Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **October/November 2016**

MARK SCHEME

Maximum Mark: 40

Published

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the October/November 2016 series for most Cambridge IGCSE®, Cambridge International A and AS Level components and some Cambridge O Level components.

® IGCSE is the registered trademark of Cambridge International Examinations.

© UCLES 2016

1 (a) (i) Explain one possible reason for the change in the world sugar price between 2011 and 2013. [3]

Accept any one factor/reason that would cause a decrease in demand **or** an increase in supply.

e.g. A fall in incomes leading to a decrease in demand. (Up to 3 marks)

Or

An improvement in technology that would increase supply or more favourable growing conditions in terms of rainfall and sunshine which would raise crop yields, leading to greater supply and lower prices. (Up to 3 marks)

(ii) Explain one possible reason for the difference in the price of sugar in the US and the world price of sugar shown in Table 1. [2]

Accept responses that relate to relative factor endowments in the U.S. compared to other countries (Up to 2 marks)

Other valid responses can be accepted for example government policy in the U.S. that might cause prices in the U.S. to be higher. The higher US price might result from higher costs of production, e.g. resulting from higher labour costs (without a corresponding increase in productivity) or from less fertile growing areas. The higher prices in the US could also be the result of import tariffs which push up prices. (Up to 2 marks)

(b) (i) What is meant by 'dumping'? [2]

Dumping is selling in overseas markets at a price below the (marginal) cost of production (candidates do not need to refer to the marginal cost of production).

Accept the WTO definition of dumping as also applying to a situation when goods are being sold in a market at a price that is lower than the price charged in the producer's domestic market.

Accept any response that states that dumping is selling below costs. (2 marks)

Selling at low prices in an overseas market without elaboration. (1 mark maximum)

(ii) Explain why Mexican producers might choose to dump their sugar in the US market. [2]

The intention is to undercut rivals with low prices in the short-term and prices will then be increased in the long-run once domestic producers have been forced out of the market and competition has been removed (idea of predatory dumping). (Up to 2 marks)

Accept other feasible explanations of the aims of dumping, e.g. to keep prices higher in Mexico.

© UCLES 2016

(iii) Consider how an economist would decide whether the accusation that Mexican producers were dumping sugar in the US was justified. [2]

For an explanation that low prices are because of relative factor endowments, i.e. Mexico is better at producing sugar than the US (Up to 2 marks)

For an explanation that suggests that the costs of production would need to be examined and whether the price is below cost or whether the low prices are a reflection of factor endowment (Up to 2 marks)

(c) With the help of a diagram, explain the likely impact on the US market for raw sugar if a minimum price higher than US$0.21 had been imposed in 2013. [3]

For a diagram showing the imposition of a minimum price above the market price of US$0.21, showing that the quantity supplied exceeds the quantity demanded. (1 mark)

For an explanation of the effects of a minimum price imposed above equilibrium in terms of a lower quantity demanded and a greater quantity supplied, resulting in an excess supply of sugar (Up to 2 marks)

(d) Consider who, if anybody, in the US and Mexico might benefit from a trade war despite the advantages of free trade. [6]

For an explanation of the benefits of free trade based upon comparative advantage. (Up to 2 marks)

For a consideration of those who might benefit from a trade war for example domestic producers, workers and consumers in the short-run. (Up to 3 marks)

Reserve 1 mark for a conclusion. (1 mark)

© UCLES 2016

2 (a) With the help of a supply and demand diagram, explain how the introduction of an indirect tax on a good would affect the surplus enjoyed by the consumers of that good. [8]

For **knowledge and understanding** displayed through a supply and demand diagram of the impact of an indirect tax upon the equilibrium price and quantity of a product, i.e. all four marks are for the diagram.

For an accurately labelled diagram (D,S,P,Q) (1 mark) showing the shift of the supply curve to the left (1 mark), the rise in equilibrium price (1 mark) and the fall in equilibrium quantity (1 mark) (Up to 4 marks)

For **application** showing how the impact of the tax affects consumer surplus. Candidates should define/show an awareness of consumer surplus (1 mark), explain how the impact of an indirect tax would reduce consumer surplus (1 mark) and refer to the significance of price elasticity of demand (up to 2 marks) (Up to 4 marks)

(b) Discuss whether it is better to introduce an indirect tax or to adopt policies to improve consumers' knowledge and understanding to deal with the problem of demerit goods [12]

An indirect tax will increase the price of the product reducing the demand, but the impact depends upon the price elasticity of demand. Improving consumers' knowledge will shift the demand curve to the left, but the success of this policy depends upon the effectiveness of the campaign to improve consumers' knowledge and understanding which might be very expensive and may take a long time to make a difference.

For **analysis** of the problems associated with demerit goods that are under-priced and over-consumed and the two policies designed to reduce the problem. (Up to 8 marks)

For an explanation of the 'problem of demerit goods' in terms of under-pricing and over-consumption (1 mark) that results from imperfect information (1 mark). (Up to 2 marks)

For an explanation of how an indirect tax can deal with the problem of demerit goods. (Up to 3 marks)

For an explanation of how a policy of improving consumers' knowledge can deal with the problem of demerit goods (Up to 3 marks)

For **evaluative comment** on the policies in terms of reducing the problem. Reserve 1 mark for a conclusion on which policy is likely to be the most effective (Up to 4 marks)

© UCLES 2016

3 (a) Explain, with the help of a diagram, what is meant by equilibrium national income, and show how this equilibrium changes when there is an increase in aggregate demand. [8]

Equilibrium national income occurs where aggregate demand and supply are equal. An increase in aggregate demand will shift the aggregate demand curve upwards and result in a higher level of national income. All four marks are for the diagram.

For **knowledge and understanding** of equilibrium national income and where it occurs on an aggregate demand and aggregate supply diagram. (Up to 4 marks)

For **application** showing the impact upon equilibrium national income of an increase in aggregate demand. (Up to 4 marks)

(b) Discuss the factors that determine how much an increase in aggregate demand will affect prices, employment and the balance of payments of an economy. [12]

The impact of an increase in aggregate demand depends upon where the equilibrium occurs. This might be above or below the full employment level of national income. This will determine whether the increase in national income is an increase in real or money national income. The impact upon the balance of payments depends upon a range of factors including whether the economy is relatively open or closed and whether the new equilibrium level of national income generates inflation at a rate in excess of that of the economy's competitors.

For a discussion of prices and employment. (Up to 6 marks)

For a discussion of the balance of payments. (Up to 6 marks)

8 marks maximum

For an **analysis** of the impact of an increase in aggregate demand on prices, employment and balance of payments. (Up to 8 marks)

For **evaluative comment** on the factors that influence the impact, such as the level of employment in the economy and whether it is an open or a closed economy. (Up to 4 marks)

© UCLES 2016

4 At the end of October 2014, the value of the US dollar on foreign exchange markets rose to a four-year high because it was believed that the US central bank was about to raise interest rates.

(a) With the help of a diagram, explain how exchange rates are determined in a free market and why an expected rise in interest rates in the US would cause the value of the US dollar to rise. [8]

A rise in US interest rates is likely to cause an inflow of funds into the US causing upward pressure on the US exchange rate. It might also cause a fall in US imports as aggregate demand falls causing a fall in outflow of US dollars again creating upward pressure on the dollar.

For **knowledge and understanding** of the factors that determine exchange rates in a free market, with the help of a diagram. (Up to 4 marks)

For **application** showing a diagram with an increase in demand for the dollar as a result of the rise in interest rates in the U.S. (Up to 4 marks)

The diagram can gain up to four marks, two marks under 'knowledge and understanding' and two marks under 'application'.

(b) Discuss the probable impact of this exchange rate rise on the US economy and assess whether it is likely to benefit this economy overall. [12]

There will be an impact upon US imports and exports as imports become cheaper and exports become dearer. This will affect the current account of the balance of payments, but also employment and prices. The significance of this for the US current account of the balance of payments depends upon elasticity. There will be differences in the impact in the long-run and in the short-run.

For **analysis** of the impact of an exchange rate rise upon an economy considering employment, inflation and the balance of payments. (Up to 8 marks)

For **evaluative comment** on the overall effect and the extent to which it might be positive. (Up to 4 marks)

© UCLES 2016

Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/22**

Paper 2 Data Response and Essay **October/November 2016**

MARK SCHEME

Maximum Mark: 40

Published

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the October/November 2016 series for most Cambridge IGCSE®, Cambridge International A and AS Level components and some Cambridge O Level components.

® IGCSE is the registered trademark of Cambridge International Examinations.

© UCLES 2016

1 (a) (i) Compare the US balance of trade with India in 2009 with that in 2014. [2]

The US has a deficit in both years (1 mark)

The deficit has grown or increased or worsened. (1 mark)

It is essential that the candidate uses the term 'deficit'. If figures are shown with a negative sign, but there is no reference to deficit: no marks.

(ii) Explain two factors, other than India's ban on US agricultural products, that could explain the change in the US balance of trade that you have identified. [4]

A growth in the deficit could be caused by a number of factors. These include:

- A decline in India's exchange rate against the US dollar.
- A change in tastes away from US goods in favour of India's goods.
- An improvement in the efficiency of Indian industry that means that the price of Indian goods is lower than the price of American goods.
- The imposition of tariffs on US goods by the Indian government.

Accept any valid factor identified (1 mark) and explained (1 mark).

(Up to 2 marks for each explanation)

If the candidate identifies factors that would explain the deficit in the two years but does not explain why the deficit has grown then maximum of 1 + 1

References to China are not accepted, unless the factor identified could be applied to India.

(iii) In addition to the balance of trade in goods, what other balances would you require to calculate the US current account balance with India? [2]

Any two from: Balance on Services (1 mark)

Balance on Income (1 mark)

Balance on Current Transfers (1 mark)

Allow 1 mark for 'Invisibles' with no further elaboration. If the candidate lists different types of services: 1 max.

Allow reference to primary and secondary income here.

© UCLES 2016

(b) (i) Use a diagram to show how an import duty on a product affects its price. [2]

For an accurate diagram. (Up to 2 marks) A supply and demand diagram showing a shift to the left in the supply curve as a result of the indirect tax and the resulting rise in equilibrium price is acceptable. Also acceptable is the tariff diagram that shows the world supply and demand before and after the imposition of the tax. No explanation needed. If the candidate shows a supply and demand diagram with a rise in price, but no shift in supply this is worth 0 marks.

(ii) What is likely to determine the extent of the change in sales when an import duty is imposed on US cars in China? [2]

For clear recognition that this depends upon the price elasticity of demand (1 mark)
For clear understanding that the fall in sales will be greater if the price elasticity of demand is high. (Or less if the price elasticity of demand is low). (1 mark)

(Allow 1 mark if the candidate states that it depends upon the size of the import duty)

(iii) Explain a possible reason why China imposed export quotas on tungsten and molybdenum. [2]

The effect would be to raise the export price (1 mark) and as a result raw material costs for the production of a range of American products would rise giving an advantage to Chinese producers of these goods (1 mark) (Up to 2 marks)

There are a number of other possible reasons that could be explained by the candidate.

- e.g. to preserve declining/scarce resources and ensure a supply for domestic producers
- to increase revenue from exports due to the increase in price.
- to reduce production of tungsten and molybdenum because of the environmental impact of their production.

Award 2 marks to any valid reason that is explained.

(c) Consider whether the protectionist measures adopted by countries such as India, China and Argentina regarding trade with the US could ever be justified. [6]

For argument(s) in favour of protectionism. These include the infant industry argument, the anti-dumping argument etc. (Up to 3 marks)

One argument well explained could be awarded 3 marks

For argument(s) against protectionism. These include reference to the principle of comparative advantage, the dangers of retaliation and trade wars etc. (Up to 3 marks)

One argument well explained could be awarded 3 marks

5 marks maximum for the arguments for and against protectionism

Reserve a mark for a reasoned conclusion on whether protectionist measures could ever be justified. (1 mark)

© UCLES 2016

2 (a) Explain, with the help of a diagram, what happens in the market for a product when the price of a substitute increases, and how economists would measure the relationship between these two products. [8]

For **knowledge and understanding** of the impact of a rise in the price of a substitute using a supply and demand diagram(s). (Up to 4 marks)

The diagram should be correctly labelled (1 mark) and show an increase in demand for a good as the price of its substitute rises (1 mark). It should also show a rise in the equilibrium price of the good (1 mark) and a rise in the equilibrium quantity (1 mark).

An alternative diagram shows the change in the price of one good and the change in the quantity demanded of the other good on the axes together with a curve showing the direct relationship between the two goods. This is acceptable, but please ensure that the impact on the price of the substitute and the quantity of the substitute demanded is explained to ensure that 'what happens in the market' is considered.

For **application** using the cross elasticity of demand to show how economists measure the relationship between substitutes. (Up to 4 marks)

For understanding of the cross elasticity of demand in terms of what it measures (1 mark)

For an accurate formula (1 mark)

For explaining why substitutes have a positive value for cross elasticity**.** For stating that substitutes have a positive cross elasticity (1 mark) and explaining why this occurs (1 mark) (Up to 2 marks)

(b) Discuss how habit-forming demerit goods and goods with lots of substitutes are each likely to respond to price rises, and consider the extent to which knowledge of their likely response would be useful to government policy makers. [12]

Habit-forming demerit goods are likely to be price inelastic and goods with lots of substitutes are likely to be price elastic. Government policy makers will use this information to assess which products to tax and also the extent to which the consumption of demerit goods will fall if the goods are taxed.

For **analysis** explaining how habit-forming demerit goods and goods with lots of substitutes are each likely to respond to price rises (only one type of good considered: 3 max) (Up to 4 marks)

For **analysis** explaining how government policy makers could use the information (only one type of good considered: 3 max) (Up to 4 marks)

8 marks maximum

For **evaluative comment** on the extent to which this information would be useful. A concluding comment is essential for full marks. (Up to 4 marks)

© UCLES 2016

3 (a) Explain any two factors that cause the supply of a product to be price-inelastic. [8]

For **knowledge and understanding** of the meaning of price elasticity of supply and 'inelastic' in this context. (Up to 4 marks)

Accurate formula: (up to 2 marks). If no formula provided allow 1 mark for clear understanding of what price elasticity of supply measures.

Accurate and clear understanding of what is meant by price inelastic supply (up to 2 marks). For both marks it is essential that the candidate shows understanding that price inelastic supply means that the **percentage** change in quantity supplied is less than the **percentage** change in price.

4 marks maximum

For **application** with explanation of any two factors that are likely to cause the elasticity of supply of a product to be inelastic. For e.g. shortage of factors of production, the nature of the product, the time period under consideration, availability of stocks etc.

Up to 3 marks for each factor explained

4 marks maximum

(b) Discuss the policies that a government might adopt to increase the price elasticity of supply of agricultural goods in an economy and consider which policy is likely to be most effective. [12]

For **analysis** of at least **two** policies that might be adopted to increase elasticity of supply of agricultural products such as reduced import controls, subsidies and a range of supply side policies including training schemes to increase the supply of skilled labour and tax reductions to increase incentives. (Up to 8 marks)

For each policy explained (up to 4 marks)

Allow 1 mark for the identification of the policy and up to 3 marks for explaining how this could increase the price elasticity of supply.

If the candidate provides a list of policies without explanation 3 marks maximum for analysis.

8 marks maximum

For **evaluative comment** on the effectiveness of the policies explained. A concluding comment on which policy is likely to be most effective is essential for full marks.
(Up to 4 marks)

© UCLES 2016

4 (a) Explain what is used as money in a modern economy and how an increase in the quantity of money can cause prices to rise. [8]

For **knowledge and understanding** of 'money' in a modern economy.

(Up to 4 marks)

- For an understanding of what is meant by money in terms of its general acceptability in settlement of debt or as a medium of exchange when purchasing goods and services (1 mark)

- For explaining what acts as money in a modern economy: cash and bank deposits (Up to 3 marks)

If there is no reference to bank deposits 2 maximum. For elaboration reward recognition of modern methods of transferring bank deposits for example cheques and contactless payments and what is meant by 'near money'.

4 marks maximum

For **application** showing how an increase in the money supply can cause an increase in aggregate expenditure and demand-pull inflation. (Up to 4 marks)

4 marks maximum

(b) Discuss the policy options available to a government faced with inflation and consider which is most likely to be effective. [12]

A range of policies are available such as contractionary fiscal or monetary policy that are designed to reduce aggregate demand, or supply-side policies that are designed to shift aggregate supply to the right to match the excess aggregate demand. Supply-side policies might also be used to solve the problem of cost-push inflation. This type of inflation might also be solved by other policies such as support for the exchange rate.

For **analysis** explaining the policies available and how each is designed to solve the problem of inflation.

For an explanation of any policy designed to solve the problem of inflation.

(Up to 4 marks)

8 marks maximum

For evaluative comment on the most effective policy. This might include a consideration of the strengths and weaknesses of each policy and whether the policy is appropriate given the type of inflation that is present. A concluding comment on which policy is most likely to be effective is essential for full marks.

4 marks maximum

© UCLES 2016

Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/23**

Paper 2 Data Response and Essay **October/November 2016**

MARK SCHEME

Maximum Mark: 40

Published

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the October/November 2016 series for most Cambridge IGCSE®, Cambridge International A and AS Level components and some Cambridge O Level components.

® IGCSE is the registered trademark of Cambridge International Examinations.

© UCLES 2016

1 (a) (i) Calculate the price elasticity of demand for meat in Bishkek. [2]

For evidence of correct formula (1 mark) **and** correct calculation = (–) 4.16 (1 mark)

Accept answers within the range 4.1 to 4.2.

Correct calculation with no formula shown (2 marks), correct formula with incorrect calculation (1 mark).

(ii) How does the price elasticity of demand for meat differ from the price elasticity of demand for flour in Bishkek? [2]

Price elasticity of demand for meat exceeds 1 and so is elastic (1 mark), the data indicates that there is an inelastic demand for flour. (1 mark)

(iii) How might an economist explain this difference? [2]

For any explanation that is valid in terms of the factors that influence elasticity

For identification of a valid factor (1 mark) for explanation of this factor (1 mark).

For example, the candidate might explain that the data indicates that meat has many substitutes whereas flour has few substitutes. Or that meat is more expensive and therefore takes up a higher proportion of consumer spending. One factor explained can gain both marks.

(b) With the help of a supply and demand diagram, explain how the Russian central bank is 'attempting to protect the value of the rouble'. [3]

For an explanation of how the sale of foreign exchange reserves by the Russian central bank can increase the demand for the rouble and support its value. (up to 2 marks)

For an accurate supply and demand diagram of the foreign exchange market. (1 mark)

If the candidate only explains an action to support the value of the rouble that does not involve the sale of foreign exchange reserves, for example an increase in interest rate. (1 mark maximum)

(c) Consider the extent to which the economic performance of Kyrgyzstan would be affected by the fall in remittances from Russia. [5]

The data indicates that the fall in remittances from Russia will have serious consequences for the Kyrgystan economy. This is because of the scale of these remittances and the extent of the fall. In addition the remitted roubles will purchase fewer US dollars. The outcome would be reduced aggregate demand and possibly cost-push inflation.

For analysis of the effects of the fall in remittances upon other macro indicators such as the national income, employment and prices. (up to 4 marks)

For evaluative comment on the scale of the impact. (1 mark)
Allow approaches that focus on a narrow range of indicators, but also those that consider a wider range of indicators in less detail as long as there is explanation of the effects.

© UCLES 2016

(d) Discuss whether the actions of the Russian and Kyrgyzstan governments in protecting the value of their currencies are likely, on balance, to have benefited their economies. [6]

Protecting the value of a currency has advantages and disadvantages. Advantages include the fact that importers and exporters will be more sure of the value of their transactions and this will enhance trading conditions, there is less opportunity for speculators to create a run on the currency and so on.

The disadvantages include the cost of the intervention in terms of foreign exchange reserves and the fact that changes in the exchange rate that are determined by market forces cannot offset differences in inflation rates between trading nations.

For explaining the negative effects of protecting the value of their currencies.
(up to 3 marks)

For explaining the positive effects of protecting the value of their currencies. (up to 3 marks)
(up to 5 maximum)

For a conclusion based upon the evidence offered. (1 mark)

© UCLES 2016

2 (a) Distinguish between the concepts of market equilibrium and disequilibrium and show what happens in a free market for a good when disequilibrium exists. [8]

Market equilibrium means that there is no tendency for price and quantity to change. Dis equilibrium means that excess demand or excess supply exists and as a result price and quantity will change as a result of market forces.

For clear **knowledge and understanding** of the terms equilibrium and disequilibrium. (up to 4 marks)

For knowledge and understanding of the meaning of equilibrium in a free market. (up to 2 marks)

For knowledge and understanding of the meaning of disequilibrium in a free market. (up to 2 marks)

If the candidate shows where equilibrium and/or disequilibrium occurs, but does not explain what this means. (1 mark maximum)

For **application** showing how equilibrium is re-established in a free market when disequilibrium exists. (up to 4 marks)

For showing how market forces operate to re-establish equilibrium when an excess demand exists. (up to 3 marks)

For showing how market forces operate to re-establish equilibrium when an excess supply exists (up to 3 marks) (4 marks maximum)

(b) Discuss whether subsidies or improved information is the more effective policy to deal with the problems raised by the under-consumption of merit goods. [12]

For **analysis** of the problems associated with the under-consumption of merit goods and the two policies designed to reduce the problem. (up to 8 marks)

For an explanation of the problems of merit goods in terms of under-consumption (1 mark) that results from imperfect information (1 mark) (up to 2 marks)

For an explanation of how a subsidy can deal with the problem of merit goods. (up to 4 marks)

For an explanation of how a policy of improving information can deal with the problem of under-consumption of merit goods. (up to 4 marks) (8 marks maximum)

For **evaluative comment** on the policies in terms of reducing the problems. A concluding comment on which policy is likely to be most effective is essential for full marks. (up to 4 marks)

© UCLES 2016

3 (a) Explain with the help of a diagram why production possibility curves are usually drawn with increasing opportunity costs, and show how they can be used to illustrate scarcity. [8]

For **knowledge and understanding** of production possibility curves and why they are usually drawn with increasing costs. (up to 4 marks)

For a production possibility curve accurately drawn with appropriate axes (1 mark) and displaying increasing opportunity costs (1 mark) (up to 2 marks)

For an explanation of why increasing opportunity costs arise as a movement along the opportunity cost curve takes place. (up to 2 marks)

For **application** showing how production possibility curves can be used to illustrate scarcity with due reference to choice and opportunity cost and that points outside the curve are unattainable. (up to 4 marks)

(b) Discuss whether it is likely that economies that have an increase in labour and a high rate of technological innovation will come nearer to solving the economic problem. [12]

For **analysis** of the impact of an increase in the labour supply and a high rate of technological innovation upon the goods and services produced. This could be illustrated with a diagram showing an outward shift in the production possibility curve. (up to 8 marks)

For explanation of the 'economic problem' in terms of unlimited wants and scarce resources. (up to 2 marks)

For explanation of the impact of an increase in the labour supply on the capacity of an economy to produce goods and services. (up to 4 marks)

For explanation of the impact of a high rate of technological innovation on the capacity of an economy to produce goods and services. (up to 4 marks)

For **evaluative comment** on whether the economic problem can be solved. (up to 4 marks)
(8 marks maximum)

4 (a) Using diagrams, explain how rising raw material prices and a fall in the rate of interest might cause different types of inflation. [8]

For **knowledge and unbderstanding and application** of how rising raw material prices can cause cost-push inflation. (No diagram 3 max) (up to 4 marks)

For **knowledge and understanding and application** of how a fall in the rate of interest can cause demand-pull inflation. (No diagram 3 max) (up to 4 marks)

(Allow 2 marks maximum for answers that show understanding of the way in which a fall in the rate of interest could cause cost-push inflation through the impact upon the exchange rate)

© UCLES 2016

(b) Discuss how the policy chosen to reduce the rate of inflation will be influenced by the cause of the inflation. Consider which type of inflation is most difficult to reduce and why. [12]

The most appropriate policy to reduce inflation depends upon the type of inflation that exists. Demand-pull inflation is best approached through contractionary monetary or fiscal policy or through supply side policies. The most appropriate policy to reduce cost-push inflation depends upon the source of the rise in costs. For example, a rise in raw material costs might be off-set by new sources of supply. Increasing costs through a declining exchange rate can be offset by support for the exchange rate and so on. Which type of inflation is most difficult to reduce depends upon a number of factors. For example, if the inflation is demand-pull then policy might have a considerable time lag. If inflation is caused by a shortage of raw materials, it might take a long time before new sources of supply are found.

For **analysis** that explains how demand-pull inflation can be reduced through:

- Contractionary monetary policy i.e. through a decrease in the quantity of money and a rise in the rate of interest
- Contractionary fiscal policy i.e. through a decrease in government spending and a rise in taxation.
- Supply side policies i.e. through an increase in aggregate supply that offsets the excess aggregate demand. (up to 6 marks)

For **analysis** that explains cost-push inflation can be reduced through:

- Support for the exchange rate
- A range of supply-side policies aiming to reduce costs etc.

(up to 6 marks) (8 marks maximum)

For **evaluative comment** on the most 'difficult to reduce' aspect of the question. A concluding comment on which policy is likely to be most effective is essential for full marks. (up to 4 marks)

© UCLES 2016