe, hyperinflation led to the abandonment of its currency in 2008 and the use of the US dollar as an alternative. More recently, Venezuelan restaurants and supermarkets stopped displaying prices and consumers only found out the value of their purchases at the checkout.

To avoid the consequences of high inflation, central banks often set a low 'target' rate of inflation, typically around 2% a year. But this policy has also been criticised by some people. If central banks follow such a target the outcome would be to erode the real value of money over time. Central banks have often been instructed by governments to have an inflation target, and yet even a 2% inflation rate will halve the real value of money in 36 years.

Central banks can use high interest rates as a tool of monetary policy to keep down the rate of inflation, but very often monetary policy requires low interest rates to stimulate consumption spending and investment in an economy.

It should not be forgotten that there are potential benefits of relatively low levels of inflation and this is why some countries have an inflation target of, say, 2%. A former chief economist of the International Monetary Fund even suggested that many countries' inflation target should be 4% rather than 2%.

Source: Adapted from The Times and The Financial Times, both 9 February 2019.

(a) Explain how inflation can halve the 'real value' of money. [2]

(b) With the aid of a diagram, explain why 'rapid price rises encourage panic-buying by consumers, creating shortages that further increase inflation'. [4]

(c) With reference to **one** function of money explain why hyperinflation in Zimbabwe caused the country to abandon its currency in 2008. [2]

(d) Using aggregate demand and aggregate supply analysis, discuss whether it is possible to use monetary policy to achieve **both** a high level of investment **and** a low rate of inflation. [6]

(e) Discuss whether everybody in an economy such as Venezuela would be worse off as a result of hyperinflation. [6]

Section B

Answer **one** question.

2 **(a)** With the aid of a diagram, compare what happens to an economy's resources to cause a movement along its production possibility curve with what happens to an economy's resources to cause a shift of its production possibility curve. [8]

(b) Discuss whether the advantages of a transition from a planned economy to a market economy always outweigh the disadvantages. [12]

3 **(a)** With the aid of a diagram, explain the consequences for consumers and producers of introducing a minimum price in the market for a product. [8]

(b) Discuss whether decisions made by a business are more likely to be influenced by knowledge of the price elasticity of demand for its product or by knowledge of the price elasticity of supply of its product. [12]

4 **(a)** With the aid of a diagram, explain how a central bank intervenes to maintain a fixed exchange rate when the economy is experiencing a current account deficit on its balance of payments. [8]

(b) Discuss whether expenditure-reducing policies are likely to reduce the current account deficit on the balance of payments for an economy with a floating exchange rate. [12]

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