Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/21**

Paper 2 AS Level Data Response and Essays **May/June 2025**

2 hours

2493284048

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **one** question.
  - Section C: 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 60.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages.

DC (CJ) 351804/1
© UCLES 2025

[Turn over

stemup.co.uk

Section A

Answer all parts of Question 1.

1 Inflation rate falls in the United States (US), but fears continue over the economic outlook

Americans have been worried about the rate of inflation in the US, especially the increases in food, rent, energy and vehicle prices.

Content removed due to copyright restrictions.

© UCLES 2025

stemup.co.uk

Content removed due to copyright restrictions.

One economist stated that 'we still expect the impact of the increase in interest rates to push the economy into a mild recession in the first half of 2023'.

Sources: Adapted from 'Economic growth beats forecasts in US', The Times*, 27 January 2023 and adapted from 'Inflation rate falls in America – but fears continue over economic outlook',* The Times*, 28 January 2023*

(a) Using the data in Table 1.1, compare changes in the inflation rate and changes in the interest rate in the US. [2]

(b) Explain one reason why using the Consumer Price Index (CPI) to measure the inflation rate in the US may not produce an accurate result. [2]

(c) 'In an attempt to bring about disinflation, the Federal Reserve used a contractionary monetary policy.' Consider whether disinflation is more harmful than deflation. [4]

(d) Assess whether increases in the interest rate make a recession in the US inevitable. [6]

(e) Assess whether the Federal Reserve setting an inflation target as part of its monetary policy is likely to be helpful for the US economy. [6]

Section B

Answer **one** question.

EITHER

2 **(a)** With the help of a diagram, explain the reasons for a movement within a production possibility curve (PPC) and a shift of a PPC **and** consider the extent to which opportunity cost determines the shape of a PPC. [8]

(b) Assess whether a shift to the right of a PPC is only caused by an increase in the quantity of resources. [12]

OR

3 **(a)** With the help of a diagram, explain how changes in a subsidy can influence the price and quantity sold of a product in a market **and** consider how expenditure on a subsidy is affected by the price elasticity of demand for the product. [8]

(b) Assess whether an increase in the tax on a demerit good is always the best way to reduce the consumption of such a product. [12]

Section C

Answer **one** question.

EITHER

4 **(a)** Explain how the circular flow of income in an economy changes when that economy moves from a closed to an open economy **and** consider what determines the extent of the change. [8]

(b) Assess whether the potential benefits of free trade always outweigh the arguments for protectionism. [12]

OR

5 **(a)** Explain the difference between a budget surplus and a budget deficit **and** consider the extent to which a budget surplus is better than a budget deficit. [8]

(b) Assess whether expansionary fiscal policy always benefits an economy. [12]

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (UCLES) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced online in the Cambridge Assessment International Education Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download at www.cambridgeinternational.org after the live examination series.

Cambridge Assessment International Education is part of Cambridge Assessment. Cambridge Assessment is the brand name of the University of Cambridge Local Examinations Syndicate (UCLES), which is a department of the University of Cambridge.

© UCLES 2025

stemup.co.uk

Surname	StemUp Model Solution
Answer booklet	Write the question number in the left-hand margin at the start of each answer.

Question number

Answers for paper 9708/21

1(a) The interest rate rose continuously, from 0.25% in January 2022 to 1.50% in June 2022 and 4.50% in December 2022, whereas the inflation rate rose between January and June 2022 and then fell by December 2022. The proportionate changes in the interest rate were also much greater than those in the inflation rate: the interest rate increased 18 times over the year (4.50 ÷ 0.25 = 18), while inflation changed by far less.

1(b) The CPI is based on a basket of goods and services, weighted to represent what the average household buys. As buying patterns change, the basket and weights may no longer be typical of all households, and they are only updated periodically, so with rapid changes in food, rent, energy and vehicle prices, the CPI may not reflect the true rise in the cost of living for many US households.

1(c) Disinflation is a fall in the rate of inflation, so prices are still rising but more slowly. The problems of inflation therefore remain, only on a smaller scale: people on fixed incomes still lose purchasing power, exports become less competitive, and there are menu costs, shoe leather costs and uncertainty that makes investment planning harder.

Deflation is a sustained fall in the general price level. If it is caused by a large fall in aggregate demand, consumers delay spending because they expect lower prices, firms cut output and investment, unemployment rises and the real burden of debt increases, which can lead to a recession and a deflationary spiral.

Which is more harmful depends on the extent and length of each. Mild disinflation

Question number	
	from a high rate, as in the US, is usually helpful rather than harmful, whereas prolonged demand-led deflation is generally more damaging. So disinflation is normally less harmful than deflation, unless the inflation rate remains well above target.
1(d)	Higher interest rates (from 0.25% to 4.50% during 2022) make borrowing more expensive for consumers and firms and increase the reward for saving. Spending on credit, such as cars and housing, falls and firms postpone investment, so consumption and investment fall. As a result aggregate demand falls, and higher borrowing costs also raise firms' costs, so output falls and unemployment rises. If real GDP falls for two consecutive quarters, the US is in a recession, as the economist expected for the first half of 2023. However, a recession is not inevitable. Spending may be interest inelastic if consumers and firms are confident, have high savings or borrowed earlier at fixed rates. Other factors also influence AD and AS: strong demand for exports, rising government spending, falling energy prices or productivity gains can keep output growing. Indeed, the source shows the economy beat growth forecasts despite the rate rises. The Federal Reserve can also cut rates again once inflation falls. On balance, large and rapid interest rate increases make a recession more likely, especially because of time lags of up to two years, but they do not make it inevitable. The outcome depends on the size of the rises, how sensitive spending is to interest rates and what happens to the other components of AD. A slowdown is likely, but a recession is not certain.
1(e)	An inflation target, such as the Federal Reserve's 2% target, can be helpful because it creates stability and confidence. It tells consumers, firms and workers that the Federal Reserve will act, for example by raising interest rates, if inflation rises well above the target. This anchors inflation expectations, so workers are less

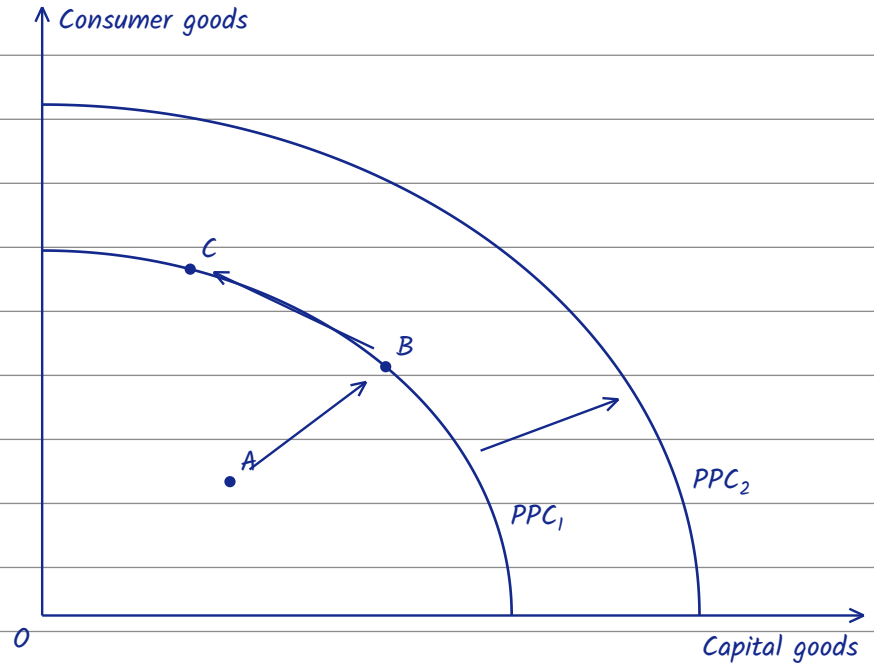
Question number

likely to demand large wage increases, which helps prevent a wage-price spiral. Firms can plan investment with more certainty, and the target makes the central bank accountable.

However, a target may not be helpful. The Federal Reserve faces a balancing act: to hit the target it may have to raise interest rates so much that it causes a downturn and higher unemployment, so it may not be willing to take the necessary action, and the target then loses credibility. Much recent inflation came from cost-push factors such as energy and food prices, which monetary policy controls only slowly, so inflation stayed far above 2% for a long time.

Overall, a target is likely to be helpful if it is credible and flexible, for example an average target over time, because the benefit of stable expectations outweighs the risk of overreacting. It helps most for demand-pull inflation; for supply shocks it needs other policies alongside it.

2(a) A production possibility curve (PPC) shows the maximum combinations of two goods an economy can produce when all its resources are fully and efficiently employed, given the existing state of technology.



Question number

A movement within the PPC is caused by a change in the use of existing resources. At point A, inside PPC1, resources are unemployed or used inefficiently; if they are employed, output moves from A to B on the curve. A movement along the curve from B to C happens when existing resources are reallocated from capital goods to consumer goods; more consumer goods can only be made by giving up capital goods, which is the opportunity cost.

A shift of the PPC, from PPC1 to PPC2, is caused by an increase in the quantity or quality of resources or by an improvement in technology, which raises productive capacity. A shift outwards does not involve opportunity cost, because with the extra resources more of both goods can be produced.

The shape of the PPC is determined by opportunity cost. If resources are equally suited to producing both goods, the opportunity cost is constant and the PPC is a straight line. In reality resources are specialised, so as more of one good is produced, less suitable resources must be moved and the opportunity cost increases, giving a curve that is concave to the origin, as in the diagram. So opportunity cost fully explains the shape of the PPC, although what determines opportunity cost is how specialised the resources are.

2(b)

A shift to the right of the PPC shows an increase in the productive capacity of the economy, so more of both goods can be produced (PPC1 to PPC2 in the diagram in 2(a)). This is potential economic growth.

An increase in the quantity of resources is one cause. More land, for example the discovery of new oil or mineral reserves; more labour, from net immigration, a rising birth rate or a higher retirement age; more capital, from investment in machinery and infrastructure; and more enterprise, as more people start businesses. With more factors of production, more goods and services can be produced, so the PPC shifts outward.

However, it is not only the quantity of resources that matters. An increase in the

Question number

quality of resources also shifts the PPC outwards. Education and training raise the skills and productivity of labour, better health reduces absence, and newer capital is more productive than old capital. With the same number of workers, each worker produces more, so total potential output rises.

Technological change is another cause. New production methods, automation and better information technology allow more output from the same inputs. Technology may affect only one industry: an improvement in the technology for producing consumer goods would pivot the PPC outwards along that axis only. Improvements in the organisation of production, such as better management or division of labour, have a similar effect.

The relative importance of these causes depends on the economy. In a developing economy with a fast-growing population and low capital per worker, increases in the quantity of labour and capital may be the main cause. In a developed economy with an ageing population, the quantity of labour may be falling, so growth depends mainly on quality and technology. Quantity and quality are also linked: investment adds to the capital stock and often brings newer technology with it.

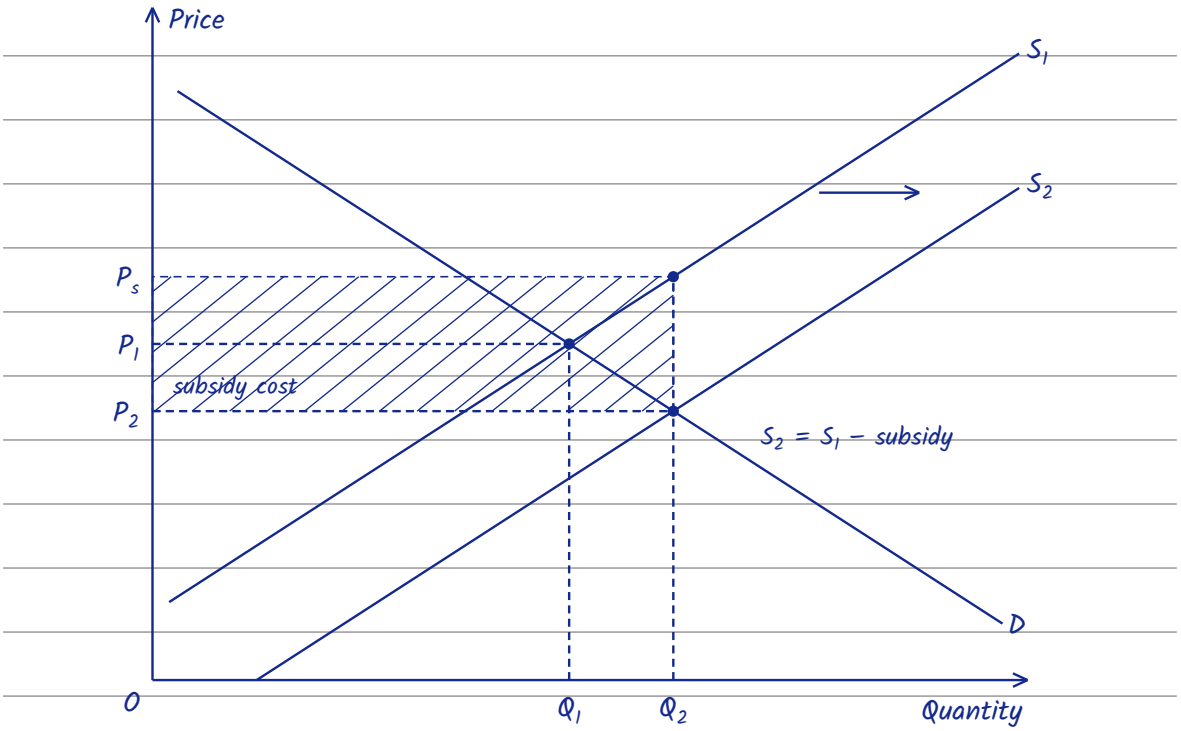
Evaluation also depends on the time period. An increase in quantity, such as immigration, can shift the PPC quickly, while education and research take many years to have an effect, though their effect may be larger and more lasting. In addition, the quantity of some resources can fall, through depletion of natural resources or emigration, and quality improvements may be needed just to stop the PPC shifting inwards.

In conclusion, a shift to the right of the PPC is not only caused by an increase in the quantity of resources. Improvements in the quality of resources and in technology are equally, and in most modern economies more, important causes of an increase in productive capacity.

3(a) A subsidy is a sum of money paid by the government to producers, usually per unit

Question number

produced, which reduces their costs of production.



An increase in a subsidy lowers the cost of producing each unit, so firms are willing to supply more at every price and the supply curve shifts to the right, from S1 to S2. At the original price P1 there is excess supply, so the price falls to P2 and the quantity sold rises from Q1 to Q2. Consumers pay a lower price and consume more, which is why governments subsidise products such as public transport or basic foods.

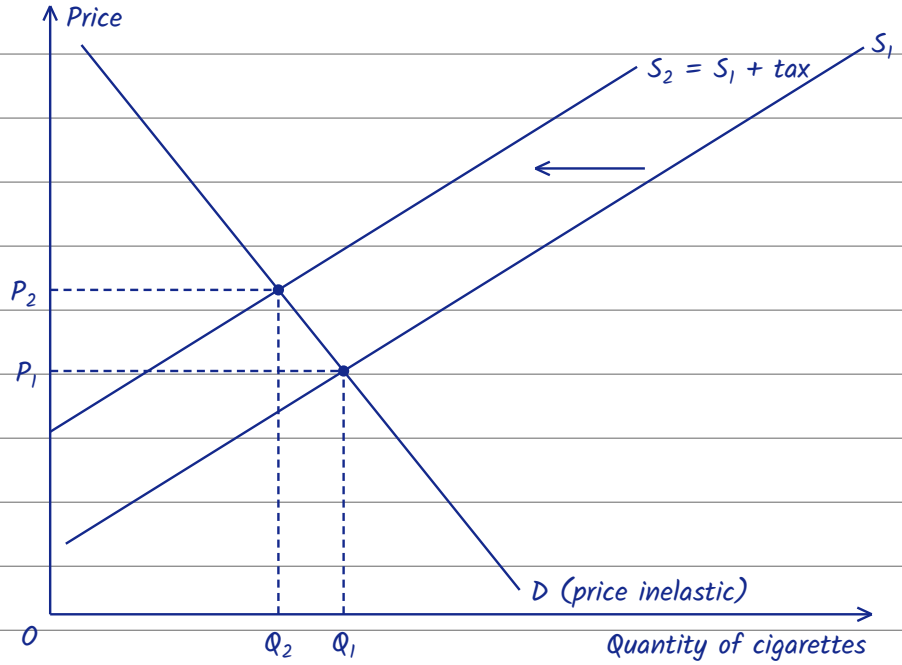
A decrease in a subsidy has the opposite effect: costs rise, supply shifts left from S2 to S1, the price rises from P2 to P1 and the quantity sold falls from Q2 to Q1.

Government expenditure on the subsidy is the subsidy per unit (Ps – P2) multiplied by the quantity sold (Q2), the shaded rectangle. This depends on price elasticity of demand. If demand is price elastic, the fall in price causes a proportionately larger rise in quantity, so Q2 is much larger and expenditure on the subsidy is high. If demand is price inelastic, quantity rises only a little, so expenditure is lower, although more of the subsidy is passed on to consumers as a lower price. So the more price elastic demand is, the greater the government's

Question number

expenditure on a given subsidy per unit.

3(b) A demerit good, such as cigarettes or alcohol, is a product that is more harmful to the consumer than they realise, and is over-consumed because of information failure and because consumption creates negative externalities for third parties. An increase in an indirect tax raises firms' costs, so supply shifts left from S1 to S2. The price rises from P1 to P2 and the quantity consumed falls from Q1 to Q2. The tax also raises revenue that the government can spend on healthcare or on education about the dangers of the product, and it makes consumers pay a price closer to the full social cost.



However, demand for many demerit goods is price inelastic, because they are addictive and have few substitutes. As the diagram shows, a large tax increase then causes only a small fall in consumption from Q1 to Q2, while the price rises a lot. The tax is also regressive: low-income consumers spend a higher proportion of their income on products like cigarettes, so it widens inequality. Very high taxes encourage smuggling and illegal markets, where products may be even more harmful and pay no tax.

Question number

Other methods may be more effective. An information or education campaign, such as health warnings on packets, tackles the cause of the problem, information failure, and shifts demand to the left, which can change behaviour in the long run and may make demand more elastic. Regulation, such as banning sales to young people or banning advertising, directly limits consumption. A minimum price above equilibrium also raises the price, without the government having to collect the tax, but it raises producers' revenue rather than government revenue.

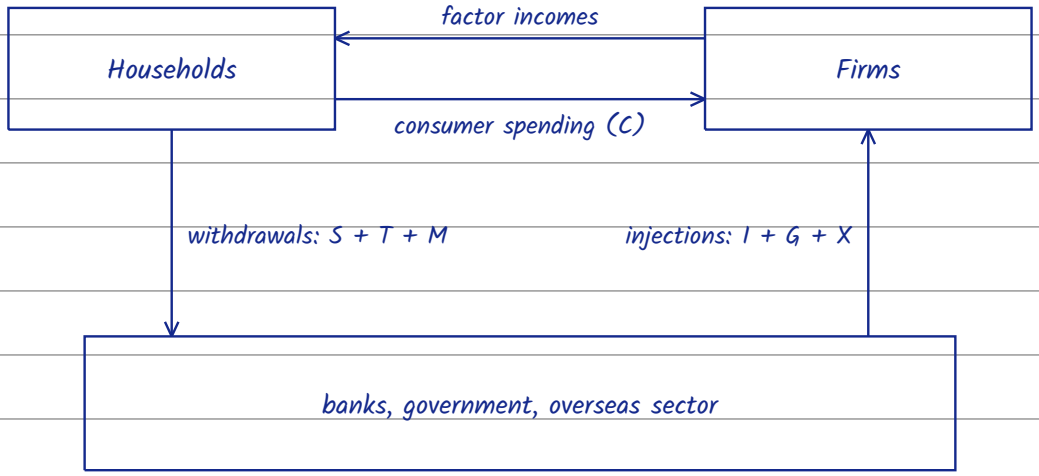
These alternatives have weaknesses too. Information campaigns cost money and take a long time to work, and some consumers ignore them. Bans and regulations need enforcement and can also create illegal markets. A minimum price has the same problem as a tax if demand is inelastic.

Whether a tax is the best way depends on price elasticity of demand, the size of the tax and the type of consumer. For young people, whose demand is more price elastic, a tax may be very effective; for long-term addicted users it is not. It also depends on what the government wants: if it also needs revenue, a tax has an advantage that a ban does not.

In conclusion, an increase in tax is not always the best way to reduce the consumption of a demerit good, because demand is often price inelastic and the tax is regressive. It is most effective as part of a combination of policies, together with information campaigns and regulation, which reduce consumption in the long run.

4(a) The circular flow of income shows how income flows around an economy in a continuous process. Households own the factors of production and supply them to firms; firms pay them factor incomes (wages, rent, interest and profit); households spend this income on the goods and services produced by firms, which becomes firms' revenue.

Question number



In a closed economy with a government, not all income is passed on. Withdrawals (leakages) are savings (S) and taxes (T), which take income out of the flow, and injections are investment (I) and government spending (G), which add spending that does not come from households' consumption.

When the economy opens up to trade, a third withdrawal and a third injection are added. Spending on imports (M) is a withdrawal, because the income goes to foreign producers, and spending on exports (X) by foreigners is an injection into the flow. National income is in equilibrium when S + T + M = I + G + X, so trade can now raise or reduce the level of national income.

The extent of the change depends on how open the economy becomes: the proportion of income spent on imports (the marginal propensity to import), the size of exports relative to GDP, the level of protection, the exchange rate and income in trading partners. A small economy that specialises and trades heavily, such as Singapore, will see a large change, while a large economy with a big domestic market will see a smaller one. So the extent of the change depends mainly on the size of X and M relative to national income.

Question number

4(b)

Free trade is international trade without barriers such as tariffs, quotas or subsidies. Protectionism is the use of such barriers to protect domestic producers from foreign competition.

The main benefit of free trade comes from specialisation according to comparative advantage. If each country specialises in the products it can produce at a lower opportunity cost and trades, world output increases and resources are allocated more efficiently. Firms can produce at lower cost through economies of scale by selling to larger markets, competition from imports forces domestic firms to become more efficient, and consumers gain lower prices and a wider choice of products. Together this can increase economic growth and living standards.

However, there are arguments for protection. The infant industry argument says new (sunrise) industries need temporary protection until they grow large enough to gain economies of scale and compete with established foreign firms. Declining (sunset) industries may be protected to slow their decline and give time for workers and other factors to move to new uses, reducing structural unemployment. Strategic industries, such as food, energy and defence, may be protected so the country is not dependent on imports. Anti-dumping duties protect domestic firms from foreign firms selling below cost, and import controls may be used to reduce a current account deficit.

The strength of these arguments is limited. Infant industries may never "grow up" and come to depend on protection; protection of sunset industries can delay necessary change; and tariffs raise prices for consumers and for firms that use imported components. Protection also invites retaliation, so exporters lose markets, and a trade war can leave all countries worse off. Many protectionist arguments are also used by interest groups to protect profits rather than for genuine economic reasons.

Who benefits also matters. Free trade benefits consumers and efficient exporters, but workers in industries that lose out to imports can suffer long-term

Question number

unemployment, so the gains are not shared equally. The theory of comparative advantage also assumes no transport costs, perfect factor mobility and constant costs, which do not hold in reality.

In conclusion, the potential benefits of free trade usually outweigh the arguments for protectionism, because the gains in output, efficiency and choice are large and long-lasting, while protection tends to be costly. But they do not always outweigh them: temporary, targeted protection may be justified for a genuine infant industry, against dumping or for strategic reasons, provided it is limited and reviewed.

5(a) The government budget compares government revenue, mainly from taxation, with government spending over a year. A budget surplus occurs when revenue is greater than spending ($T > G$), and a budget deficit when spending is greater than revenue ($G > T$), so the government must borrow to finance the difference.

A budget surplus allows the government to repay debt, which lowers future interest payments and gives room to borrow in a future recession. It also reduces aggregate demand and so inflationary pressure. However, a surplus means taxes are high or spending is low, which reduces AD, so it may slow growth and raise unemployment, and it may mean under-investment in infrastructure, education and health.

A budget deficit injects spending into the economy, increasing AD through the multiplier, which can reduce unemployment in a recession, and borrowing can finance investment in infrastructure that raises long-run growth. However, deficits add to national debt and interest payments, may crowd out private investment if interest rates rise, and can be inflationary if the economy is near full capacity.

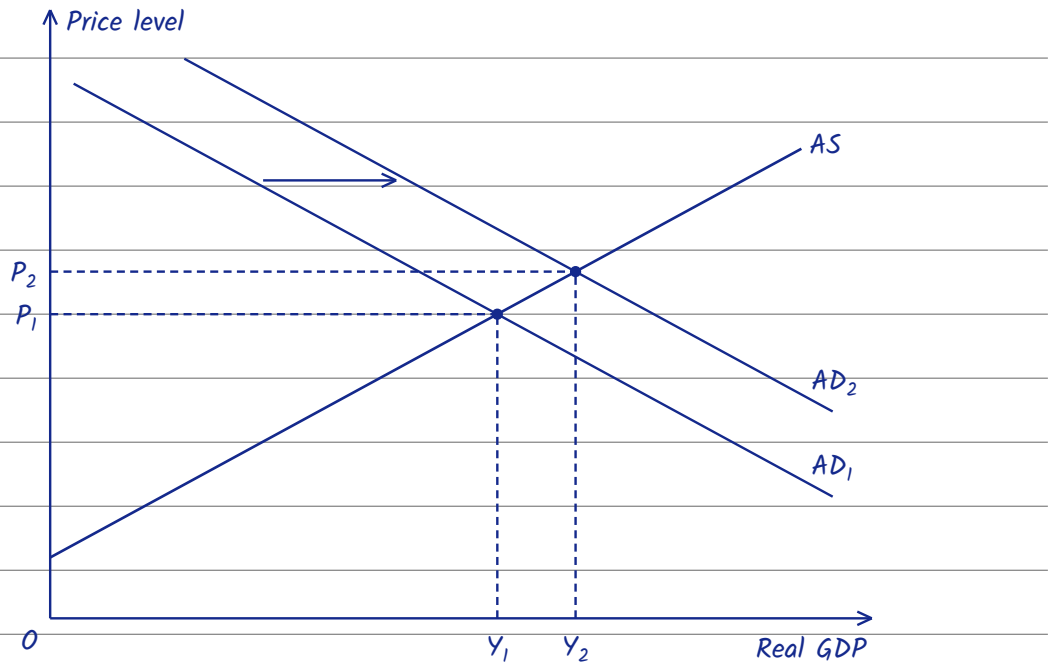
So a surplus is not always better. It depends on the state of the economy: a surplus is better during a boom with high inflation, but a deficit is better in a recession. It also depends on what a deficit finances and how large and

Question number

long-lasting it is. Overall, neither is better in all cases; the appropriate position depends on the economic cycle.

5(b) Expansionary fiscal policy is an increase in government spending and/or a reduction in taxation, designed to increase aggregate demand. It usually increases the budget deficit.

Higher government spending directly increases AD, while lower income tax increases disposable income and so consumption, and lower corporation tax can increase investment. AD shifts right from AD1 to AD2, and through the multiplier effect, the extra spending becomes income for others, who spend part of it, so real GDP rises from Y1 to Y2 by more than the initial injection.



Higher output means firms need more workers, so cyclical unemployment falls and living standards rise. If the spending is on infrastructure, education or health, or tax cuts improve incentives to work and invest, expansionary fiscal policy can also increase productive capacity and shift LRAS to the right, giving long-run growth. However, expansionary fiscal policy may not always benefit the economy. As the diagram shows, higher AD also raises the price level from P1 to P2; if the economy

Question number

is close to full employment most of the effect is on prices rather than output, causing demand-pull inflation. The larger deficit must be financed by borrowing, increasing the national debt and future interest payments, which may later require higher taxes or spending cuts. Government borrowing may raise interest rates and crowd out private investment. Some of the extra income will be spent on imports, worsening the current account, and time lags mean the policy may take effect after the economy has already recovered.

The effect depends on the extent of the policy and the state of the economy. In a deep recession with a large negative output gap, as in many countries in 2020, expansionary fiscal policy is very beneficial, because there are unused resources and little risk of inflation. When the economy is near capacity, or government debt is already very high, the costs may outweigh the benefits. It also depends on what the money is spent on: investment in infrastructure is more beneficial in the long run than spending on current consumption.

In conclusion, expansionary fiscal policy does not always benefit an economy. It is beneficial when there is spare capacity and the spending raises long-run productive capacity, but it can cause inflation, higher debt and crowding out when used at the wrong time or on too large a scale.

Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/22**

Paper 2 AS Level Data Response and Essays **May/June 2025**

2 hours

2121461485

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **one** question.
  - Section C: 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 60.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages.

DC (EV/CB) 351808/1
© UCLES 2025

[Turn over

stemup.co.uk

Section A

Answer all parts of question 1.

1 Can South Africa escape from its economic difficulties?

South Africa has serious economic difficulties. Despite its vast natural resources, the main economic indicators show a country in trouble. As Fig. 1.1 shows, despite a fall over the last year, unemployment remains very high. It is amongst the highest in the world, particularly for young people, and this has led to one of the highest and most persistent levels of income inequality in the world, with a Gini coefficient of 0.67.

Economic growth is amongst the worst in Africa and this, together with high government expenditure, means that the country has had a fiscal deficit of more than 4% of GDP in recent years. Despite falls in the value of South Africa's currency (rand), the current account of the balance of payments is projected to move to a significant deficit of 2.3% of GDP in 2023 and to deteriorate further to about 2.5% of GDP in 2024. South Africa is also suffering extended power cuts of up to 10 hours per day due to the collapse of the state electricity provider. What can be done?

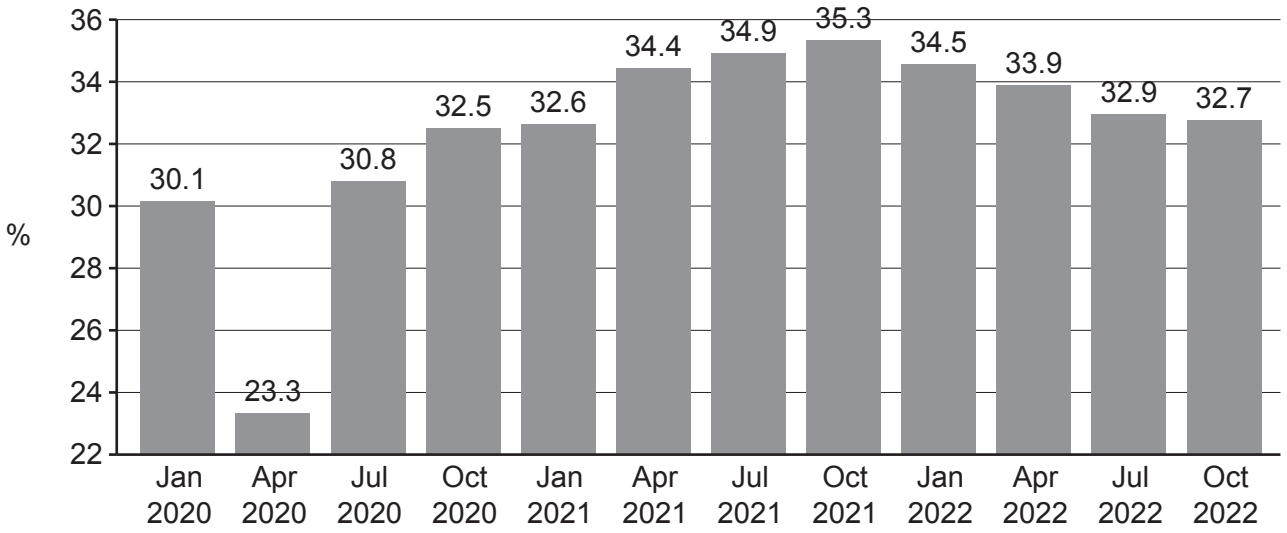


Fig. 1.1 South Africa % rate of unemployment, January 2020 to October 2022

Source: tradingeconomics.com

stemup.co.uk

In a March 2023 statement, the International Monetary Fund (IMF) recommended that the South African government should adopt the following policies:

- Improvements in infrastructure, particularly electricity supplies and transport links. This should be achieved by promoting more private sector investment.
- Encourage more competition within South Africa and free trade with neighbouring countries by reducing protection. Closer links with the African Continental Free Trade Area (AfCFTA) should be established.
- To tackle the very high rates of unemployment and income inequality, a range of policies has been suggested. These include setting the minimum national wage at an appropriate rate to encourage more people back into the workforce. This should be done alongside policies to strengthen employment protection. In addition, other policies include improving levels of education and training and better support for the transition from school to work. Finally, policies to promote entrepreneurship need to be introduced.

However, will these policies help South Africa escape from its economic difficulties?

Sources: adapted from: FocusEconomics article,
'Will South Africa find a way out of its economic rut?'
and IMF concluding statement concerning South Africa, 22 March 2023

(a) **(i)** Identify the overall change in the unemployment rate in South Africa between January 2020 and October 2022. [1]

(ii) Compare the trend in the unemployment rate in South Africa between January 2020 and January 2022 with that between January 2022 and October 2022. [1]

(b) Identify **one** possible impact on firms in South Africa and **one** possible impact on the government of South Africa of such a high rate of unemployment. [2]

(c) Consider whether continued falls in the value of the South African rand may lead to a reduction in the current account deficit of the balance of payments. [4]

(d) Assess the extent to which closer membership of the AfCFTA may help South Africa to achieve the growth needed to 'escape from its economic difficulties'. [6]

(e) Assess the extent to which the policies suggested to improve infrastructure and to reduce the high rates of unemployment in South Africa are likely to reduce income inequality. [6]

© UCLES 2025

stemup.co.uk

Section B

Answer **one** question.

EITHER

2 **(a)** With the help of examples, explain the difference between public goods and free goods **and** consider whether a market economy can ever produce public goods. [8]

(b) Assess the extent to which a government can ensure that both merit and demerit goods are produced in desirable quantities. [12]

OR

3 **(a)** Explain **three** reasons, associated with costs of production, why the supply curve for a particular market may shift to the right **and** consider the extent to which government microeconomic policy may also shift the supply curve for a particular market to the right. [8]

(b) Assess the extent to which knowledge of a product's price elasticity of supply is the most useful measure of elasticity to a firm needing to react quickly to changes in its market. [12]

Section C

Answer **one** question.

EITHER

4 **(a)** With the help of an AD/AS diagram(s), explain one demand-side and one supply-side cause of deflation **and** consider which is likely to be more damaging to an economy. [8]

(b) Assess the extent to which using fiscal policy would be the best way to reduce a high rate of inflation. [12]

OR

5 **(a)** With the help of a diagram, explain **two** ways in which a fall in the balance of trade in goods may affect the value of a floating exchange rate **and** consider the extent to which a change in the relative rate of interest between two countries may have a greater impact on the exchange rate. [8]

(b) Assess whether an improvement in the terms of trade or a surplus on the current account of the balance of payments is of more benefit to an economy. [12]

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (UCLES) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced online in the Cambridge Assessment International Education Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download at www.cambridgeinternational.org after the live examination series.

Cambridge Assessment International Education is part of Cambridge Assessment. Cambridge Assessment is the brand name of the University of Cambridge Local Examinations Syndicate (UCLES), which is a department of the University of Cambridge.

stemup.co.uk

Surname	StemUp Model Solution
Answer booklet	Write the question number in the left-hand margin at the start of each answer.

Question number	
	Answers for paper 9708/22
1(a)(i)	The unemployment rate increased overall (from 30.1% in January 2020 to 32.7% in October 2022).
1(a)(ii)	Between January 2020 and January 2022 the unemployment rate increased (from 30.1% to 34.5%), whereas between January 2022 and October 2022 it fell (from 34.5% to 32.7%).
1(b)	Firms: they may find it easier and cheaper to recruit workers, as there is a large supply of labour, so they can pay lower wages. Government: it receives less income tax revenue and has to spend more on welfare payments, which adds to the fiscal deficit of more than 4% of GDP.
1(c)	A fall in the value of the rand makes South African exports cheaper in foreign currencies and makes imports more expensive in rand. This should increase the demand for exports and reduce the demand for imports, so the value of net exports (X – M) rises and the current account deficit falls. However, this depends on the price elasticity of demand for exports and imports. If demand is price inelastic, export revenue rises only a little while spending on imports rises, so the deficit may get worse. Power cuts of up to 10 hours a day also limit firms' ability to produce more exports, and dearer imported inputs raise costs. This is why, despite falls in the rand, the deficit is projected to widen to 2.3% of GDP in 2023 and 2.5% in 2024. So continued falls are unlikely to reduce the deficit much unless supply problems are solved.

Question number

1(d) Closer membership of the AfCFTA removes tariffs and other barriers with other African countries. This opens up large additional markets for South African firms, which can lead to export-led growth and economies of scale. Greater competition from imports encourages domestic firms to become more efficient, leading to lower prices and better products, which increases consumption at home and abroad. A larger free trade area may also attract more foreign direct investment, which increases productive capacity and creates jobs.

However, domestic businesses will face increased competition, and less efficient firms may lose sales to cheaper imports from other members. This could lead to a fall in demand for domestically produced goods, higher unemployment in a country where it is already over 32%, and slower growth. Imports may rise faster than exports, worsening the current account deficit. Growth is also limited by supply-side problems that trade cannot solve, such as power cuts of up to 10 hours a day and poor transport links.

On balance, closer membership of the AfCFTA can help South Africa achieve growth in the long run, as it is one of the most industrialised economies in Africa and is well placed to export to its neighbours. However, it will only help to the extent that the electricity and infrastructure problems are fixed, so on its own it is unlikely to be enough to escape South Africa's economic difficulties.

1(e) The policies are supply-side policies. Improving transport links and electricity supplies increases labour mobility, so people in poorer areas can reach jobs, and encourages firms to expand and create jobs. Setting an appropriate national minimum wage raises the incomes of the lowest paid, and employment protection safeguards their jobs. Better education, training and support for the transition from school to work make young people more employable, while promoting entrepreneurship allows people to move into self-employment. Moving people from

Question number

unemployment into work raises the incomes of the poorest, which should reduce the Gini coefficient of 0.67.

However, these policies are expensive to implement when the fiscal deficit is already above 4% of GDP, so they may be cut back or withdrawn. They also take a long time to work, especially education and infrastructure. People may not be receptive: some may prioritise earning an income now rather than training. A minimum wage set too high and stronger employment protection may make firms reluctant to hire, increasing unemployment. If the benefits go mainly to those already in work or with higher incomes, inequality will not fall.

Overall, the policies are likely to reduce income inequality to some extent in the long run, mainly through education, training and job creation, but the impact depends on how well they are financed and targeted at the poorest. They will reduce inequality slowly rather than quickly.

2(a) A free good is a good that is not scarce, so it has zero opportunity cost and no factors of production are needed to produce it, for example the air we breathe or sunlight. A public good is a good that is non-excludable, meaning people who do not pay cannot be prevented from consuming it, and non-rival, meaning one person's consumption does not reduce the amount available to others. Examples are national defence and street lighting. Unlike free goods, public goods are scarce and use resources, so they have an opportunity cost.

Because public goods are non-excludable, consumers can enjoy them without paying. This is the free rider problem: people have no incentive to reveal how much they value the good or to pay for it. Firms therefore cannot charge a price or make a profit, so a market economy is unlikely to provide public goods at all. This is a missing market, a form of market failure, which is why public goods are usually provided by governments and paid for by taxation.

However, a market economy might produce public goods in some cases. Technology

Question number

can make a good excludable, such as encrypted television broadcasts, so a price can be charged. Firms may also provide them if they are funded by advertising or sponsorship, or if the government gives them a subsidy or contract. Unless one of these happens, it is unlikely that a market economy could ever produce pure public goods in the quantity society wants.

2(b) Merit goods, such as education and healthcare, are considered desirable by society but are under-consumed in a free market, because of information failure and because they create positive externalities. Demerit goods, such as cigarettes and alcohol, are considered undesirable but are over-consumed. The desirable quantity is the socially optimum level where marginal social benefit equals marginal social cost.

For merit goods the government can provide a subsidy to producers, which reduces costs, shifts supply right, lowers the price and increases consumption towards the optimum. It can provide the good directly and free of charge, as with state schools, or set a maximum price. It can also provide information about the benefits of the good, which shifts demand to the right.

For demerit goods the government can impose an indirect tax, which shifts supply left, raises the price and reduces consumption. It can set a minimum price, ban or regulate the good, for example by limiting sales by age, or run information campaigns on the harmful effects, which shift demand to the left.

However, the government cannot ensure desirable quantities. It is difficult to measure external costs and benefits in money, so the government does not know the exact optimum quantity, and deciding which goods are merit or demerit goods involves value judgements. The effectiveness of taxes and subsidies depends on price elasticity of demand: demand for demerit goods such as cigarettes is often price inelastic, so taxes reduce consumption only slightly. Consumers may not respond to information campaigns.

Question number

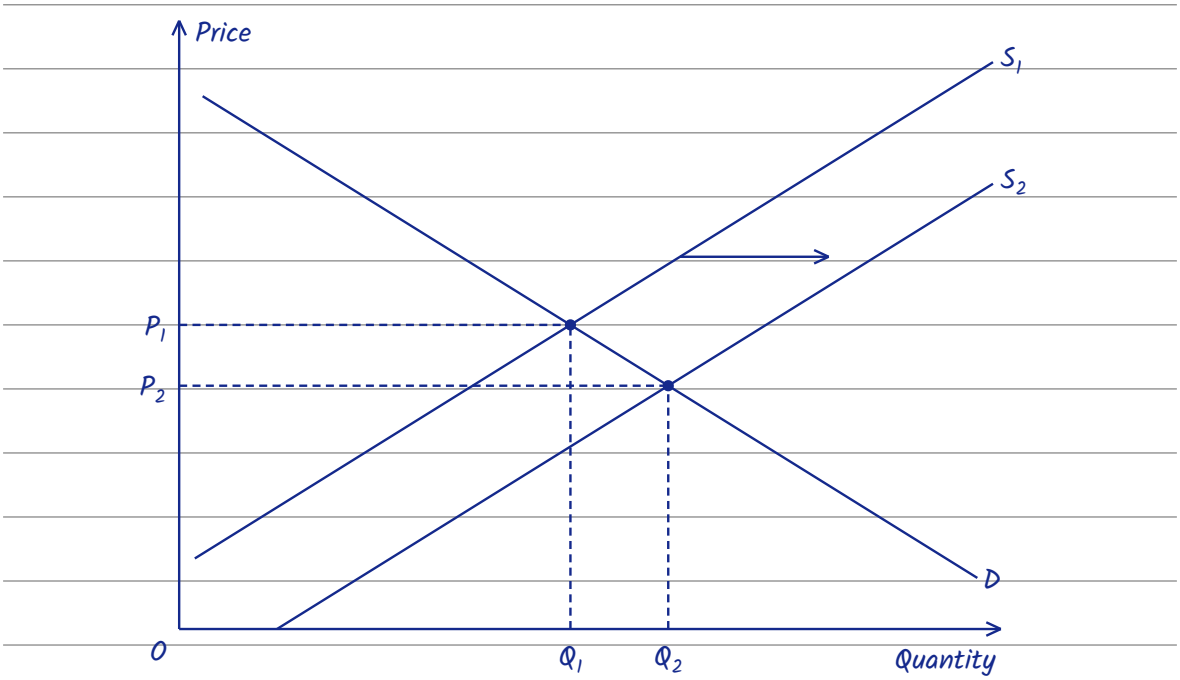
There are further problems. Maximum prices cause shortages and minimum prices cause surpluses, and both need enforcing, which is costly. Bans and high taxes create illegal markets. Direct provision and subsidies have a large opportunity cost, as the money cannot be spent on other services, and may increase the budget deficit. Free provision can lead to over-use and long waiting lists. These are examples of government failure, where intervention leads to a less efficient outcome.

The extent to which a government succeeds depends on the good and the policy. It is generally easier to increase the consumption of merit goods, for example by making education compulsory and free, than to reduce the consumption of addictive demerit goods. A combination of policies, such as a tax with an information campaign and regulation, is more effective than a single policy.

In conclusion, a government can move the quantities of merit and demerit goods closer to the desirable level, but it cannot ensure that both are produced in desirable quantities, because of imperfect information, the cost of intervention and the risk of government failure.

3(a) Supply shows the quantity producers are willing and able to sell at each price. A fall in costs of production means firms can supply more at each price, so the supply curve shifts to the right, from S1 to S2, lowering the price from P1 to P2 and increasing quantity from Q1 to Q2.

Question number



Three reasons associated with costs are: first, a fall in wage rates or in the price of raw materials, which directly reduces the cost of each unit; second, an increase in worker productivity, for example through training, so that each worker produces more and the cost per unit falls; third, improvements in technology or lower energy and transport costs, which make production and distribution cheaper.

Government microeconomic policy can also shift supply to the right. A subsidy paid to producers in a particular market, for example education or public transport providers, reduces their costs and shifts supply to the right. Removing or reducing an indirect tax or relaxing regulations has a similar effect.

However, the extent of the shift depends on the size of the subsidy, whether producers use it as intended rather than adding it to profit, and the price elasticity of supply in the market. Other regulations, such as strict safety rules, may limit supply at the same time. So government policy can shift supply to the right, but usually by less than changes in costs, which affect every firm in the market.

3(b)

Price elasticity of supply (PES) measures the responsiveness of quantity supplied to a change in price: PES = % change in quantity supplied ÷ % change in price. If

Question number

PES is greater than 1 supply is elastic; if it is less than 1 it is inelastic.

Knowledge of PES is useful to a firm that needs to react quickly to changes in its market, because it tells the firm how quickly it can increase output when demand and price rise. If the firm has spare capacity, stocks of finished goods, flexible labour and easily available raw materials, its supply is elastic and it can respond quickly, gaining extra sales and profit before competitors. If PES is low, it knows it must invest in capacity or stockholding to be able to react.

However, PES is of limited use if production times are long, for example for agricultural products, or if the product is perishable and cannot be stored. In these cases, even knowing the PES does not help the firm to react quickly. PES is also about the firm's own ability to change output, not about how its customers will respond.

Other measures of elasticity may be more useful. Price elasticity of demand (PED) tells a firm how quantity demanded and total revenue will change if it changes its price: if demand is inelastic it can raise price to increase revenue; if elastic, a price cut increases revenue. Cross elasticity of demand (XED) tells the firm how a competitor's price cut will affect its sales, which is vital in a competitive market where it must respond quickly. Income elasticity of demand (YED) is useful in a recession: a firm selling luxury goods with high YED will see a large fall in demand, and may switch to producing more inferior or cheaper goods, though this depends on its ability to switch production.

Elasticity estimates have limitations. They are based on past data, assume other things remain equal and change over time, so in a fast-changing market the estimates may already be out of date.

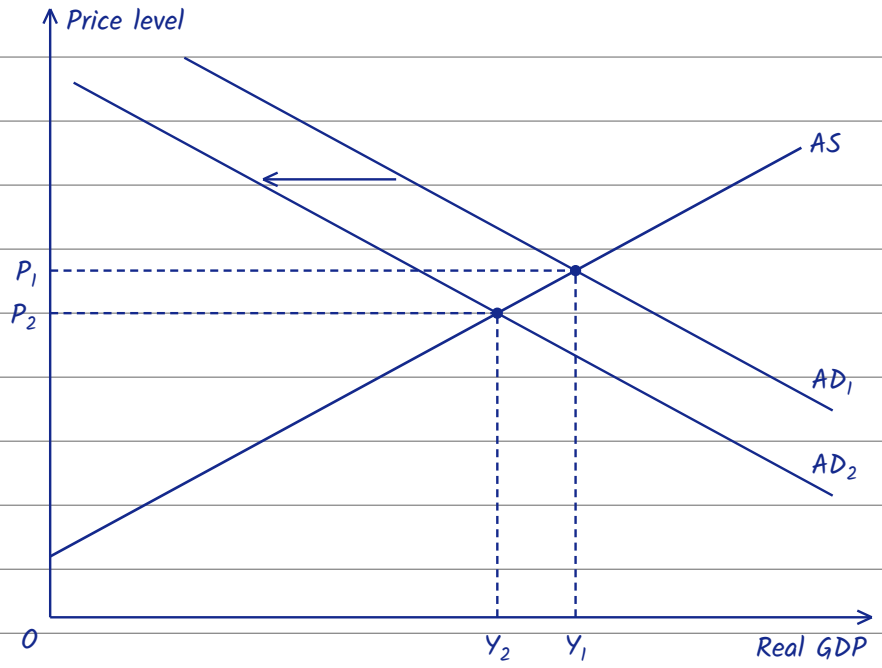
Which measure is most useful depends on the change in the market. If demand suddenly rises, PES is the most useful because the firm needs to know whether it can increase output. If a competitor changes its price, XED and PED are more useful, and if incomes fall, YED is.

Question number

In conclusion, knowledge of PES is not the most useful measure in all cases. It is important for reacting to rising demand, but for most changes, such as price competition, PED and XED are more useful, so a firm is best placed to react quickly if it knows all of these elasticities.

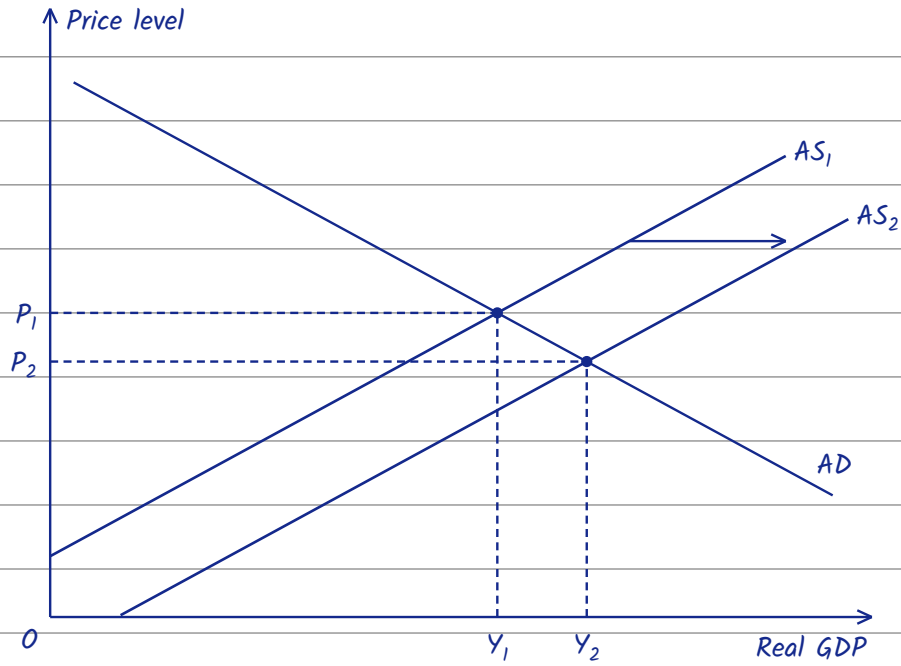
4(a) Deflation is a sustained fall in the general price level over a period of time.

Demand-side cause: a fall in aggregate demand, for example because of a fall in consumer confidence, higher interest rates or cuts in government spending. AD shifts left from AD1 to AD2, so the price level falls from P1 to P2 and real GDP falls from Y1 to Y2.



Supply-side cause: an increase in aggregate supply, for example because of new technology, higher productivity or lower costs of raw materials and energy. AS shifts right from AS1 to AS2, so the price level falls from P1 to P2 but real GDP rises from Y1 to Y2.

Question number



Demand-side deflation is likely to be more damaging. Lower real GDP means a fall in economic growth or a recession, and firms need fewer workers, so unemployment rises. Consumers may delay purchases expecting lower prices, and the real value of debt rises, which can create a deflationary spiral. Supply-side deflation is associated with higher output and employment, and it reduces inflationary pressure and makes exports more competitive, so it is usually beneficial ("good deflation").

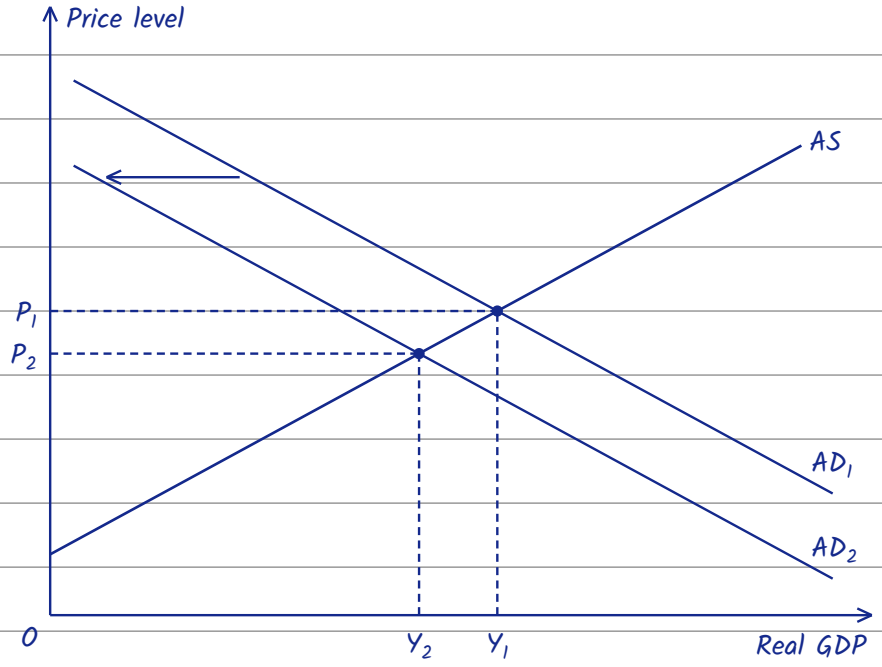
However, this depends on how large and long-lasting the deflation is and whether expectations of falling prices become established. In conclusion, demand-side deflation is more damaging because it reduces output and jobs, while supply-side deflation is generally beneficial.

4(b) Inflation is a sustained rise in the general price level. A high rate of inflation reduces purchasing power, makes exports less competitive and creates uncertainty, so governments aim to reduce it.

Fiscal policy uses taxation and government spending. To reduce inflation the government would use contractionary fiscal policy: raising income tax reduces

Question number

disposable income and consumption, and cutting government spending directly reduces AD. AD shifts left, reducing demand-pull pressure, so the price level is lower than it would otherwise have been. It can be targeted, for example cutting spending in sectors where demand is strongest, and it also reduces the budget deficit.



However, fiscal policy has disadvantages. As the diagram shows, lower AD also reduces real GDP from Y1 to Y2, so growth slows and unemployment rises. Tax increases and spending cuts are politically unpopular and take time to be agreed and implemented, so there are time lags. Higher indirect taxes would themselves raise prices in the short run. Most importantly, if inflation is cost-push, caused by higher energy or import prices, reducing AD does not tackle the cause and only deepens the fall in output.

Monetary policy is an alternative. Raising interest rates increases the cost of borrowing and the reward for saving, reducing consumption and investment, and may cause the currency to appreciate, making imports cheaper. An independent central bank can change rates quickly and the decision is not political, so many countries use it as the main tool against inflation. But it also reduces output and

Question number

employment, has time lags of up to two years, and is less effective if spending is not interest sensitive.

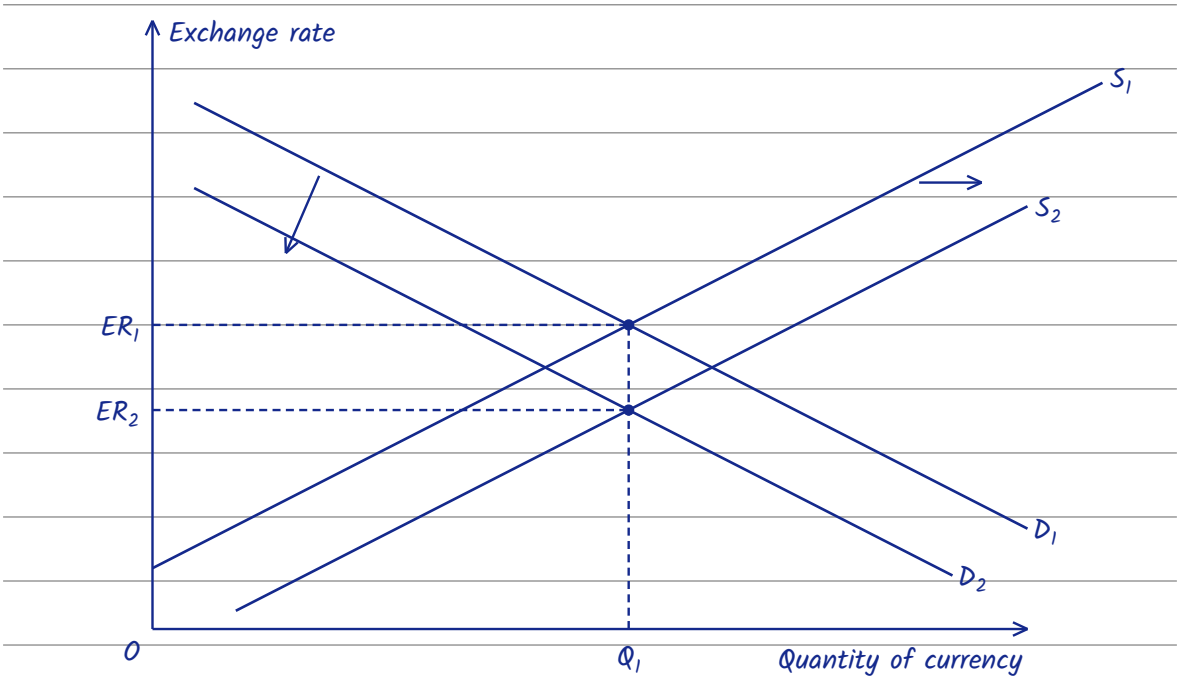
Supply-side policies, such as education and training, deregulation and investment in infrastructure, shift AS to the right, reducing inflation while increasing output. They tackle cost-push inflation and do not cause unemployment, but they take many years to work, so they cannot reduce a high rate of inflation quickly.

The best policy depends on the cause of the inflation, how high it is and the state of the public finances. For demand-pull inflation with a large budget deficit, contractionary fiscal policy is effective. For cost-push inflation, supply-side policies are needed in the long run.

In conclusion, fiscal policy is not usually the best way to reduce a high rate of inflation on its own. Monetary policy is normally faster and more flexible, with fiscal policy supporting it, and supply-side policies are needed to keep inflation low in the long run. A combination of policies is most effective.

5(a) A floating exchange rate is determined by the demand for and supply of the currency on the foreign exchange market. A fall in the balance of trade in goods (exports of goods minus imports of goods) can affect it in two ways.

Question number



First, if imports of goods increase, domestic residents must sell their currency to buy foreign currency, so the supply of the currency increases from S1 to S2.

Second, if exports of goods fall, foreigners need less of the currency to pay for them, so the demand for the currency falls from D1 to D2. Both changes cause the exchange rate to fall (depreciate) from ER1 to ER2.

A change in relative interest rates can also affect the exchange rate. If interest rates in one country rise relative to another, foreign savers move their funds (hot money) there to gain a higher return, which increases demand for the currency and causes it to appreciate. However, the extent depends on confidence and stability in that country, expected future changes in the exchange rate, and other factors such as speculation.

Flows of hot money are very large and can move instantly, so in the short run a change in relative interest rates is likely to have a greater impact than a fall in the trade balance, which changes slowly. In the long run, however, a persistent trade deficit is likely to have a more lasting effect. So interest rates have the greater impact in the short run, but trade matters more in the long run.

Question number

5(b)

The terms of trade is the ratio of an index of average export prices to an index of average import prices, multiplied by 100. An improvement means export prices rise relative to import prices. The current account of the balance of payments records trade in goods and services, primary income and secondary income; a surplus means more money flows in than out.

An improvement in the terms of trade means each unit of exports buys more imports. The country can therefore buy more imported goods, raw materials and capital goods for the same quantity of exports, which raises living standards and can lower firms' costs. If the improvement is due to rising world demand for its exports, for example for its commodities, export revenue rises, and it may strengthen the country's reputation and attract FDI. However, if it is caused by domestic inflation or an appreciation of the currency, exports become less competitive. If demand for exports is price elastic, export volumes and revenue fall, leading to job losses and a current account deficit.

A current account surplus means export earnings exceed import spending. Net exports are an injection, so a surplus increases AD, economic growth and employment. It increases foreign currency reserves and can provide confidence and stability. However, a surplus may come from export-led growth that leaves fewer goods and services for the domestic population, reducing living standards, or from weak domestic demand. It can be inflationary, it involves an opportunity cost as resources are used to produce goods for others, and it may cause the currency to appreciate or lead to retaliation from trading partners in deficit.

Which is of more benefit depends on the cause of each and the state of the economy. An improvement in the terms of trade due to rising demand for exports is very beneficial and may also create a current account surplus. A surplus is most beneficial for an economy with unemployment and spare capacity, while an economy at full employment benefits more from being able to buy more imports.

It also depends on the time period. An improvement in the terms of trade gives an

Question number

immediate gain in purchasing power, but if caused by inflation it may damage the current account later. A large, persistent surplus can also be a sign of imbalances. In conclusion, neither is always of more benefit. An improvement in the terms of trade caused by higher demand for exports is likely to be of greater benefit because it raises living standards directly, but a current account surplus is more beneficial to an economy with high unemployment. The cause of each matters more than which one occurs.

Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/23**

Paper 2 AS Level Data Response and Essays **May/June 2025**

2 hours

2132973822

You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **one** question.
  - Section C: 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 60.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages.

DC (EV) 351809/2
© UCLES 2025

[Turn over

stemup.co.uk

Section A

Answer all parts of Question 1.

1 How onions became a luxury good in the Philippines

Global inflation is putting a strain on food prices, particularly in low-income countries in Asia.

Content removed due to copyright restrictions.

It was also reported that the government had set up a partnership with two local universities to experiment growing onions and other vegetables using alternative techniques in a controlled environment to increase crop yields.

Sources: Chad de Guzman, 'In the Philippines, onions are now more expensive than meat', Time Magazine, *9 January 2023*
Cost of living: How onions became a luxury in the Philippines, BBC, 27 January 2023

stemup.co.uk

(a) Use a demand and supply diagram to demonstrate how 'a series of typhoons' affected the market price of food crops in Southeast Asia in January 2023. [2]

(b) Is the short-run price elasticity of supply of red onions elastic or inelastic? Justify your answer. [2]

(c) With the help of a production possibility curve (PPC) diagram, consider the impact on the opportunity cost to a farmer in the Philippines of starting to grow red onions. [4]

(d) Assess whether a 'suggested retail price' is the best way of stabilising onion prices in the Philippines. [6]

(e) Assess the extent to which the increase in onion prices is likely to have affected all households equally in the Philippines. [6]

Section B

Answer **one** question.

EITHER

2 Semi-conductors are widely used in the production of many types of electronic goods such as smartphones. It has been estimated that the price elasticity of supply for semi-conductors is 0.2 in the short run and 0.8 in the long run.

(a) Explain what these estimates mean for producers of smartphones that use semi-conductors **and** consider the significance of the long-run estimate. [8]

(b) Assess the likely effects on resource allocation of a continuing increase in demand for semi-conductors. [12]

OR

3 **(a)** Explain what is meant by a merit good and why governments provide merit goods such as healthcare free of charge **and** consider why such provision may not always be successful. [8]

(b) Assess whether a charge made for healthcare at the point of use is likely to be more beneficial to consumers and providers than if healthcare is available to all free of charge. [12]

© UCLES 2025

stemup.co.uk

Section C

Answer **one** question.

EITHER

4 **(a)** Explain **two** causes of economic growth **and** consider the extent to which their impact can be measured. [8]

(b) Assess the extent to which economic growth is always beneficial for the people and government in an economy. [12]

OR

5 **(a)** The terms of trade index for an economy changed from 105 to 110 in a given year.

Explain **two** likely reasons for this change **and** consider the extent to which the change is likely to benefit the current account of the balance of payments of this economy. [8]

(b) Assess whether government policy can influence an economy's comparative advantage in a good or service. [12]

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (UCLES) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced online in the Cambridge Assessment International Education Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download at www.cambridgeinternational.org after the live examination series.

Cambridge Assessment International Education is part of Cambridge Assessment. Cambridge Assessment is the brand name of the University of Cambridge Local Examinations Syndicate (UCLES), which is a department of the University of Cambridge.

© UCLES 2025

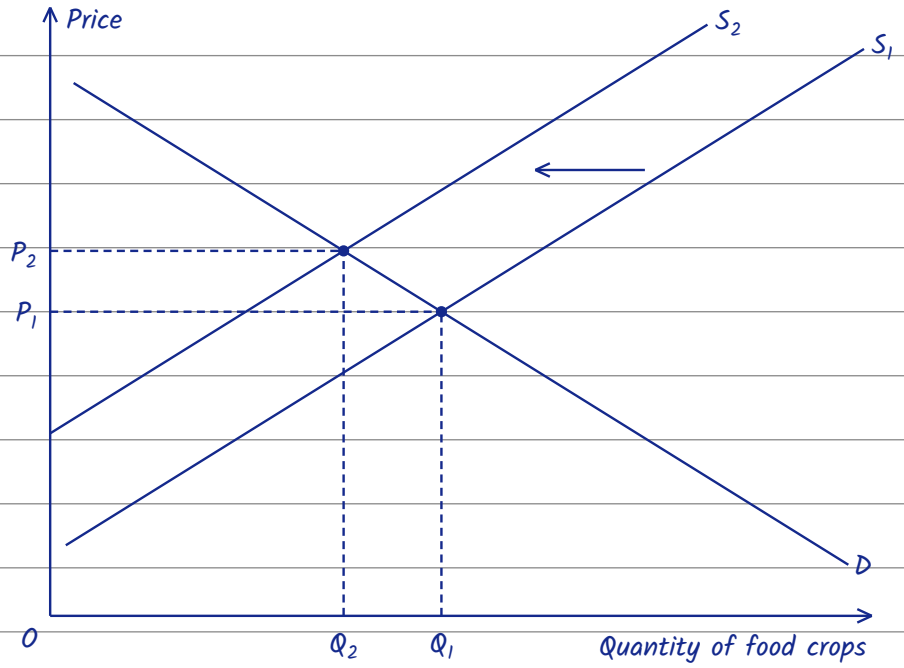
stemup.co.uk

Surname	StemUp Model Solution
Answer booklet	Write the question number in the left-hand margin at the start of each answer.

Question number

Answers for paper 9708/23

1(a)



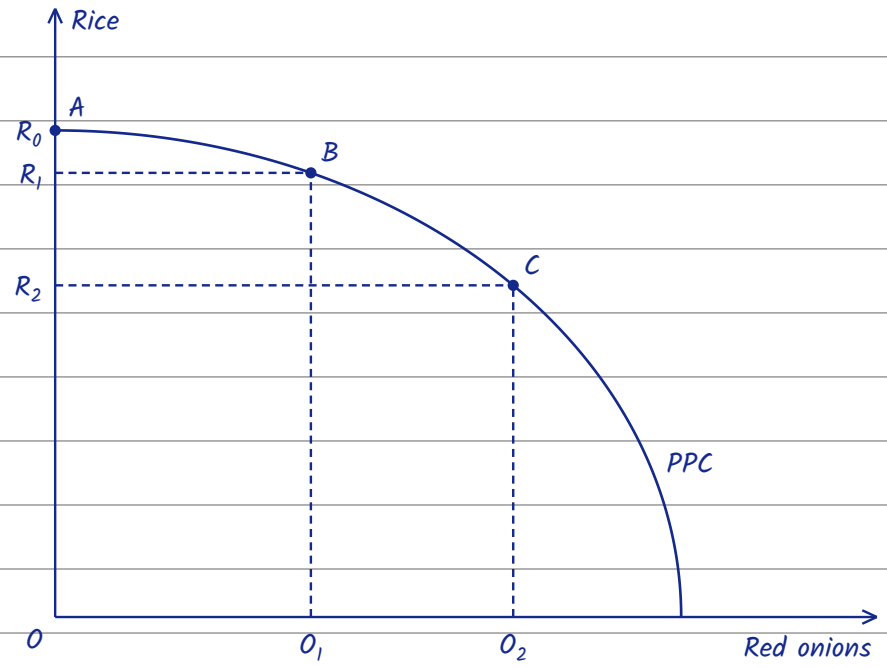
The typhoons destroyed crops, so the supply of food crops fell and the supply curve shifted left from S1 to S2. The equilibrium price rose from P1 to P2 and the equilibrium quantity fell from Q1 to Q2.

1(b)

Inelastic (PES less than 1). Red onions take months to grow, and the typhoons destroyed crops, so in the short run farmers cannot increase the quantity supplied quickly when the price rises; the quantity supplied responds proportionately less than the change in price.

Question number

1(c)



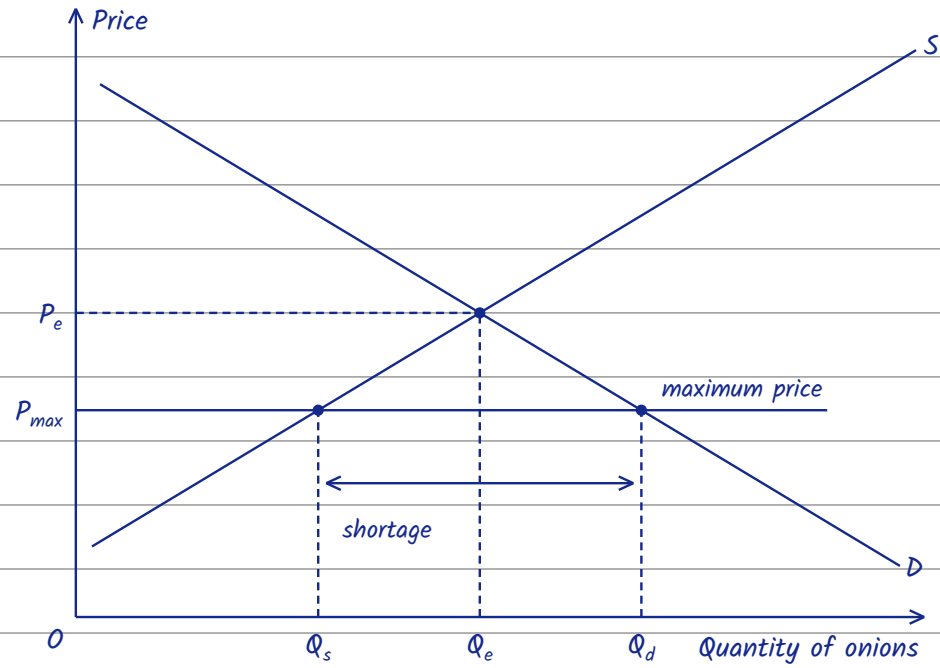
At point A the farmer uses all resources to grow another crop, rice, and produces zero red onions. If the farmer starts to grow red onions, the farmer moves along the PPC from A to B, producing O1 onions but only R1 rice. The opportunity cost of the onions is the rice given up, R0 – R1.

As the PPC is concave, the opportunity cost rises the more red onions are grown: moving from B to C gives a smaller increase in onions for a larger loss of rice, because land and labour less suited to onions must be used. If resources were equally suited to both crops the PPC would be a straight line and the opportunity cost constant. So the opportunity cost of starting to grow onions is low at first but increases with output.

1(d)

A suggested retail price acts like a maximum price set below the equilibrium price, Pe. It stops sellers from charging excessively high prices when supply is limited by typhoons, keeps onions affordable for low-income households, reduces the incentive to hoard onions to sell later at inflated prices, and shows the public the government is managing food inflation, which can reduce panic buying.

Question number



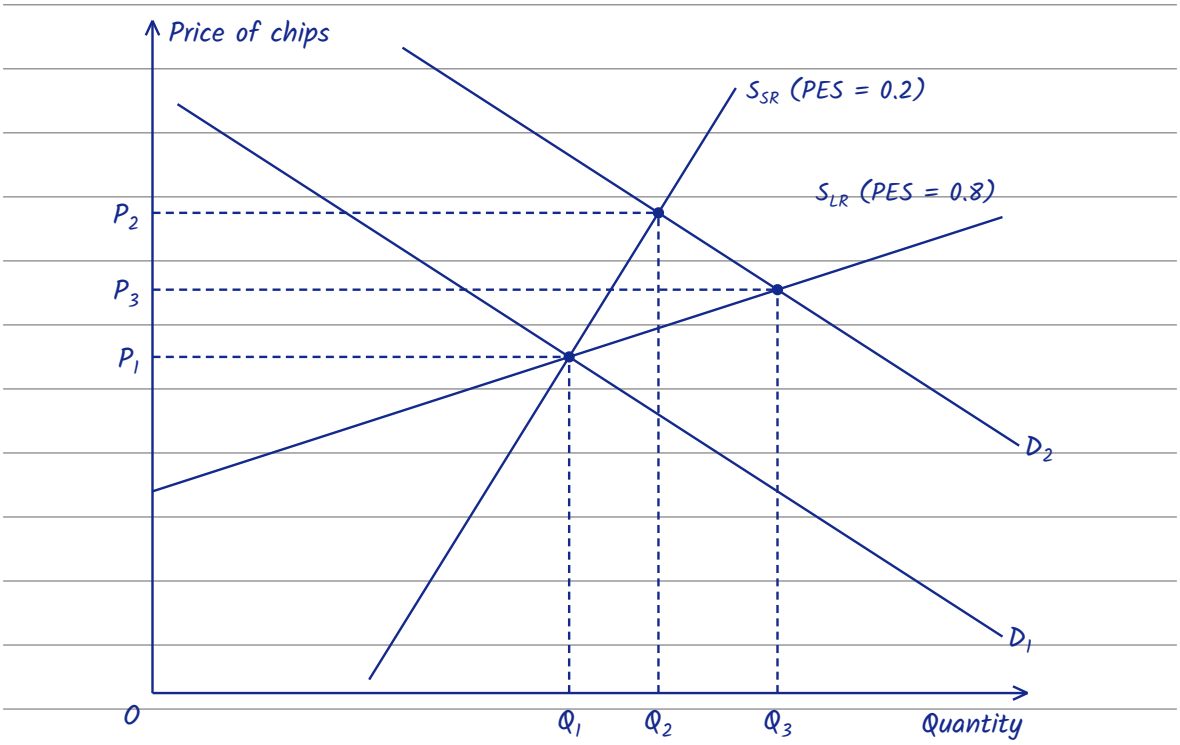
However, at Pmax quantity demanded (Qd) exceeds quantity supplied (Qs), so there is a shortage. Sellers may sell onions illegally above the price, and farmers may grow fewer onions if they cannot cover their costs, worsening supply in the long run. A "suggested" price is not legally binding and needs monitoring, so it may simply be ignored.

An alternative is a buffer stock scheme: the government buys onions when there is a surplus and stores them, then sells them during shortages, which stabilises prices in both directions. However, it is expensive, needs cold storage and onions are perishable. The government could also allow controlled imports by temporarily removing tariffs, which increases supply quickly, or invest in irrigation, storage and new growing techniques, as in the partnership with the universities, which increases yields but takes time.

Overall, a suggested retail price is not the best way of stabilising onion prices because it treats the symptom, not the cause, and can create shortages. Policies that increase supply, such as controlled imports in the short run and investment in storage and yields in the long run, are likely to be more effective.

Question number	
1(e)	The increase in onion prices affected all households to some extent. Onions are used widely in Filipino cooking across all income groups, and as a necessity with few close substitutes, demand is price inelastic, so most households kept buying similar quantities and paid much more. Prices rose across markets, so households in all regions faced the increase. However, the effect was not equal. Low-income households spend a higher proportion of their income on basic food, so a price rise takes a larger share of their budget and reduces their real income more than for wealthier households. Wealthier households can more easily afford the higher price or switch to substitutes. Households that use onions heavily are affected more than those that use few. Rural households that grow their own onions may be protected, and onion farmers may even gain from higher prices, while urban households who buy at market prices are hit hardest. Overall, although almost every household paid more for onions, the burden was not shared equally: the price rise was regressive in effect, hitting low-income, urban households the most.
2(a)	Price elasticity of supply (PES) measures the responsiveness of quantity supplied to a change in price: PES = % change in quantity supplied ÷ % change in price Both estimates are less than 1, so supply of semi-conductors is price inelastic: a rise in price leads to a proportionately smaller increase in quantity supplied. A PES of 0.2 means that in the short run a 10% rise in price increases quantity supplied by only 2%; in the long run a 10% rise increases it by 8%.

Question number



For smartphone producers, this means that when demand for semi-conductors rises (D1 to D2), supply cannot respond quickly, so in the short run the price rises sharply to P2 and quantity rises only to Q2. Smartphone producers face higher costs and shortages, which can delay production.

Supply is more elastic in the long run because chip makers have time to build new fabrication plants and train workers; in the short run they are limited by existing capacity, low stocks and complex production processes.

The long-run estimate is significant because, at 0.8, supply is still inelastic. Even in the long run the price only falls to P3, so shortages and high costs could last, encouraging smartphone producers to secure supply chains through long-term contracts and chip makers to invest in more capacity.

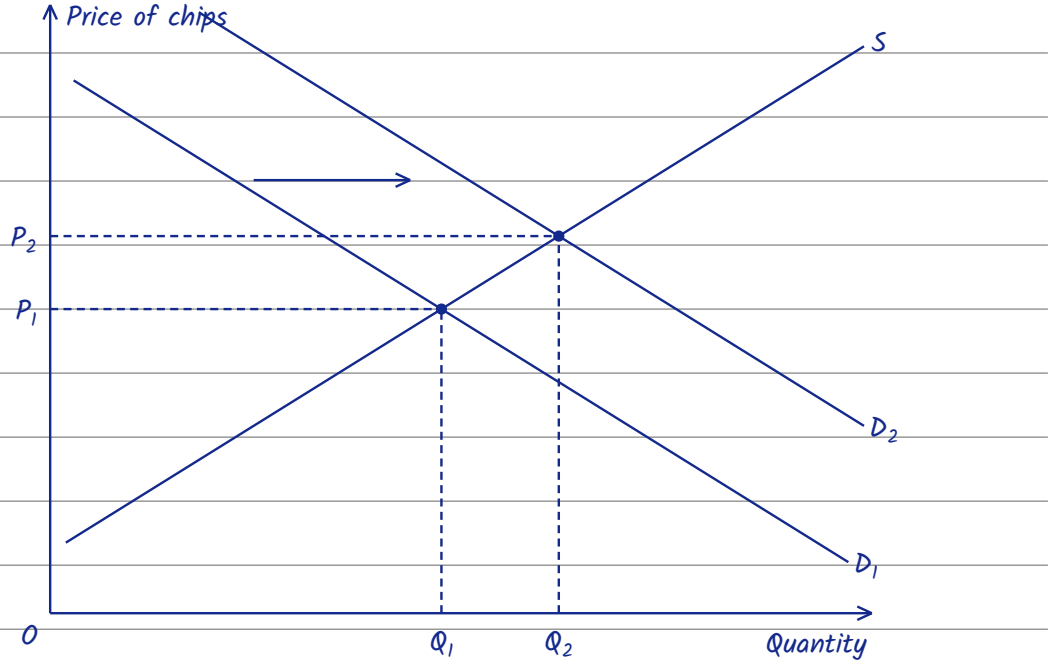
2(b)

Resource allocation is the way scarce resources are divided between different uses. In a market economy it is decided by the price mechanism.

A continuing increase in demand shifts the demand curve for semi-conductors to the right, from D1 to D2. At the original price there is excess demand, so the price

Question number

rises from P1 to P2. This shows the three functions of the price mechanism. The rationing function: the higher price removes the excess demand, so chips go to those most willing and able to pay. The signalling function: the rising price signals to producers that consumers want more, and higher profits signal that more resources should move into the industry, so new firms may enter. The incentive function: higher prices and profits encourage existing producers to expand output from Q1 to Q2 and invest in new capacity.



Resources therefore move away from other goods towards semi-conductor production. On a PPC this is a movement along the curve: more semi-conductors are produced, but the opportunity cost is the output of other goods that could have been produced. In factor markets, demand for engineers, silicon and specialised equipment rises, raising wages and prices and attracting resources from other industries.

However, the effects may be limited. Supply is very price inelastic (PES of 0.2 in the short run), because new plants take years to build, so the main effect at first is higher prices rather than more output. The reallocation depends on the availability of silicon and other inputs, the costs of extraction, high barriers to

Question number

entry, and government policy, such as environmental legislation limiting extraction, or subsidies and export controls on chips. If firms believe the rise in demand is temporary, they may not invest.

There may also be costs. Semi-conductor production uses large amounts of water and energy and creates pollution, which are negative externalities not reflected in price, so resources may be over-allocated from society's point of view. Higher chip prices also raise costs for many other industries, such as cars and electronics.

The effect depends on time and on whether demand keeps rising. In the short run, the main effect is higher prices and shortages; in the long run, as capacity is built, more resources are allocated to the industry and output rises considerably.

In conclusion, a continuing increase in demand will lead to more resources being allocated to semi-conductor production through the price mechanism, but because supply is inelastic and there are time lags and barriers, the reallocation will be slow, and much of the early effect will be on price rather than quantity.

3(a) A merit good is a good that is more beneficial to consumers than they realise and so is under-consumed in a free market, because of information failure. It also creates positive externalities, so marginal social benefit is greater than marginal private benefit. Healthcare is an example.

By providing healthcare free of charge, the government removes the price barrier and encourages greater consumption, moving closer to the socially optimum level and improving overall welfare. Some healthcare, such as vaccinations, has the features of a public good: protection from disease is non-excludable and non-rival, so the private sector would under-provide it, and government provision protects public health. Free provision also ensures fair access for low-income households, reducing inequality.

However, free provision may not always be successful. If people still do not see the benefits of healthcare, for example of check-ups, making it free will not increase

Question number

consumption much. Time, travel and waiting costs may discourage people from using it despite no charge. Zero price can also cause excess demand, long waiting lists and lower quality, and it has a high opportunity cost for the government. So free provision increases consumption but is only successful if combined with information and sufficient funding.

3(b) A charge at the point of use means patients pay a fee when they receive treatment, while free healthcare is funded through taxation, so it has a zero price to the consumer.

Charging can benefit consumers and providers. A price discourages unnecessary or excessive use, which reduces waste and waiting times for those who need treatment. The fees generate revenue that providers can reinvest in better equipment, staff and quality. Charges also reduce the strain on government budgets, so funds can go to other public services or be targeted as subsidies for those in genuine need. Paying patients may also expect and receive better service, as providers compete.

However, charging has problems. It increases inequality in access, as fees affect low-income people disproportionately. Some will avoid seeking care because of cost even when treatment is essential, leading to worse health outcomes and higher long-term costs when illnesses become serious. Preventive care, such as check-ups and vaccinations, is likely to be under-consumed, which ignores the positive externalities of healthcare. Because of information failure, consumers may not know what treatment they need, so a price does not lead to the right level of consumption.

Free healthcare ensures everyone can be treated according to need rather than ability to pay, and encourages preventive care, which benefits society through a healthier, more productive workforce. But free provision can lead to excess demand, long waiting lists and over-use, and it requires high taxes, with a large opportunity

Question number

cost.

Whether charging is more beneficial depends on the size of the charge, whether there are exemptions for low-income groups, children and the elderly, and the type of care. A small charge for non-urgent services, such as prescriptions, may reduce over-use without deterring those in need, whereas charging for emergency or preventive care is harmful.

It also depends on who is considered. Providers and taxpayers are likely to benefit from charges, but consumers on low incomes are likely to lose.

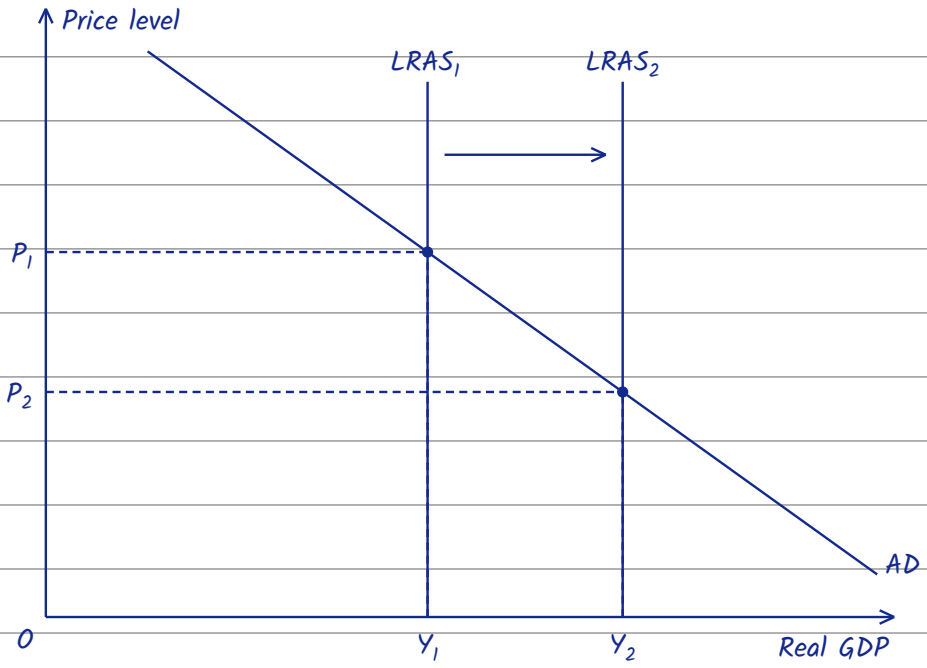
In conclusion, charging at the point of use is unlikely to be more beneficial overall than free healthcare, because healthcare is a merit good and charges reduce consumption by those who need it most. A mainly free system with small, targeted charges and exemptions is likely to give the best balance.

4(a) Economic growth is an increase in the real value of goods and services produced in an economy over time, usually measured by the percentage change in real GDP.

One cause is an increase in aggregate demand. For example, a cut in income tax increases disposable income, so consumption increases; AD shifts right and, if there is spare capacity, real GDP rises (actual growth). However, if job insecurity is high, people may save the extra income, so the increase in growth is smaller.

A second cause is an increase in long-run aggregate supply. Investment in capital and education raises productivity, which increases productive capacity and shifts LRAS to the right, as shown, allowing higher real GDP in the long run (potential growth).

Question number



The impact of these causes can be measured to some extent, since real GDP figures show the growth that occurs. However, it is difficult to measure the impact of each cause separately, because many factors change at the same time and there are time lags. A large hidden or informal economy means some output is not recorded, and GDP data are estimates that are often revised. So the overall growth can be measured approximately, but the impact of individual causes can only be estimated.

4(b) Economic growth is an increase in real GDP over time. It can be actual growth, when spare capacity is used, or potential growth, when productive capacity increases.

Growth can benefit people. Higher real GDP per head means people can consume more goods and services, raising their material living standards. As output increases, firms need more workers, so unemployment falls and incomes rise. Sustained growth raises confidence, encouraging further investment and consumption.

Growth also benefits the government. Higher incomes and spending generate more

Question number

tax revenue without raising tax rates, and lower unemployment reduces spending on welfare benefits. This can reduce a budget deficit or allow more spending on public services like healthcare, education and infrastructure, further improving living standards.

However, growth is not always beneficial. It may benefit mainly the wealthy, widening the gap between rich and poor, so many people do not see an improvement. Increased production and consumption can lead to pollution, congestion and depletion of natural resources, reducing quality of life and making growth unsustainable. If growth is too rapid and AD grows faster than capacity, it leads to demand-pull inflation and instability, and rising demand for raw materials and energy can cause shortages and higher prices. Rising incomes can also increase imports, worsening the current account. Longer working hours and stress may reduce wellbeing even as GDP rises.

For the government, the extra revenue may be needed to deal with the costs of growth, such as pollution, congestion and pressure on public services in growing cities, and inflation may force it to raise interest rates.

Whether growth is beneficial depends on its type and how it is distributed. Growth based on rising productivity and investment, which raises LRAS, is more sustainable than growth driven by excessive AD. Growth in a low-income country, where many people lack basic needs, is likely to bring larger benefits than in a high-income country. Government policies, such as progressive taxation and environmental regulation, can make growth more inclusive and sustainable.

In conclusion, economic growth is not always beneficial for people and government. It usually brings higher incomes, jobs and tax revenue, but if it is unequal, environmentally damaging or inflationary, the costs can outweigh the benefits for some groups. Sustainable, inclusive growth is beneficial; growth at any cost is not.

5(a) The terms of trade measures the rate at which a country's exports exchange for

Question number

imports:

terms of trade = (index of average export prices ÷ index of average import prices) × 100

A rise from 105 to 110 is an improvement of (110 − 105) ÷ 105 × 100 = 4.8%, so export prices have risen relative to import prices. Two likely reasons are: first, higher export prices, for example due to increased world demand for the country's exports, higher quality, or domestic inflation; second, lower import prices, for example due to a fall in world prices of commodities such as oil, or an appreciation of the currency, which makes imports cheaper in domestic currency.

Higher export prices mean the country receives more revenue for selling the same quantity of goods and services, which improves the current account balance. Lower import prices mean the same quantity of imports costs less, which also improves the current account.

However, the effect depends on price elasticity of demand. If demand for exports is price elastic, higher export prices cause a proportionately larger fall in export volumes, so export revenue falls and the current account worsens. Cheaper imports may also increase the quantity of imports bought. So the improvement benefits the current account only if it is caused by stronger demand for exports or if demand for exports is price inelastic.

5(b)

A country has a comparative advantage in a good or service when it can produce it at a lower opportunity cost than other countries. It depends on the quantity and quality of its factors of production and its technology.

Government policy can influence comparative advantage. Investment in education and training improves the skills of the workforce, which raises productivity in skill-intensive industries such as financial services or software, lowering their opportunity cost. Government support for research and development, through grants or tax credits, can lead to innovation and give the country a technological

Question number

advantage in certain sectors. Investment in infrastructure, such as ports, transport and digital networks, reduces costs of production and distribution, making domestic industries more competitive. Subsidies and industrial policy can help new industries grow large enough to gain economies of scale, as Taiwan did with government support for its semi-conductor industry.

However, there are limits. Some sources of comparative advantage, such as climate, natural resources and location, cannot be changed by policy. Policies such as education and R&D take many years to change opportunity costs, and they are expensive, with a large opportunity cost for the government. Even if a comparative advantage is created, global competition can erode it, as other countries copy the policies or technology advances elsewhere.

There is also a risk of government failure. Governments may "pick winners" badly, supporting industries that never become competitive. Subsidies may create an artificial advantage that disappears when they are removed, may protect inefficient firms and can lead to retaliation from trading partners or breach WTO rules. Policies that favour one sector may draw resources away from other parts of the economy, creating inefficiencies.

The extent of the influence depends on the type of good, the time period and the quality of the policy. Policy is more effective for manufactured goods and services, where comparative advantage depends on skills, capital and technology, than for primary products, which depend on natural endowments. It is also more effective in the long run than the short run.

In conclusion, government policy can influence an economy's comparative advantage, mainly in the long run by improving the quality of human and physical capital and technology. However, it cannot change natural advantages, and its success depends on the cost, time and risk of government failure, so policy can shape comparative advantage but not fully determine it.

Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/24**

Paper 2 AS Level Data Response and Essays **May/June 2025**

2 hours



You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **three** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **one** question.
  - Section C: 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 60.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **4** pages.

© UCLES 2025

[Turn over

stemup.co.uk

Section A

Answer all parts of Question 1.

1 Economic challenges in Malaysia

Annual growth in real GDP in Malaysia averaged 5.2% during the past ten years. There was a great deal of instability in GDP between July 2020 and July 2021, largely due to the COVID-19 pandemic. Economic growth was projected to grow by between 5.5% and 6.5% in 2022. The percentage change in real GDP per annum in Malaysia between January 2019 and January 2022 is shown in Fig. 1.1.

Content removed due to copyright restrictions.

Source: Adapted from Press Release from the Malaysia Ministry of Finance, 11 February 2022

© UCLES 2025

stemup.co.uk

(a) Using the data in Fig. 1.1, describe the trend shown in the annual rate of economic growth in Malaysia over the period January 2019 to January 2022. [2]

(b) Explain what is meant by 'real GDP'. [2]

(c) Consider the extent to which the potential advantages of subsidies given to firms by the Malaysian government outweigh their potential disadvantages. [4]

(d) Assess how far external factors were responsible for economic growth in Malaysia over the period January 2019 to January 2022. [6]

(e) Assess the possible consequences of a falling rate of unemployment for Malaysia. [6]

Section B

Answer **one** question.

EITHER

2 **(a)** With the help of a formula, explain the meaning of price elasticity of demand **and** consider the significance to a firm of having price elastic or price inelastic demand for its product. [8]

(b) Assess whether governments should always support the provision of merit goods in markets such as those for education or health care. [12]

OR

3 **(a)** With the help of a diagram, explain the impact of introducing an effective minimum price for a product **and** consider the effect on the consumer surplus for that product. [8]

(b) Assess whether a minimum wage policy is the best way to redistribute income in an economy. [12]

© UCLES 2025

stemup.co.uk

Section C

Answer **one** question.

EITHER

4 **(a)** Explain why expenditure on education and training is a supply-side policy **and** consider why its impact on the general price level may differ between the short run and the long run. [8]

(b) Assess whether the consequences of inflation in an economy are always negative. [12]

OR

5 **(a)** With the help of a formula, explain the causes of an improvement in the terms of trade in an economy **and** consider whether such an improvement can ever be harmful to an economy. [8]

(b) Assess whether the depreciation of an exchange rate is always beneficial to an economy. [12]

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (UCLES) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced online in the Cambridge Assessment International Education Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download at www.cambridgeinternational.org after the live examination series.

Cambridge Assessment International Education is part of Cambridge Assessment. Cambridge Assessment is the brand name of the University of Cambridge Local Examinations Syndicate (UCLES), which is a department of the University of Cambridge.

© UCLES 2025

stemup.co.uk

Surname	StemUp Model Solution
Answer booklet	Write the question number in the left-hand margin at the start of each answer.

Question number

Answers for paper 9708/24

1(a) Overall, the rate of economic growth in Malaysia fell over the period and fluctuated a great deal. Up to January 2021 the growth rate fell and became negative, whereas from July 2021 to January 2022 it became positive again.

1(b) GDP is the total value of goods and services produced in an economy over a year. Real GDP is GDP adjusted for inflation (measured at constant prices), so it shows the change in the volume of output rather than in prices.

1(c) Subsidies reduce firms' costs of production, which makes them more competitive at home and abroad. This can increase sales, output and exports, raising AD and AS and reducing unemployment. Lower costs may also be passed on as lower prices, increasing consumer surplus.

However, firms may use the payments to boost profits rather than cut costs or prices, and subsidies may protect inefficient firms. They are expensive for the government, adding to the budget deficit and having an opportunity cost, and they may lead to retaliation by other countries.

Overall, the advantages are likely to outweigh the disadvantages only if subsidies are temporary and targeted, for example to help firms recover from the pandemic. Otherwise the cost to the Malaysian government is likely to outweigh the benefits.

1(d) External factors played a large part. Exports increased strongly, reaching an all-time high in the last quarter of 2021, which raised AD and helped growth recover in late 2021. Malaysia, as an exporter of oil and gas, also benefited from

Question number

higher world oil and gas prices, and from the recovery in demand from its major trading partners and in global economic activity. The COVID-19 pandemic itself was an external shock that caused the instability in GDP between July 2020 and July 2021.

However, internal factors were also responsible. Government subsidies to firms may have helped them to increase exports and output, policies to make markets more flexible may have increased productivity, and a high level of FDI and domestic investment encouraged by government policy increased AD and productive capacity. Domestic lockdowns also reduced output in 2020 and 2021.

On balance, external factors were probably the main influence on growth over the period, both the fall caused by the global pandemic and the recovery led by exports and commodity prices. However, internal policies affected how well Malaysia could take advantage of external demand, so growth was the result of both.

1(e) A falling rate of unemployment means more people earn incomes, which raises overall income levels and the standard of living. The government receives more tax revenue and spends less on welfare benefits, so it can spend more on infrastructure and merit goods such as education and healthcare. Higher employment also increases total output, which may increase export opportunities and encourage investment by firms.

However, falling unemployment means aggregate demand is rising, which may lead to demand-pull inflation if aggregate supply cannot keep up. As labour becomes scarce, wages rise, which increases firms' costs and may cause cost-push inflation. Labour productivity may fall if less skilled workers are employed. Higher incomes also increase demand for imports, which could lead to a current account deficit.

Overall, the consequences of falling unemployment are likely to be mainly positive for Malaysia, especially after the job losses of the pandemic, when there is spare

Question number	
	capacity. The negative consequences become more likely only if unemployment falls below its natural rate and the economy overheats.
2(a)	Price elasticity of demand (PED) measures the responsiveness of quantity demanded to a change in price: PED = % change in quantity demanded ÷ % change in price Demand is price elastic if PED is greater than 1 (ignoring the minus sign), so quantity demanded changes by a larger proportion than price; it is price inelastic if PED is less than 1, so quantity changes by a smaller proportion. If demand is price inelastic, a rise in price causes a proportionately smaller fall in quantity demanded, so total revenue increases; a fall in price causes total revenue to fall. If demand is price elastic, a rise in price causes a proportionately larger fall in quantity, so total revenue falls; a price cut increases sales by a larger proportion, so total revenue increases. For example, with PED of −2, a 10% price cut raises sales by 20%. This distinction is significant for a firm's pricing decisions. If demand is elastic, the firm should cut its price to increase revenue, or use advertising and branding to build loyalty and make demand less elastic. If demand is inelastic, it can raise its price to increase revenue, which also helps it pass on cost increases. However, PED estimates may be inaccurate and change over time, and competitors may react to price changes, so knowing PED is very useful but not sufficient on its own.
2(b)	Merit goods, such as education and healthcare, are goods that are more beneficial to consumers than they realise and are under-consumed in a free market. This is because of information failure and because they create positive externalities: an educated, healthy workforce benefits society as well as the individual. There are strong reasons for governments to support their provision. Because

Question number

consumers undervalue them and do not take account of external benefits, the free market produces less than the socially optimum quantity, causing a welfare loss. Price is also a barrier for low-income households. Governments can correct this by direct provision free of charge, subsidies to providers or consumers (for example vouchers), making consumption compulsory (for example schooling to a certain age) and providing information about the benefits. This increases consumption towards the optimum, improves productivity and growth in the long run and reduces inequality.

However, governments should not always support provision. Government provision may be inefficient, because there is no profit motive or competition, leading to poor quality and long waiting lists. Support has a large opportunity cost, as the money could be spent on other projects such as infrastructure, and a lack of funding may mean higher taxes or a budget deficit. Information failure may still exist: people may not use free services if they do not see their benefits. Governments may also lack the information to know the optimum quantity, so they may over-provide, which is government failure.

Private provision may be possible and more efficient in some markets. Many people are willing to pay for private education and health insurance, and private providers may innovate more. In these cases, government support may simply replace private spending rather than increasing total consumption.

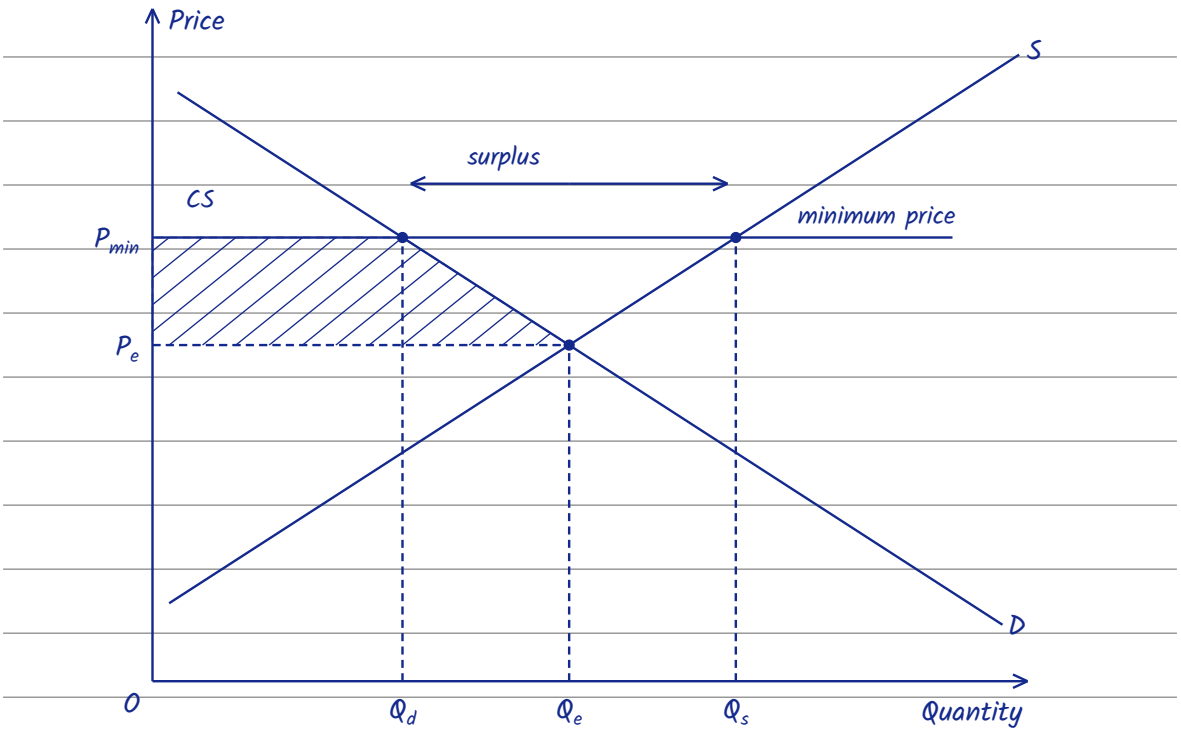
Whether governments should support provision depends on the level of income in the economy, the size of the external benefits and the efficiency of the government. Support is most justified for basic education and preventive healthcare, such as vaccinations, which have large external benefits, and for low-income groups who cannot afford them. It is less justified for higher levels of provision that mainly benefit the individual.

In conclusion, governments should support the provision of merit goods such as education and healthcare, but not always or in every form. Support should be

Question number

targeted where under-consumption and external benefits are greatest, and the method chosen should be the most efficient, which may involve working with private providers.

3(a) An effective minimum price is a legal price floor set above the equilibrium price, below which the product cannot be sold.



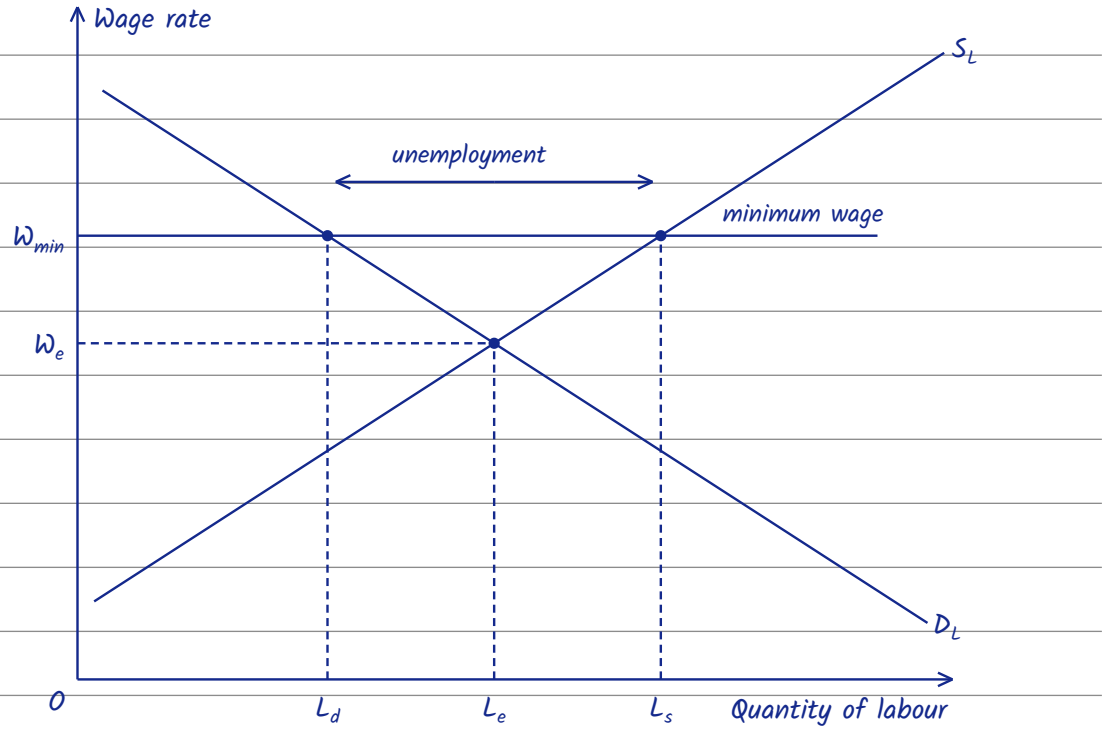
Before the minimum price, the market is in equilibrium at Pe and Qe. When the minimum price Pmin is set above Pe, quantity demanded falls to Qd because consumers buy less at the higher price, while quantity supplied rises to Qs because producers are willing to supply more. Supply exceeds demand, so there is a surplus of Qs − Qd, which the government may have to buy or which may be wasted. Consumer surplus is the difference between the price consumers are willing to pay and the price they actually pay, shown by the area below the demand curve and above the price. Before the minimum price it was the triangle above Pe up to Qe. After it, consumers pay a higher price and buy less, so consumer surplus falls to the small triangle labelled CS above Pmin; the shaded area is lost.

Question number

Consumer surplus will always fall with an effective minimum price, but the extent depends on PED and on how far Pmin is above Pe. If demand is price inelastic, quantity falls little and most of the loss is transferred to producers as higher revenue; if elastic, quantity falls more and the loss is greater.

3(b) A minimum wage is a legal minimum hourly wage that employers must pay, set above the equilibrium wage. Redistribution of income means transferring income from higher to lower income groups to reduce inequality.

A minimum wage can redistribute income because it raises the wages of the lowest-paid workers relative to others. It may redistribute income from employers' profits to workers, especially where employers have monopsony power, and it provides an incentive for people to enter the labour market rather than rely on benefits. It costs the government little, as employers pay the higher wages.



However, as the diagram shows, when the minimum wage is set above the equilibrium wage We, the quantity of labour demanded falls to Ld while supply rises to Ls, creating unemployment. Those who lose their jobs become poorer, so

Question number

inequality may not fall. Firms may raise prices to cover higher costs, causing inflation that reduces the real gains of low-income earners. Higher paid workers may demand higher wages to maintain differentials. The minimum wage does not help the unemployed, pensioners or those in the informal economy, and it may not be enforced.

Other policies may be better. A progressive income tax, where higher earners pay a higher proportion of income in tax, together with transfer payments such as unemployment benefits and pensions, directly targets those on the lowest incomes, including those not in work. However, high marginal tax rates may reduce incentives to work and invest, may encourage tax avoidance, and benefits can create a poverty trap and are expensive. State provision of essential goods and services, such as free education and healthcare, also redistributes real income, and inheritance and capital taxes tackle inequality in wealth, though they can be avoided.

Which policy is best depends on the cause of inequality and the economy. Where most poor households are in low-paid work, a minimum wage is effective; where poverty is caused by unemployment, old age or disability, taxes and transfers are better. It also depends on the level of the minimum wage: a moderate minimum wage raises low pay with little job loss, but a high one causes unemployment.

In conclusion, a minimum wage is not the best way to redistribute income on its own, because it only helps those in work and may cause unemployment. A system of progressive taxes and transfer payments is more effective at reducing inequality overall, with the minimum wage as a useful complement.

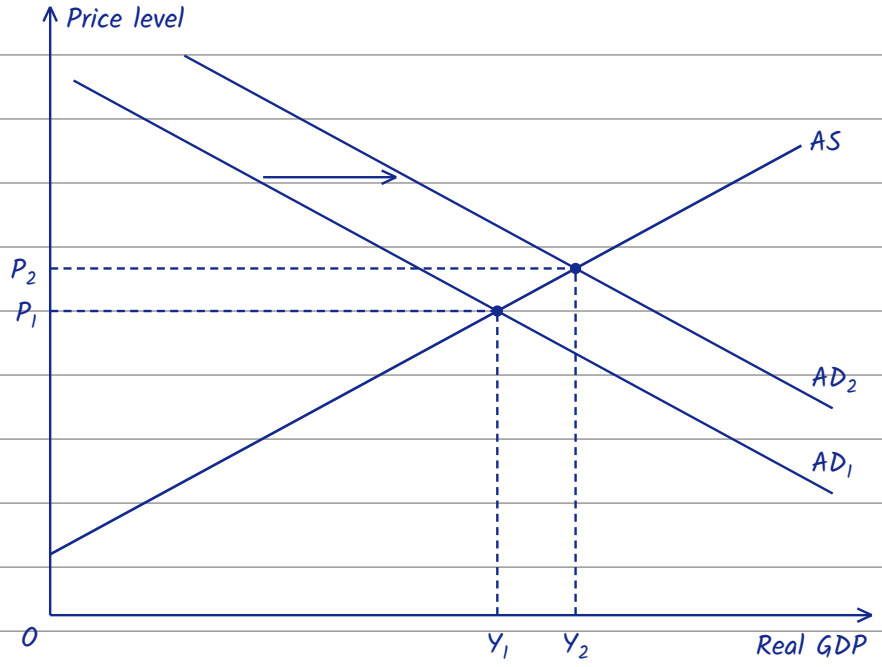
4(a) Supply-side policies are government policies designed to increase aggregate supply, the productive capacity of the economy, shifting the LRAS curve to the right.

Expenditure on education and training is a supply-side policy because it increases workers' skills and productivity, increasing the quality of labour, so more output can

Question number

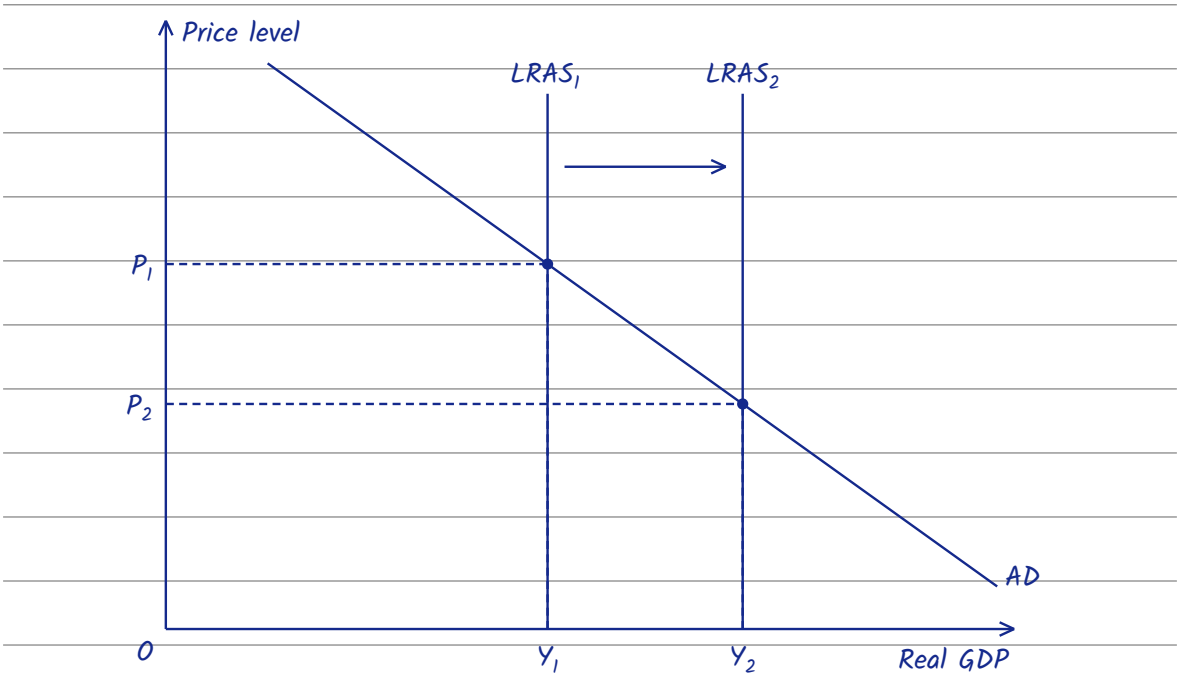
be produced from the same resources, and it improves occupational mobility, reducing structural unemployment.

In the short run, the increase in government expenditure is an injection that increases AD, shifting it from AD1 to AD2. If AS has not yet changed, the general price level rises from P1 to P2.



In the long run, as the newly trained workers enter the labour force, productivity and productive capacity rise, LRAS shifts right from LRAS1 to LRAS2 and the general price level falls from P1 to P2 (or rises less than it otherwise would).

Question number



The impact differs because of time lags: education takes years to raise productivity, so in the short run the effect is mainly on AD. However, if the spending is ineffective and productivity does not rise, it may simply raise the price level, and if there is spare capacity, the short-run rise in prices is small. So the impact differs mainly because supply-side effects take time.

4(b)

Inflation is a sustained rise in the general price level, measured by a consumer price index. Its consequences depend on how high it is, whether it is anticipated and its cause.

There are many negative consequences. Inflation reduces the purchasing power of money, so people on fixed incomes, such as pensioners, and savers whose interest rate is below inflation lose out, which redistributes income arbitrarily. If inflation is higher than in other countries, exports become less price competitive and imports more attractive, worsening the current account of the balance of payments. There are shoe leather costs, as people spend time searching for better returns on their money, and menu costs from continually changing prices. Uncertainty makes planning difficult, so firms may postpone investment, reducing long-run growth.

Question number

High inflation can also lead to a wage-price spiral.

However, the consequences are not always negative. Moderate inflation reduces the real value of debt, which benefits borrowers, including the government, and may encourage borrowing for investment. If prices rise faster than costs, firms' profits rise, encouraging them to expand output and employ more workers. The value of assets such as property may rise, increasing wealth. Low, stable inflation also avoids the risk of deflation and makes it easier for real wages to adjust without cutting money wages. This is why most central banks target a low positive rate, such as 2%, not zero.

Whether the consequences are negative depends on the rate of inflation. Low and stable inflation has few costs, while high inflation, and especially hyperinflation, is very damaging. It also depends on whether it is anticipated: if wages, pensions and interest rates are index-linked, the redistribution effects are reduced. The cause also matters: demand-pull inflation during strong growth comes with rising output and employment, while cost-push inflation comes with falling output. Finally, the effect on competitiveness depends on inflation relative to trading partners and on exchange rates.

In conclusion, the consequences of inflation are not always negative. Low, stable and anticipated inflation can have positive effects for borrowers, firms and growth, but high, unexpected or accelerating inflation has mainly negative consequences for the economy.

5(a) The terms of trade measures the rate at which a country's exports exchange for its imports:

terms of trade = (index of average export prices ÷ index of average import prices) × 100

An improvement occurs when this value increases, meaning export prices rise and/or import prices fall relative to each other. Causes include higher world

Question number

demand for the country's exports, for example for its commodities, domestic inflation that raises export prices, an appreciation of the currency, which makes imports cheaper in domestic currency, and a fall in world prices of imported goods such as oil.

An improvement is usually seen as beneficial, as more imports can be bought with the same volume of exports, raising living standards. However, it can be harmful. If it is caused by higher export prices due to inflation or an appreciation, exports become less competitive. If demand for exports is price elastic, export volumes fall by a larger proportion, reducing export revenue, which may lead to a current account deficit and unemployment in export industries.

So an improvement can be harmful when it results from a loss of competitiveness and export demand is elastic, but it is beneficial when it results from rising world demand for exports. Its effect depends on its cause.

5(b)

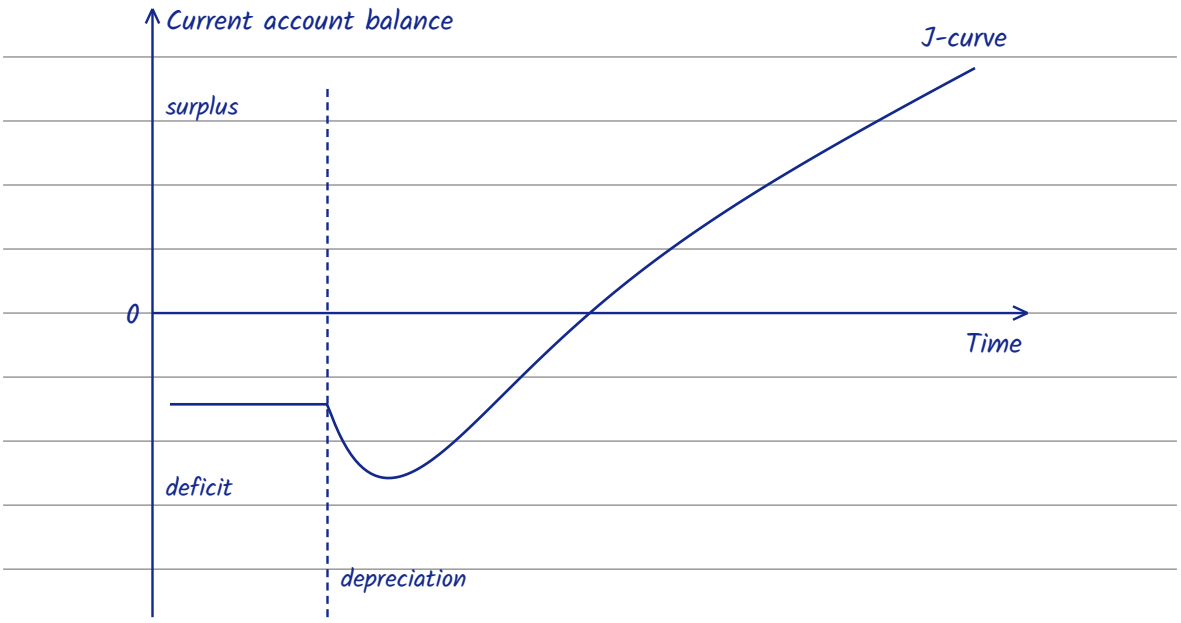
A depreciation is a fall in the value of a floating exchange rate against other currencies, caused by market forces of demand and supply.

A depreciation can benefit an economy. Exports become cheaper in foreign currencies, so demand for exports rises, and imports become more expensive in domestic currency, so people switch to domestic products. This can help reduce a current account deficit. Higher net exports increase aggregate demand, which leads to higher output and employment, especially in export industries, and economic growth.

However, it also has disadvantages. Imports of finished products become more expensive, reducing living standards. If the country imports raw materials and components, firms' costs rise, causing cost-push inflation, which can reduce the competitive advantage gained from the depreciation. Higher AD may also cause demand-pull inflation if the economy is near full capacity. Debts in foreign currencies become more expensive to repay.

Question number

Whether the current account improves depends on price elasticity of demand for exports and imports. The Marshall-Lerner condition states that the current account will improve only if the sum of the PEDs for exports and imports is greater than 1. In the short run demand is often inelastic, because contracts are fixed and buyers take time to switch, so the current account may first get worse before it improves, the J-curve effect.



The benefit also depends on the cause of the depreciation and the state of the economy. A depreciation is most beneficial when there is spare capacity, so higher demand raises output rather than prices, and when the country has enough productive capacity to supply more exports. It also depends on the reaction of other countries, which may retaliate, and on whether the depreciation reflects weak confidence in the economy, which can cause capital outflows.

In conclusion, a depreciation is not always beneficial. It can increase exports, growth and employment and improve the current account in the long run if demand is price elastic, but it can cause inflation and reduce living standards, especially for an economy that relies on imported raw materials and has price inelastic demand.