Cambridge International AS & A Level

Cambridge Assessment International Education
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 **May/June 2019**

MARK SCHEME

Maximum Mark: 40

Published

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Question	Answer	Marks	Guidance
1(a)	**Describe, using Fig. 1.1, how the value of the yuan against the US dollar has changed between 2014 and 2017.** There has been a depreciation/fall in value. **(1 mark**) The depreciation was from about 6.0 yuan per US dollar at the beginning of 2014 to about 6.9 yuan per US dollar in 2017. This is a change of 0.9/6.0 = 15%. **(1 mark)**	**2**	Accept an answer between 14% and 16%.
1(b)	**The US President threatened to increase protectionism of the US economy.** **Explain, using a diagram, how one of the methods of protectionism mentioned in the article can work.** **TARIFF** For an explanation of how a tariff can work, stressing that it is a tax/duty on imported goods. **(2 marks)** For a diagram of a tariff. **(2 marks)** (1 mark for PQDS, 1 mark for showing distinction between supply without tariff and supply with tariff). OR **QUOTA** For an explanation of how an import quota can work, stressing that it relates to a limit in terms of the value of imported goods, or the volume of imported goods, or the market share of imported goods **(2 marks)** For a diagram of an import quota. **(2 marks)** (1 mark for PQDS, 1 mark for showing vertical quota line).	**4**	

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Question	Answer	Marks	Guidance
1(c)	**Explain two effects of the fall in China's current account surplus for China's economy.** For example: • If there is a decline in the demand for exports, resources could be diverted to produce goods for domestic consumption. • There could be a reduction in inflationary pressure if there is a fall in aggregate demand. • If the fall in the surplus is due to an increase in imports, it could lead to a higher standard of living. • A lower demand for exports could lead to an increase in unemployment. • There could be a decrease in GDP and economic growth. **(Up to 2 marks for each effect)** **4 marks maximum**	**4**	A disadvantage of having a persistent current account surplus is that one country's surplus is another country's deficit. The country with the deficit may decide to introduce protectionist methods, potentially damaging the extent of international trade.
1(d)	**Explain two likely reasons why China has opted for a managed float exchange rate system.** For example: • The government will still have some influence. • The central bank will be able to influence exchange rate by intervention, e.g. buying/selling currencies or by changes in interest rates. • Extent of float will be within certain limits. • The government will be able to influence an economy through demand management. • A managed float will allow an economy to have the best of both worlds (floating/fixed). **(Up to 2 marks for each reason)** **4 marks maximum**	**4**	A free floating exchange rate system will be self-adjusting, but freely floating exchange rates tend to be rather volatile and unstable. A pegged (fixed) exchange rate system will provide stability and therefore confidence, but the maintenance of this exchange rate could require extensive support through the use of reserves. Some reserves will be needed (US $2 trillion in the case of China), but given that there is limited floating, not as much reserves as in the case of a pegged (fixed) exchange rate system; there is greater stability than in a freely floating system, but not as much as in a pegged (fixed) exchange rate system.

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Question	Answer	Marks	Guidance
1(e)	**Discuss who would be the winners and the losers from a 'trade war' between the US and China.** Consideration of who would be the winners from a protectionist 'trade war' between the US and China. **(Up to 3 marks)** Consideration of who would be the losers from a protectionist 'trade war' between the US and China. **(Up to 3 marks)** **5 marks maximum** **Reserve 1 mark for a conclusion/evaluative judgement**	**6**	The case for a protectionist 'trade war': • Infant/sunrise industry argument • Declining/sunset industry argument • Strategic industry argument • Anti-dumping argument • Revenue-raising argument (through tariffs) • To help in the removal/decrease of a BOP deficit The case against a protectionist 'trade war'/in favour of free trade: • A higher level of output • Countries can consume outside of their PPCs • Greater efficiency of production
2(a)	**Explain, with the help of diagrams, how (i) constant and (ii) increasing opportunity costs determine the shape of an economy's production possibility curve.** **Knowledge and Understanding:** Explanation of opportunity (**1 mark)** Explanation of production possibility curve **(1 mark)** **(KU: up to 2 marks)** **Application:** Explanation of the distinction between constant and increasing opportunity costs: • constant opportunity costs involves a movement from one point on the PPC to another with an equal sacrifice of resources; this will be shown by a straight line PPC **Up to 3 marks** • increasing opportunity costs involves a movement from one point on the PPC to another where ever increasing amounts of one good will need to be sacrificed to produce more of the other; this will be shown by a curved PPC **Up to 3 marks** **(APP: Up to 6 marks)**	**8**	Constant opportunity costs will lead to a straight line PPC being drawn, whereas increasing opportunity costs will lead to a curved PPC being drawn.

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Question	Answer	Marks	Guidance
2(b)	**Discuss what the most significant issues of transition are that a country will face as it moves from a planned economy to a mixed economy.** **Analysis:** The issues of transition: • Inflation • Output • Employment/Unemployment • Industrial unrest • International trade • Welfare • Specialised support markets and services **Allow up to 4 marks for each issue analysed** **(AN: up to 8 marks)** **Evaluation:** For exercising some judgement on the extent to which the issues of transition will make a change from a planned economy to a mixed economy extremely difficult for a country to achieve **Up to 3 marks plus 1 mark for a conclusion.** **(EV: up to 4 marks)**	**12**	The issues of transition: • In a planned economy, the state can play a key role in keeping prices stable, but in a mixed economy at least some of the prices are determined by the forces of demand and supply, so there is more price instability and possibly inflation • In a planned economy, the state can support relatively inefficient firms and industries, but in a mixed economy, these firms and industries, if inefficient, may not survive and so there may be a fall in output • Private sector firms will aim to maximise profits, but this could lead to them laying off some workers, increasing the level of unemployment • There may be a greater likelihood of industrial unrest in a mixed economy than in a planned economy • Possibly new international trading relationships will need to be established • In a planned economy, the state can provide welfare support for everybody; in a mixed economy, there may be a reduction in the level of welfare provision • The specialised markets and services that will be required, e.g. banking and legal services, may take a long time to become sufficiently established

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Question	Answer	Marks	Guidance
3(a)	**Explain, with the help of a diagram, the disadvantages to consumers of introducing a maximum price in a market for an essential food item.** **Knowledge and Understanding:** **1 mark** for correct diagram: • Vertical axis correctly labelled: P/Price; • Horizontal axis correctly labelled: Q/Quantity • Equilibrium price shown. **1 mark** for maximum price shown below the equilibrium price. **(KU: up to 2 marks)** **Application:** Application to a situation of excess demand**.** **Up to 2 marks** Explanation of two possible disadvantages to consumers, such as: queuing, black market, rationing or seller preferences. **Up to 2 marks each** **(APP: up to 6 marks)**	**8**	Disadvantages to consumers: • A maximum price will lead to a situation of excess demand in the market • This could lead to a queue or waiting list • A secondary, informal or black market could emerge with prices well above the maximum price

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Question	Answer	Marks	Guidance
3(b)	**Discuss whether the advantages of privatising an industry will always outweigh the disadvantages.** **Analysis:** **Up to 4 marks** for analysis of advantages of privatisation **Up to 4 marks** for analysis of disadvantages of privatisation **(AN: up to 8 marks)** **Evaluation:** For exercising some judgement on whether the privatising of an industry will always have a positive effect. This could include a consideration of a positive effect for whom – firms, government, workers and consumers. **Up to 3 marks plus 1 mark for a conclusion** **(EV: up to 4 marks)**	**12**	Advantages of privatising an industry: • Efficiency will be improved because of aim of profit maximisation • Greater competition gives an incentive to be more productive • May increase the number of shareholders, encouraging enterprise culture • Greater efficiency could lead to lower prices for customers Disadvantages of privatising an industry: • Strive for efficiency could lead to higher unemployment • There may not be greater competition; could be a natural monopoly • Aim of satisfying shareholders may mean that prices are not reduced

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Question	Answer	Marks	Guidance
4(a)	**Explain, with the help of a diagram(s), how changes in aggregate demand and aggregate supply can cause inflation in an economy.** **Knowledge and Understanding:** **1 mark** for diagram showing change in aggregate demand. **1 mark** for diagram showing change in aggregate supply. **(KU: up to 2 marks)** **Application:** **Up to 3 marks** for an explanation in relation to changes in AD and the cause of inflation in an economy. **Up to 3 marks** for an explanation in relation to changes in AS and the cause of inflation in an economy. **(APP: up to 6 marks)**	**8**	Demand-pull inflation: • reflationary policies by a government • increased consumer spending, e.g. as a result of greater consumer confidence Cost-push inflation: • wage increases to employees which are not linked to higher productivity • an increase in the cost of imported raw materials, e.g. because of a fall in the value of a currency • an increase in input prices, e.g. because of the monopoly power of suppliers or higher energy prices
4(b)	**Discuss whether deflation is more of a problem in an economy than inflation.** **Analysis:** **Up to 4 marks** for analysis of the problems of inflation. **Up to 4 marks** for analysis of the problems of deflation. **(AN: up to 8 marks)** **Evaluation:** For exercising some judgement on whether deflation is more of a problem in an economy than inflation . **Up to 3 marks plus 1 mark for a conclusion** **(EV: up to 4 marks)**	**12**	Problems of inflation: • redistribution of income • investment planning difficulties for firms • uncompetitiveness of exports (depending on relative inflation rates in different countries) • menu costs • shoe leather costs Problems of deflation: • fall in economic activity/output • rise in unemployment

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Question	Answer	Marks	Guidance
1(a)(i)	**What happened to Egypt's current account balance between 2014 and 2016?** The deficit increased **1 mark**	**1**	We need the correct economic term, so 'deficit' in this context is essential. If the candidate uses a subjective term such as 'worsened' it must be supported by figures that make it clear that the deficit has increased. If the candidate simply lists increasingly negative balances without the term 'deficit' then no marks are awarded.
1(a)(ii)	**With reference to Table 1.1 calculate the percentage rate of inflation in Egypt between 2016 and 2017 that was estimated by the IMF.** 22.1% **1 mark**	**1**	Accept any value up to 22.0–22.2%
1(b)	**Identify two Canons of Taxation satisfied by Egypt's new VAT.** For each Canon identified **1 mark** **2 marks maximum**	**2**	**The acceptable 'canons of taxation' are** **Smith's canons** **Certainty** The timing and amount to be paid must be certain and open **Convenience** The means and timing of payment must be convenient **Economy** The cost of collection must be low relative to the yield **Equity** The tax must be 'fair'. Others acceptable responses developed by other economists include, simplicity, productivity and elasticity, diversity and that the tax should automatically adjust to changes in inflation All the above are acceptable. 'Equality' is not acceptable.

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Question	Answer	Marks	Guidance
1(c)	**Explain how the decline in the value of the Egyptian pound could cause demand-pull and cost-push inflation in Egypt.** For an explanation of how the decline in the Egyptian pound could cause cost-push inflation. The decline in the value of the Egyptian pound makes imports more expensive **(1 mark)** This increases the price of imported raw materials and as a result business costs. This causes cost-push inflation **(1 mark)** **Up to 2 marks** For an explanation of how the decline in the Egyptian pound could cause demand-pull inflation. The decline in the value of the Egyptian pound makes exports cheaper **(1 mark)** and this is expected to increase the net exports and as a result aggregate demand. This causes demand-pull inflation **(1 mark)** **Up to 2 marks**	**4**	The decline in the value will make imports more expensive. This will increase the cost of imported raw materials and increase business costs. This will cause cost-push inflation. It will also make exports cheaper and this will increase net exports leading to demand pull inflation.

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Question	Answer	Marks	Guidance
1(d)	**Explain how the estimated changes in unemployment in Table 1.1 might be expected to affect the current account balance of Egypt after 2016** <u>Two approaches are acceptable:</u> For linking a fall in unemployment and rising incomes **(1 mark)** For explaining that the rise in incomes is likely to lead to rising imports **(1)** and falling exports **(1)** and an increasing deficit **(1)** **Up to 3 marks** **And/or** For explaining that the fall in unemployment means that more people are in work and that national production will rise **(1 mark)** For explaining that this would lead to a rise in exports **(1)** and a fall in imports **(1 mark)** and a reducing deficit **(1)** **Up to 3 marks** For elaboration that considers any factors that the identified change i.e. the increasing and/or reducing deficit relies upon. **Up to 2 marks** **If a candidate adopts both approaches without elaboration of either then 4 marks maximum**	**6**	The unemployment rate is expected to fall from 2016. As a result, incomes will rise and it would be expected that imports would also rise. In addition, goods formerly exported would be diverted to satisfy rising demand in the home market. Net exports would decrease as a result and the current account balance become an increasing deficit. Alternatively, it could be argued that those who enter employment will boost production and this could offset imports or boost exports. Explanations developed along these lines are equally acceptable. Some candidates might offer the view that either outcome is possible. These approaches should also be credited. Up to 4 marks are available for explaining the link between the changes in unemployment and the current account balance. Two further marks are reserved for elaboration that considers any factors that the outcome of the change depends upon e.gs include the imposition of import controls, the income elasticity of demand for imports, exchange rate changes, the availability of other factors in the production process such as capital goods and the time period under consideration.

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Question	Answer	Marks	Guidance
1(e)	**Discuss whether the Egyptian government's fiscal and monetary policies in the article are likely to succeed in curing the inflation problem** For recognition of any fiscal policy measures in the data **(1 mark)** and for an explanation of how this measure might (or might not) cure the problem of inflation **(1 mark)** For an evaluative comment that explains why this measure might not (or might) succeed in curing the inflation problem **(1 mark)** **(Up to 3 marks)** For recognition of any monetary policy measures in the data **(1 mark)** and for an explanation of how this measure might (or might not) cure the problem of inflation **(1 mark)** For an evaluative comment that explains why this measure might not (or might) succeed in curing the inflation problem **(1 mark)** **(Up to 3 marks)**	**6**	The fiscal and monetary changes referred to in the text include reducing the budget deficit, levying a new indirect tax, cutting subsidies on energy, raising interest rates and floating the Egyptian pound. Some of these changes will help to cure inflation, but others will exacerbate the problem. For example: As far as fiscal policy measures are concerned the data refers to a reduction in the budget deficit. This might help to cure inflation. On the other hand the rise in VAT and the cut in subsidies will cause a rise in prices. So these fiscal policy measures work in opposing directions. As far as monetary policy measures are concerned, a rise in interest rates might help to cure inflation, but the fall in the value of the Egyptian pound might cause cost-push inflation. Again these monetary measures work in opposing directions. Some candidates might explain how a policy is expected to work (1 mark) they then need to consider why it might not work (1 mark). Other candidates might explain why a measure might not work (1 mark). These candidates then need to consider why it might work (1 mark)

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Question	Answer	Marks	Guidance
2(a)	**Explain how economists use the concept of elasticity to distinguish between inferior goods and necessary goods when consumer incomes change.** **Knowledge and Understanding** of income elasticity of demand: What it measures **1 mark** For accurate formula **1 mark** **(KU: up to 2 marks)** **Application**: Income elasticity for inferior goods: • For recognition that the coefficient is negative **1 mark** • For an explanation of why a negative coefficient arises when incomes change **Up to 2 marks** Income elasticity for necessary goods: • For recognition that the coefficient is positive (accept zero) **1 mark** • For an explanation linking the extent of necessity to the size of the coefficient. **Up to 2 marks** **(APP: up to 6 marks)**	**8**	Clear understanding of the concept of YED and its application to inferior and necessary goods.

Question	Answer	Marks	Guidance
2(b)	**Discuss how businesses might attempt to change the price elasticity of demand for their products and consider which approach is most likely to be successful.** **Analysis:** Explains any methods that might be used to change the price elasticity of demand for a product with due reference to any difficulties that might arise with each method explained. **Up to 4 marks for each method explained** **(AN: up to 8 marks)** **Evaluation:** Compares the likely success of the methods explained **(3 marks)** and reaches a conclusion on which is most likely to be successful **(1 mark)** **(EV: up to 4 marks)**	**12**	Businesses can attempt to change the price elasticity of demand by changing the factors that make the product elastic or inelastic. For example they might attempt to make demand more price inelastic by creating more brand awareness and reducing the extent to which other products are seen as substitutes. Accept approaches that explain how businesses might attempt to make the demand for their product more elastic. Candidates might choose to explain only one method. This can be awarded up to 4 marks, but will score no marks for evaluation.

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Question	Answer	Marks	Guidance
3(a)	**Distinguish between regressive and progressive taxes and explain whether you would use an income tax or a specific indirect tax to make post-tax incomes more equal.** **Knowledge and understanding:** • For a definition of a regressive tax **1 mark** • For a definition of a progressive tax **1 mark** **(KU: up to 2 marks)** **Application:** Explains that specific indirect taxes are regressive **(Up to 2 marks)** and their impact upon the **equality** of post-tax incomes (**1 mark)** Explains that income taxes can be progressive **(Up to 2 marks)** and their impact upon the **equality** of post-tax incomes **(1 mark)** **(APP: up to 6 marks)**	**8**	Candidates need to have a clear understanding of the difference between a regressive and progressive tax and that specific indirect taxes will be regressive and income taxes can be designed to be progressive.

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Question	Answer	Marks	Guidance
3(b)	**Discuss whether subsidies on production of all types of goods will lead to an improved allocation of resources.** **Analysis:** Explaining that merit goods are under-consumed because of information failure and that subsidies will reduce price and increase their consumption improving resource allocation. **Up to 4 marks** Explaining the impact of subsidies on other types of goods for e.g. demerit goods, public goods or private goods where resource allocation will not be improved. **Up to 4 marks for each case explained** **(AN: up to 8 marks)** **Evaluation:** Comparing the impact of providing subsidies on different types of goods **(Up to 3 marks)** and for a conclusion on whether they will improve the allocation of **all** types of good **(1 mark)** **(EV: up to 4 marks)**	**12**	Candidates need to recognise that subsidies can improve the allocation of resources if they are imposed upon merit goods. They will go some way to improving the under-consumption of the good. If subsidies are imposed upon demerit goods however they will exacerbate the over-consumption of these goods. Subsidies will not improve resource allocation if applied to public goods because they still need to be provided by the public sector. In the case of other goods that cannot be classified as merit, demerit or public goods subsidies will reduce the price below the equilibrium determined in a free market.

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Question	Answer	Marks	Guidance
4(a)	**Explain, using examples, what is meant by 'protectionism' and show with the help of a diagram how export subsidies can be considered as a form of protectionism.** **Knowledge and understanding:** • Protectionism is adopting policies to assist domestic industries facing competition from foreign industries **1 mark** • through interference with market forces or the relative prices of imports and exports. **1 mark** **(KU: up to 2 marks)** **Application:** **One** example of a method of protectionism other than an export subsidy e.g. a tariff or a quota **(1 mark)** and explaining how this could be considered a method of protectionism **(1 mark)** For explaining why export subsidies can be considered as a method of protectionism: For an accurate diagram showing the impact of the export subsidy on costs and the price of exports **(Up to 3 marks)** and explaining how this could be considered a method of protectionism **(1 mark)** **(APP: up to 6 marks)**	**8**	Candidates often explain what is meant by protectionism by providing examples. A more general explanation is required. This could focus upon protectionism being any policy that interferes with market forces in international trade with the aim of giving an advantage to domestic producers. Diagram: Correctly labelled axes and curves (1 mark) Correct shift in the supply curve (1 mark) Correct change in equilibrium price and quantity (1 mark)

Question	Answer	Marks	Guidance
4(b)	**Discuss the arguments that are used to justify protectionism and consider whether these arguments can ever be justified.** **Analysis:** Considering any argument in favour of protectionism with a consideration of whether it can be justified with due reference to economic theory. **Up to 4 marks per justification** **(AN: up to 8 marks)** **Evaluation:** Summarises the arguments in favour of protectionism and considers whether this can be justified when compared to the benefits of free trade. **Up to 3 marks plus 1 mark for a reasoned conclusion** **(EV: up to 4 marks)**	**12**	Candidates may consider a range of arguments used to justify protectionism such as to protect domestic employment, to correct a balance of payments deficit, the anti-dumping argument and the infant industry argument. They need to examine each in terms of underlying economic theory to reach a conclusion. Candidates might choose to explain more than two justifications for protectionism. Each can be awarded up to 4 marks, but explanation is essential. Only 8 marks are available for this analysis.

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Question	Answer	Marks	Guidance
1(a)	**Describe, using Fig. 1.1, the change in oil production in Nigeria between 2015 and 2016.** 1 mark each for: • Oil production has fallen over the period • From around 2.2 million barrels to around 1.6 million barrels • The most rapid fall was between quarter 1 and quarter 2 in 2016 **(2 marks maximum)**	**2**	1 mark for any of these points
1(b)	**Compare, using supply and demand diagrams, how OPEC's decisions affected the world price of oil in 2014 and in 2016.** For an accurate diagram that shows the increase in the supply of oil in 2014 and the fall in price. **(Up to 2 marks)** For an accurate diagram that shows the decrease in the supply of oil in 2016 and the rise in price. **(Up to 2 marks)** **4 marks maximum**	**4**	In 2014, OPEC's policy has been to increase its supply of oil on the world market. This can be represented by a shift to the right of the world supply curve, producing a new equilibrium position with a lower price but an increase in the quantity of oil traded. In 2016, OPEC decided to reduce supply. This can be shown with a shift to the left of the world supply curve, leading to a fall in supply and a rise in the world price. **Two correct diagrams or a combined diagram is acceptable.**
1(c)	**'The demand for OPEC's oil is price inelastic.' What evidence is there in the information to support this claim?** 1 mark each for: • Fall in world price (of 60%) and fall in OPEC oil revenue (of 45%) • This means that since the % fall in price must be greater than the % rise in quantity demanded and the price must be inelastic	**2**	

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Question	Answer	Marks	Guidance
1(d)	**Fig. 1.2 shows that production in Nigeria's oil sector declined sharply from Q1 of 2016. During this period, total national output for Nigeria fell by an annual rate of only around 2%. What can be inferred from this about the relative importance of the non-oil sectors in Nigeria?** For a comparison of the change in oil sector output and the non-oil sector output **1 mark** For the correct conclusion that the non oil sector is relatively more important **1 mark**	**2**	The data refers to a fall in GDP and an economic slowdown due to the increase in 2015 and up to Q3 in 2016.The fall in non oil growth rate is not as severe as for oil growth. This would indicate that the non oil sector is of much greater economic importance for the economy.(*The non oil sector is responsible for around 90% of output)* If a candidate develops an explanation that this might not be the case, for example through the multiplier effect, then 2 marks can be awarded if the explanation is valid.
1(e)	**Analyse, using aggregate demand and aggregate supply, two likely effects of OPEC's policies on the economy of Nigeria.** Reference to two policies is essential for full marks. For explaining the likely effects on Nigeria of OPEC's policy of increasing supply and reducing price **Up to 2 marks** For explaining the likely effects on Nigeria of OPEC's policy of cutting supply and increasing price **Up to 2 marks**	**4**	From 2014 to 2016 OPEC increased the supply of oil and reduced price. In late 2016 OPEC reduced the supply of oil and increased price. Reward valid use of AD/AS analysis.
1(f)	**Discuss, with the help of the information, the extent to which OPEC will be able to control the world price of oil.** For an explanation of how OPEC can influence the world price of oil with reference to the data. **1 mark** For an explanation of any factors that undermine OPEC's influence on the world price of oil **Up to 4 marks** For evaluative comment on the extent to which OPEC can control the price **1 mark**	**6**	The data states that OPEC produces half of the global production of oil. By varying the volume of production it can influence the market price. On the other hand OPEC's market power is constrained by a number of factors. These include the rise of oil production in the US through 'fracking' and the need for government revenues amongst OPEC member countries.

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Question	Answer	Marks	Guidance
2(a)	**Using examples, explain why merit goods are said to be under-consumed and demerit goods are over-consumed.** **Knowledge and understanding** of the nature of information failure **(1 mark)** and that this leads to under-consumption and over-consumption of some goods in the market **(1 mark)** **(KU: up to 2 marks)** **Application:** Explaining why merit goods are under-consumed **(2 marks)** and with an appropriate example **(1 mark)**. Explaining why demerit goods are over-consumed **(2 marks)** and with an appropriate example **(1 mark)**. **(APP: up to 6 marks)**	**8**	The main point here is to recognise the nature of information failure and why it leads to under and over consumption. Examples of each type of good with a relevant applied explanation of information failure are required to enhance the quality of the answer.

Question	Answer	Marks	Guidance
2(b)	**Discuss whether merit goods should always be subsidised and demerit goods always taxed.** **Analysis:** Of the benefits of subsidisation of merit goods **(up to 3 marks)** compared with other methods to increase their consumption **(1 mark)**. And of the benefits of taxation of demerit goods **(up to 3 marks)** compared with other methods to decrease their consumption **(1 mark)**. **(AN: up to 8 marks)** **Evaluation:** Of the idea that merit goods should always be subsidised and demerit goods should always be taxed. Reserve **1 mark** for a reasoned conclusion**.** **(EV: up to 4 marks)**	**12**	It is usual but by no means always true that merit goods are subsidised and that demerit goods are subject to indirect taxation. This happens a lot but there are other means of increasing and decreasing consumption. The clue in the question is 'always' which can form the basis of the evaluative judgement.
3(a)	**Explain the difference between the causes of cost-push inflation and demand-pull inflation.** For **knowledge and understanding** of what is meant by 'inflation'**(1 mark)** with due reference to the relationship between aggregate demand and aggregate supply **(1 mark)**. **(KU: up to 2 marks)** **Application** Explains the causes of cost push inflation. **(Up to 3 marks)** Explains the causes of demand pull inflation. **(Up to 3 marks)** **(APP: up to 6 marks)**	**8**	At AS level inflation is seen as the result of a shift in AD or AS. Good answers will distinguish the two causes through reference to a shift to the right of AD or a shift to the left in AS.

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Question	Answer	Marks	Guidance
3(b)	**Discuss the most serious problems faced by an economy with a high and increasing rate of inflation.** **Analysis:** Of the internal effects of high and increasing rates of inflation on an economy. **(Up to 4 marks)** Of the external effects of high and increasing rates of inflation on an economy. **(Up to 4 marks)** **(AN: up to 8 marks)** **Evaluation:** Of which problems could be considered most serious **(up to 3 marks)** with **1 mark** for a reasoned conclusion. **(EV: up to 4 marks)**	**12**	The internal effects include the impact upon savings and investment, the re-distribution of incomes that might have a disincentive effect and menu costs. The external effects include the impact upon the exchange rate and the external balance and the possibility of capital flight.

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Question	Answer	Marks	Guidance
4(a)	**Explain the benefits of free trade as suggested by the principle of comparative advantage.** **Knowledge and understanding** of the principle of comparative advantage in terms of lowest opportunity costs **(Up to 2 marks)**. **(KU: up to 2 marks)** **Application:** Explaining the benefits of free trade **(4 marks)** with due reference to the limits of comparative advantage **(2 marks)**. **(APP: up to 6 marks)**	**8**	The principle of comparative advantage states that specialisation and trade will be beneficial if there are differences in the opportunity costs of production in two countries. Trade will not be beneficial if opportunity costs are the same, if the exchange rate is outside the opportunity cost ratios and if transport costs are very high.
4(b)	**Despite the benefits of free trade, there has been a recent increase in protectionism by some developed and developing economies. Discuss the possible reasons for this increase.** **Analysis:** That considers any reasons that developed economies might adopt protectionist policies **(up to 4 marks)**. That considers any reasons that developing economies might adopt protectionist policies **(up to 4 marks)**. **(AN: up to 8 marks)** **Evaluation:** That considers whether the arguments for protectionism are distinct or the same in each type of economy **(up to 3 marks)** with **1 mark** for a conclusion. **(EV: up to 4 marks)**	**12**	The reasons for the rise of protectionism in developed and developing economies are varied. These include the protection of domestic industry to preserve employment, to maintain balance in the current account, to prevent dumping and for strategic reasons.

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