Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/21**

Paper 2 AS Level Data Response and Essays **October/November 2025**

2 hours

1461351986

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.

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Section A

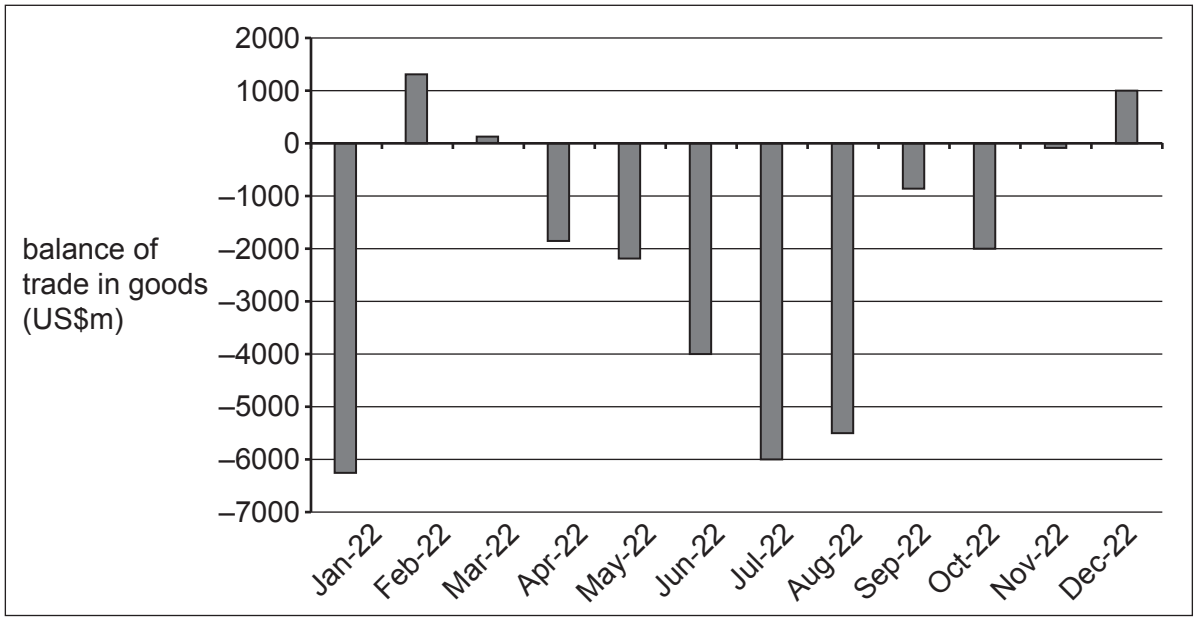
Answer all parts of Question 1.

1 Mexico's backward-looking energy policy is bad for the country and the planet

In 2023, Mexico's energy policies looked increasingly out of step with those in the rest of the world. The Mexican President reversed recent reforms of Mexico's energy market. These reforms increased the role of private sector firms. He changed the balance of the mixed economy by prioritising state-owned companies and stressed that Mexico should produce its own energy rather than importing it.

The government invested in a new oil refinery and decided to keep coal-fired power stations running. It also gave state-owned electricity and oil companies priority over private sector rivals, so it was harder for private firms to obtain permits to generate electricity or to explore for oil.

Mexico has traditionally exported crude oil and imported natural gas. However, the new plan is that the oil will be used to generate the country's electricity. There has been a global shift towards energy self-sufficiency but it is unclear whether Mexico has the capacity to produce enough electricity for its 130 million people. There may also be an impact on the country's balance of trade in goods which was in deficit for nine months of 2022, as shown in Figure 1.1.



Source: tradingeconomics.com

Fig. 1.1 Mexico's balance of trade in goods, January 2022 to December 2022

Energy is likely to become more expensive. Operating costs of the state-owned electricity producers are significantly higher than their private sector rivals. Its old and inefficient plants are expensive to maintain. These costs will be passed on to the consumer, either directly or by the government having to spend more on subsidies to keep down the price.

The environment will also suffer. Mexico will see less investment in renewable energy because of its change in energy policy. In the past, domestic and foreign firms in the private sector did much of the investing. The policy change means that Mexico is unlikely to meet its pledge to produce 35% of its electricity from renewable sources by 2024.

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The impact of the energy policy may be felt in the economy more broadly. The earlier energy reforms had helped to bring manufacturers to Mexico by making power cheaper and more reliable. Now the uncertainty is deterring investors.

The opportunity cost of Mexico's new energy policy is huge. Economists reckon that Mexico could have produced almost half its electricity from renewable sources long before its target of 2050. Multinational companies were looking at Mexico as an alternative location to other countries, but because of Mexico's change in energy policy, those companies are likely to go elsewhere.

Source: Adapted from: 'Mexico's energy policy', The Economist, The World Ahead 2023, published 2022

(a) Using the information provided, explain whether Mexico is a mixed economy. [2]

(b) Explain what is meant by 'The opportunity cost of Mexico's new energy policy is huge.' [2]

(c) Consider the extent to which direct provision of electricity in Mexico through state-owned companies may be advantageous to consumers. [4]

(d) With the help of a diagram, assess whether the potential advantages of providing a subsidy to keep down the price of electricity in Mexico will outweigh the potential disadvantages. [6]

(e) Assess the potential benefits and limitations of Mexico keeping its oil to generate the country's electricity. [6]

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Section B

Answer **one** question.

EITHER

2 **(a)** With the help of a formula, explain what is meant by price elasticity of demand for a product **and** consider the importance of time in determining whether demand for the product is likely to be relatively price elastic or relatively price inelastic. [8]

(b) Assess whether knowledge of a product's income elasticity of demand is more important to a firm producing it than knowledge of its cross elasticity of demand. [12]

OR

3 **(a)** With the help of examples, explain the nature and characteristics of free goods and private goods (economic goods) **and** consider the significance of the distinction between these two types of good. [8]

(b) Assess whether education should be classified as a public good or a merit good. [12]

Section C

Answer **one** question.

EITHER

4 **(a)** Explain the possible causes of frictional unemployment and technological unemployment **and** consider whether some element of frictional unemployment is inevitable in an economy. [8]

(b) Assess whether the consequences of technological unemployment are likely to be more serious than those of cyclical unemployment. [12]

OR

5 **(a)** Explain **two** tools of protection used by a country when trading internationally **and** consider whether one is likely to have more of an impact on the country's economy than the other. [8]

(b) Assess whether all consumers, all producers and the government in a country will benefit equally from protectionism. [12]

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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) A mixed economy is one where resources are allocated partly by the market mechanism through a private sector and partly by the government through a public sector. Mexico is a mixed economy because it has both: state-owned electricity and oil companies (public sector) and "private sector rivals" which need permits to generate electricity or explore for oil (private sector). The President has only changed the balance between them.

1(b) Opportunity cost is the value of the next best alternative forgone when a choice is made. By prioritising state-owned oil and coal, Mexico gives up producing almost half its electricity from renewable sources long before 2050, and multinational companies that might have located in Mexico are likely to go elsewhere, so the benefits given up are very large.

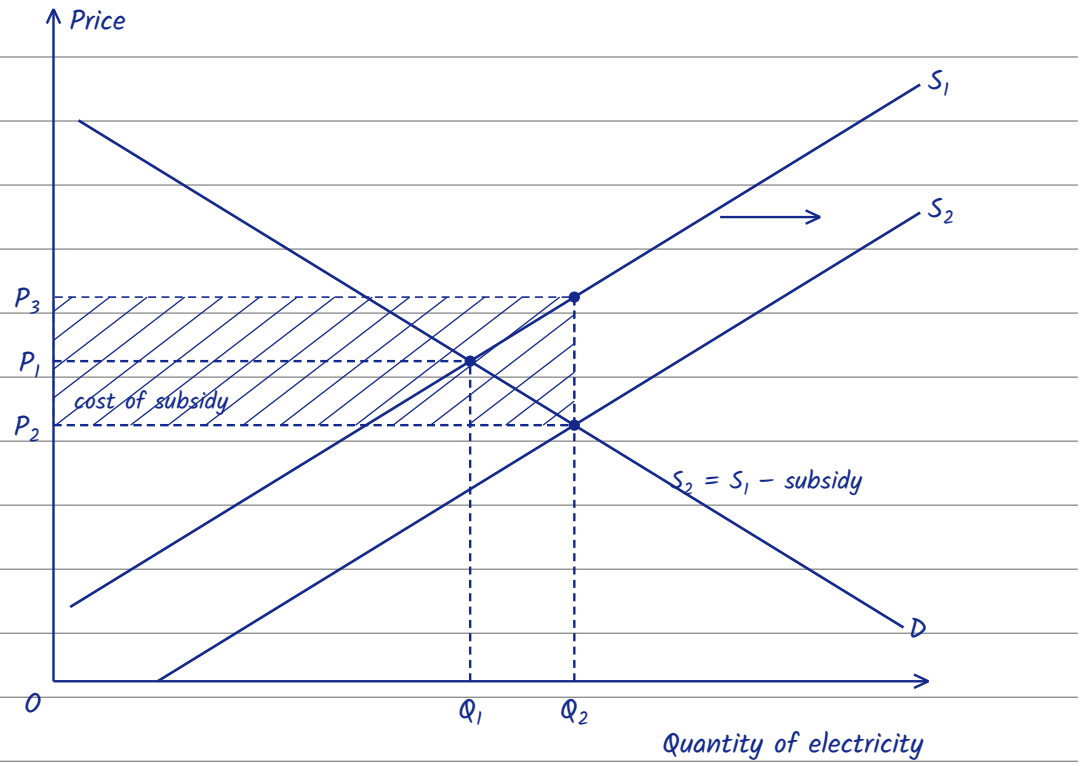
1(c) Direct provision may benefit consumers because state-owned companies do not have to maximise profit, so they can operate in the national interest, aim to supply all 130 million people and keep prices low. The government has more financial resources than private firms and can support them, which may give a secure, reliable supply.

However, operating costs of the state-owned producers are significantly higher than those of private rivals, and their old, inefficient plants are expensive to maintain. These costs will be passed on to consumers in higher prices or paid through taxes for subsidies, and there will be less investment in cleaner renewable energy.

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On balance, direct provision is likely to be of limited advantage to consumers: any benefit of lower prices depends on government subsidy, which consumers pay for anyway, while the higher costs make electricity dearer.

1(d) A subsidy is a payment from the government to producers that lowers their costs of production. In the diagram the supply curve shifts to the right from S1 to S2, so the price of electricity falls from P1 to P2 and the quantity bought rises from Q1 to Q2. The shaded area is the cost of the subsidy to the government.



Advantages: consumers pay a lower price, which is especially important for low-income households because electricity is a necessity and takes a large share of their income. Firms' energy costs are lower, which helps Mexico stay competitive, and keeping the price down reduces cost-push inflation, since the high operating costs of the state producers are not passed on to consumers directly.

Disadvantages: the subsidy must be financed by the government through higher taxes or borrowing, and it has an opportunity cost, as the money could have been spent on health, education or renewable energy. Because the state producers are

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protected from their high costs, they have little incentive to become efficient, so the subsidy props up old, inefficient plants. A lower price also encourages more consumption of electricity made from oil and coal, increasing pollution, and subsidies are difficult to remove once introduced.

Whether the advantages outweigh the disadvantages depends on the size and length of the subsidy, how well it is targeted at poorer households and how it is financed. In the short run the lower price may protect living standards, but in the long run the cost to the government, the inefficiency and the environmental damage are likely to be greater, so on balance the disadvantages probably outweigh the advantages unless the subsidy is small, temporary and targeted.

1(e)

Keeping its oil to generate electricity could benefit Mexico by increasing its energy self-sufficiency, in line with the global shift. Mexico would be less dependent on imported natural gas, so it would be protected from sudden rises in world energy prices and from disruptions to supply. Fewer energy imports would also reduce import spending, and refining and power generation could create jobs in Mexico.

There are limitations. It is unclear whether Mexico has the capacity to produce enough electricity for its 130 million people, so there may be shortages. Mexico would lose export revenue from crude oil, which could worsen its balance of trade in goods, already in deficit for nine months of 2022, with deficits of about US$6000m in January and July. There is also an opportunity cost: oil could be sold at world prices while cheaper renewable electricity was developed, and burning oil increases pollution.

The overall effect depends on whether the fall in oil exports is greater than the fall in gas imports, on world oil prices and on how efficient the state plants are.

On balance the limitations seem greater: the security gained is small compared with the lost export revenue, higher costs and lost investment in renewables.

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2(a)	Price elasticity of demand (PED) measures the responsiveness of the quantity demanded of a product to a change in its price, ceteris paribus. It is calculated as: PED = % change in quantity demanded ÷ % change in price The value is negative because price and quantity demanded move in opposite directions, so economists usually look at the absolute value. If PED is greater than 1, demand is price elastic: the percentage change in quantity demanded is greater than the percentage change in price. If PED is between 0 and 1, demand is price inelastic: the percentage change in quantity demanded is smaller than the percentage change in price. Time is important. Demand is usually more price inelastic in the short run than in the long run. When the price of petrol rises, drivers have little choice in the short run, as they still need to get to work and habits are hard to change. In the long run consumers have more time to search for and think about alternatives, such as public transport or electric cars, and firms may develop new substitutes, so quantity demanded falls by more and demand becomes more price elastic. Habit therefore has a stronger influence on short-run consumption. However, time is not the only factor. The number and closeness of substitutes, the proportion of income spent on the product and whether it is a necessity also matter; demand for salt stays inelastic however long the period. So time is an important influence, because it allows the other factors such as substitutes to operate, but it is not the sole determinant of whether demand is relatively elastic or inelastic.
2(b)	Income elasticity of demand (YED) measures the responsiveness of demand for a product to a change in income, and equals the percentage change in quantity demanded divided by the percentage change in income. For a normal good YED is positive: between 0 and 1 for a necessity and greater than 1 for a luxury. For an inferior good, such as cheap own-brand food, YED is negative.

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Knowledge of YED helps a firm forecast sales as incomes change over the economic cycle. A firm selling luxury holidays with a YED of +2.5 knows that if incomes rise by 4%, demand will rise by about 10%, so it can plan capacity, stocks and recruitment. In a recession it can switch its product mix towards cheaper lines or inferior goods, and it can target markets where incomes are growing fastest, such as emerging economies.

Cross elasticity of demand (XED) measures the responsiveness of demand for one good to a change in the price of another: the percentage change in quantity demanded of good A divided by the percentage change in the price of good B. For substitutes XED is positive, for complements it is negative and for unrelated goods it is zero.

Knowledge of XED shows a firm who its close competitors are and how much demand it would lose if a rival cut its price. In an oligopoly, such as soft drinks or mobile phones, where XED between brands is high, this is vital for deciding whether to match a price cut. For complements, a printer firm can price printers low and ink high, and a games console firm knows that a rise in console prices will reduce sales of its games.

Which is more important depends on the market. A firm in a highly competitive market with many close substitutes needs XED every day, because rivals' price changes affect its sales immediately, whereas incomes change slowly and are outside its control. A firm with few rivals, such as a monopoly, has little use for XED, but if it sells a luxury its sales depend heavily on income, so YED matters more. It also depends on the economic situation: in a recession or boom YED becomes crucial. Both measures are only estimates based on past data and assume other things remain equal, so neither can be relied on completely.

In conclusion, knowledge of YED is not always more important than XED. YED is more important for long-term planning and for products with high income elasticity, while XED is more important for short-term pricing decisions in

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competitive markets. Most firms would benefit from knowing both.

3(a) A free good is a good that is not scarce: there is enough of it to satisfy everyone's wants at a zero price, so using it has no opportunity cost. Examples are sunlight, air and seawater. No factors of production are needed to produce it, so the supply of the good exceeds or equals the demand for it at a price of zero and no market is needed to allocate it.

A private good, or economic good, is scarce, so it takes factors of production to make it and has an opportunity cost, and it is consumed by an individual for their own private benefit, for example clothing or a cup of coffee. Private goods have two characteristics. They are excludable: people who do not pay the price can be prevented from consuming them. They are rival: when one person consumes the good, less is available for others, so consumers compete with each other. Because of this the price mechanism can allocate them.

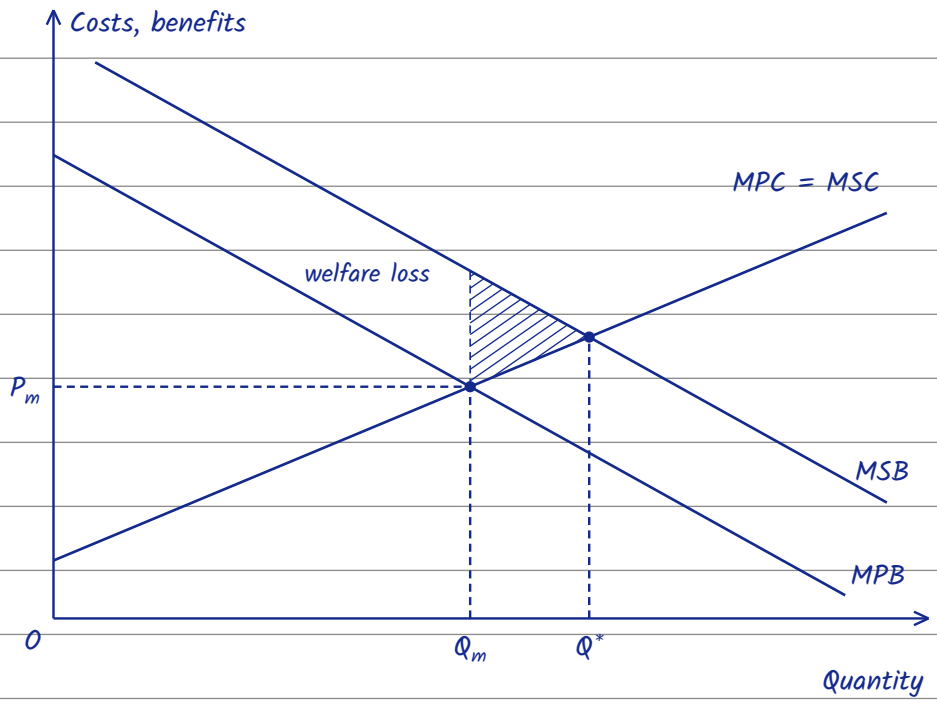
The distinction is significant because the basic economic problem of scarcity and choice only applies to economic goods; choices about free goods involve no sacrifice. However, the distinction can change: clean air in a polluted city or water in a drought becomes scarce, so a free good turns into an economic good with an opportunity cost. Therefore the distinction is important for deciding whether markets and prices are needed, but it depends on circumstances, and very few goods are truly free today.

3(b) A public good has two key characteristics. It is non-excludable: once it is provided, no one can be stopped from benefiting from it. It is non-rival: one person's consumption does not reduce the amount available to others. It is also non-rejectable. Because people cannot be excluded, there is a free rider problem: people can benefit without paying, so private firms cannot charge for it and the market fails to provide it at all, for example national defence or street lighting.

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Education does not fit this well. It is excludable, because schools and universities can charge fees and refuse entry to those who do not pay, as private schools do. It is also rival: an extra pupil in a full class reduces the teacher's time and attention available to others. Some argue education is like a public good because governments provide it free and knowledge itself, once known, can be shared without being used up, as with free online courses, but this only makes it a quasi-public good at most.

A merit good is a type of private good, rival and excludable, that is under-consumed if left to the market. This is because of imperfect information: people underestimate the private benefits of education, such as higher future earnings, especially young people and low-income families, and they ignore its positive externalities, such as a more productive workforce, lower crime and better-informed citizens. In the diagram the market produces Q_m where MPB = MPC, but the socially optimal output is Q^* where MSB = MSC, so there is a welfare loss shown by the shaded triangle.



The classification matters because it affects policy. If education were a public good, the government would have to provide all of it, financed by taxation. As a

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merit good, it can be provided by both the private and public sectors, with the government using subsidies, free state provision, compulsory schooling up to a certain age and better information to raise consumption towards Q^*.

In conclusion, education should be classified as a merit good rather than a public good. It is rival and excludable, and the fact that it is successfully provided by both the private sector and the public sector shows that the market can supply it but under-provides it. It is often provided free by governments, which makes it look like a public good, but that is a policy choice to correct under-consumption, not a characteristic of the good.

4(a) Unemployment exists when people who are willing and able to work, and are actively seeking work, do not have a job. Frictional unemployment is temporary unemployment that occurs while people move between jobs. At any time some workers have left one job to look for a better one, and school and university leavers are entering the labour market. Searching takes time, especially if information about vacancies is poor, and generous unemployment benefits may reduce the urgency of the search. It also includes seasonal and casual unemployment, such as tourism workers out of season.

Technological unemployment is a type of structural unemployment caused by new technology and working practices replacing labour with capital, such as self-service checkouts, robots in car factories and artificial intelligence. Workers who lose their jobs often do not have the skills to operate the new technology or to work in other industries, so they may remain unemployed for a long time.

Some frictional unemployment is likely to be inevitable. Labour markets are always changing: people change jobs to improve their prospects, firms open and close, and new workers enter the labour force, so there will always be some time spent searching. Information about vacancies can never be perfect. However, the amount can be reduced by online job sites, job centres and making benefits conditional on

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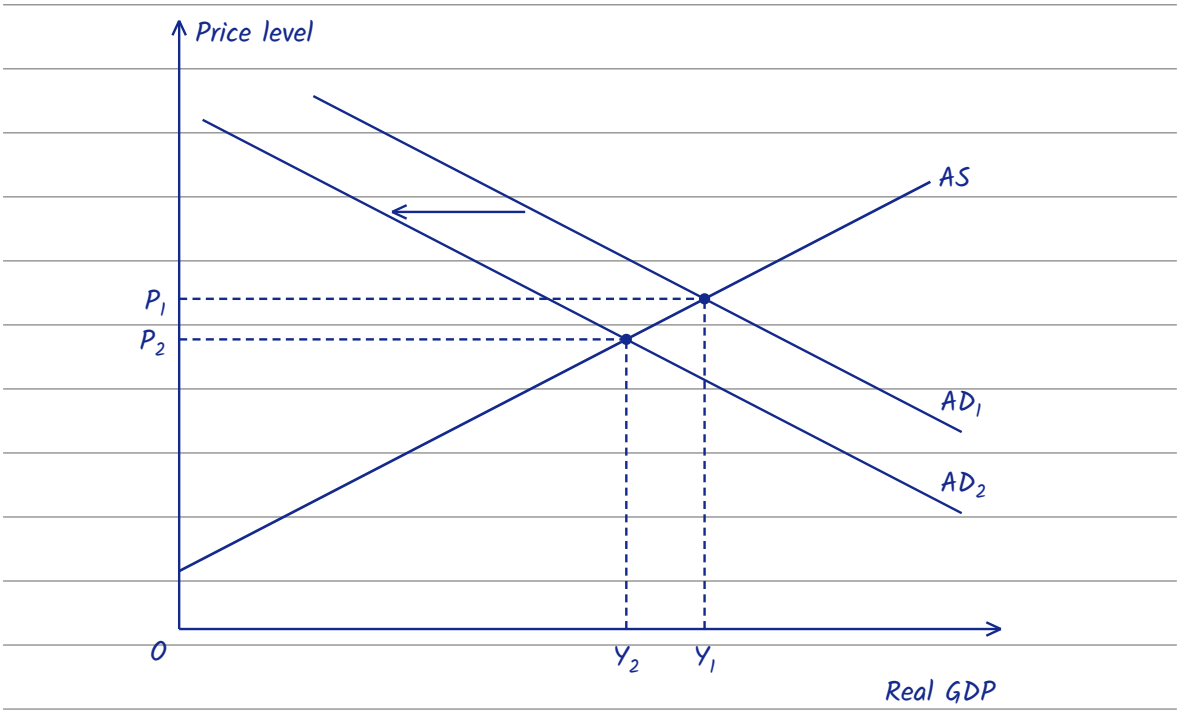
searching, so it depends on the quality of information and on how keen workers are to change jobs. On balance, some element of frictional unemployment is inevitable, which is why full employment does not mean zero unemployment, but its size is not.

4(b) Technological unemployment occurs when machines replace labour and workers lack the new skills needed. Its consequences can be serious because it is often long term: workers in declining industries, such as printing or bank branches, may need years of retraining, and older workers may never work again. It is often concentrated in particular industries and regions, causing local poverty and widening inequality between high-skilled and low-skilled workers. The longer people are unemployed, the more skills they lose, so the productive capacity of the economy is wasted and the government pays benefits for a long time.

However, technological change also raises productivity and lowers costs, shifting the LRAS curve to the right, and creates new jobs in designing, making and maintaining the new technology. In the long run total employment often rises, so the economy as a whole may benefit even though some individuals lose out.

Cyclical unemployment is caused by a deficiency of aggregate demand, for example in a recession. In the diagram AD falls from AD1 to AD2, so real GDP falls from Y1 to Y2 and firms need fewer workers.

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Its consequences are economy-wide, with job losses across many industries at the same time. Lower incomes reduce spending further through the negative multiplier, tax revenue falls while benefit payments rise, increasing the budget deficit, and confidence and investment fall. If the recession is long, hysteresis may turn cyclical unemployment into long-term unemployment. On the other hand, cyclical unemployment is temporary: when the economy recovers, firms rehire, and the government can reduce it fairly quickly with expansionary fiscal and monetary policy.

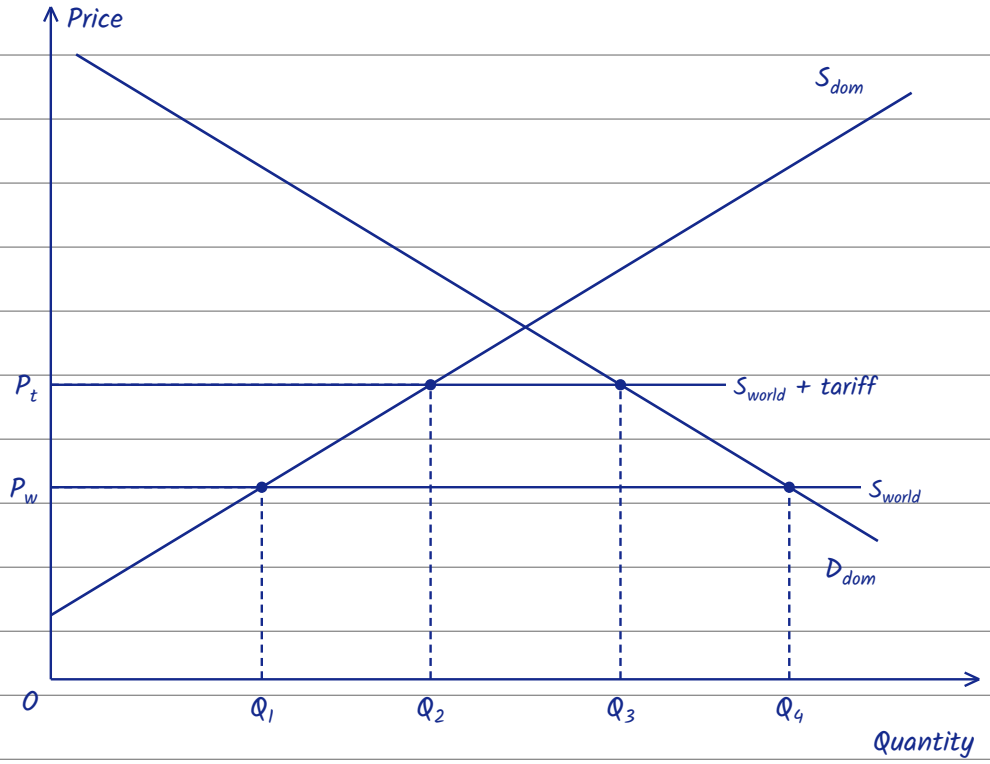
Which is more serious depends on the scale and duration of each. A deep and long recession, such as in 2008 to 2009, affects far more people than technological change in one industry, so in the short run cyclical unemployment is usually more serious. But technological unemployment is harder to cure, because demand-side policies cannot give workers new skills, and rapid change such as AI could affect many industries at once. It also depends on how flexible the labour force is and how much the government spends on retraining.

In conclusion, cyclical unemployment usually has more serious consequences in the short run because it is widespread, whereas technological unemployment is likely to

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be more serious in the long run for the workers and regions affected, unless effective retraining is provided.

5(a) Protectionism is the use of measures by a government to restrict imports and protect domestic industries from international competition. A tariff is a tax on imports. In the diagram, with free trade the country buys at the world price P_w: domestic firms supply Q1 and imports are Q1Q4. A tariff raises the price to P_t, so domestic output rises to Q2, consumption falls to Q3 and imports fall to Q2Q3, and the government gains tax revenue.



An import quota is a physical limit on the quantity or value of a good that can be imported. By restricting supply, it also raises the domestic price and allows domestic producers to sell more, but the government earns no revenue; the extra price per unit goes to the foreign firms or importers holding the licences.

A quota is likely to have a more certain impact on the volume of imports, because the limit is fixed, whereas the effect of a tariff depends on the price elasticity of demand for imports: if demand is inelastic, imports fall only a little. However, a

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tariff raises revenue that can be used in the economy. The impact of either also depends on its size, on whether domestic firms can increase supply and on whether other countries retaliate. Overall a strict quota is likely to have more impact on trade, but a large tariff can have just as great an impact.

5(b) Protectionism, such as a tariff or a quota, raises the domestic price of imported goods and reduces the quantity imported. Its effects on consumers, producers and the government are very different.

Consumers are likely to be worse off. In the tariff diagram in 5(a), the price rises from P_w to P_t and consumption falls from Q4 to Q3, so consumer surplus falls. Consumers also have less choice and may get lower quality if domestic firms face less competition. Low-income consumers lose most, because protected goods such as food and clothing take a larger share of their income. However, not all consumers lose equally: consumers who work in protected industries may keep their jobs and incomes, which can outweigh the higher prices they pay.

Domestic producers of the protected good gain: they sell more, Q2 instead of Q1, at a higher price, so producer surplus rises, at the expense of consumers. Protection can allow infant industries to grow and achieve economies of scale. But not all producers gain. Firms that use imported raw materials or components face higher costs, and exporters may lose sales if other countries retaliate. Protected firms may also become complacent and inefficient, so the long-run benefits of the infant industry argument may never materialise.

The government receives tax revenue from a tariff, equal to the tariff per unit multiplied by the imports, and the current account may improve if imports fall, while employment in protected industries may be maintained. However, quotas raise no revenue, and if domestic supply is price inelastic, imports may not fall much. If other countries retaliate, exports fall, and the government may lose income tax revenue and pay more benefits. There is also a deadweight loss, so the

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economy as a whole loses.

The gains and losses therefore depend on the type of measure, the price elasticities of demand and supply, the time period and whether there is retaliation.

In the short run protected producers and the government may gain, while in the long run inefficiency and retaliation can harm everyone.

In conclusion, consumers, producers and the government will not benefit equally from protectionism. Protected producers and the government are most likely to gain, while consumers, particularly those on low incomes, and producers who rely on imports or exports are likely to lose, and the losses to consumers usually exceed the gains to producers and the government.

Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/22**

Paper 2 AS Level Data Response and Essays **October/November 2025**

2 hours

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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.

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Section A

Answer all parts of Question 1.

1 How do we make sure cocoa bean farmers get paid a living wage?

Chocolate is very big business.

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Perhaps the long-term solution is to reduce the country's dependence on cocoa bean exports and diversify into other products that can offer more and better paid job opportunities.

Source: Adapted from Reuters, 4 April 2023

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(a) **(i)** Identify **one** possible reason for the value of price elasticity of demand (PED) for chocolate. [1]

(ii) Calculate the percentage change in the value of global sales of chocolate between 2017 and 2026, as shown in Table 1.1. [1]

(b) With the help of a demand and supply diagram, demonstrate why cocoa bean prices continued to fall in 2023. [2]

(c) Consider whether a buffer stock system controlled by the government of Ivory Coast would be likely to prevent fluctuations in the price of cocoa beans. [4]

(d) Assess the extent to which the use of a minimum pricing policy would be the best way to ensure cocoa bean farmers get paid a living wage. [6]

(e) Assess the advantages and disadvantages of Ivory Coast continuing to specialise in the production and export of cocoa beans. [6]

Section B

Answer **one** question.

EITHER

2 **(a)** With the help of a diagram, explain the difference between producer surplus and consumer surplus **and** consider the extent to which producers always gain when the price of a product increases due to higher costs of production. [8]

(b) Assess the view that a business should be more concerned about the income elasticity of demand for its product than its cross elasticity of demand when incomes are falling. [12]

OR

3 **(a)** With the help of a diagram, explain the difference between a movement along a production possibility curve (PPC) and a shift of this curve **and** consider whether a decision to produce more of one product will always incur an equal opportunity cost. [8]

(b) Assess the extent to which it is always necessary to increase the size of the labour factor of production in order to cause an outward shift of the production possibility curve. [12]

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Section C

Answer **one** question.

EITHER

4 **(a)** Explain **three** components of the current account of the balance of payments **and** consider the extent to which a depreciation in the exchange rate will always lead to a surplus on the current account. [8]

(b) Assess the extent to which the use of supply-side policy would be the best way to reduce a deficit on the current account of the balance of payments. [12]

OR

5 **(a)** With the help of an aggregate demand and aggregate supply (AD/AS) diagram, explain why **two** components of AD may increase **and** consider the extent to which an increase in AD will always lead to inflation. [8]

(b) Assess the view that the effects of a high rate of inflation are always more damaging for consumers than for firms. [12]

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Question number

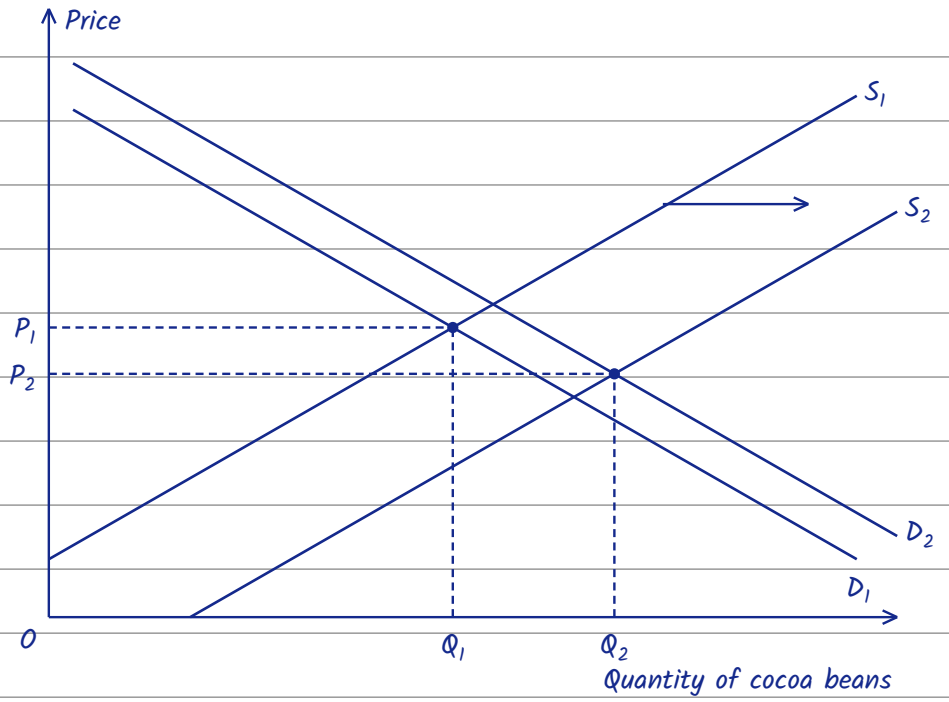
Answers for paper 9708/22

1(a)(i) The value shows that demand for chocolate is price inelastic (between 0 and 1). A reason is that chocolate is habit-forming, and a bar costs only a small proportion of consumers' income.

1(a)(ii) % change = (value in 2026 – value in 2017) ÷ value in 2017 × 100

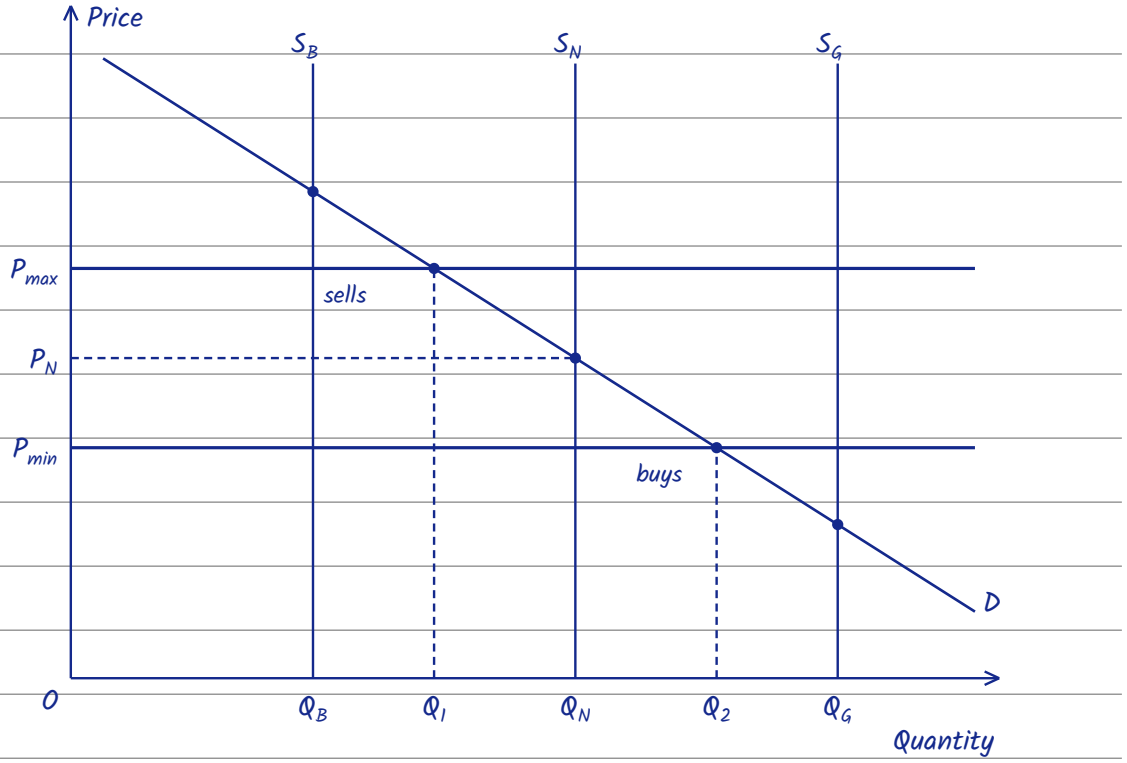
= +58.8% (an increase of about 59%)

1(b) Supply of cocoa beans increased, for example because of good harvests and more land planted, shifting supply from S1 to S2, further to the right than the small increase in demand from D1 to D2. The excess supply at P1 makes the price fall from P1 to P2.



Question number

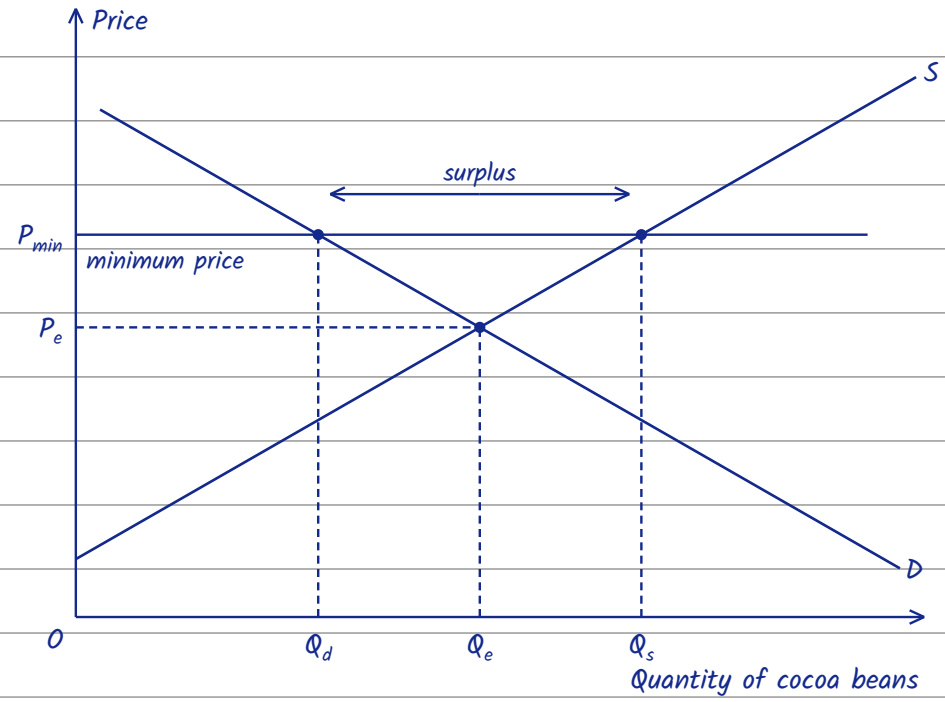
1(c) A buffer stock system is designed to reduce fluctuations in price by keeping it between a minimum price and a maximum price. If a good harvest makes the price fall towards the minimum, the government buys and stores cocoa beans, reducing market supply and raising the price. If a poor harvest pushes the price towards the maximum, it releases cocoa beans from the store, increasing supply and lowering the price.



In the diagram, with a good harvest (S_G) the government buys Q_2Q_G to keep the price at P_{min}; with a bad harvest (S_B) it sells Q_BQ_1 to keep the price at P_{max}. However, it may not prevent fluctuations. Cocoa beans are perishable and expensive to store, the government of Ivory Coast may not have the budget to keep buying surpluses after several good harvests, and if the minimum price is set too high the stock keeps growing and the scheme collapses. So it can reduce, but is unlikely to fully prevent, price fluctuations.

1(d) A minimum price is a price floor set above the equilibrium price, below which cocoa beans cannot legally be sold. In the diagram it is set at P_{min} above P_e.

Question number



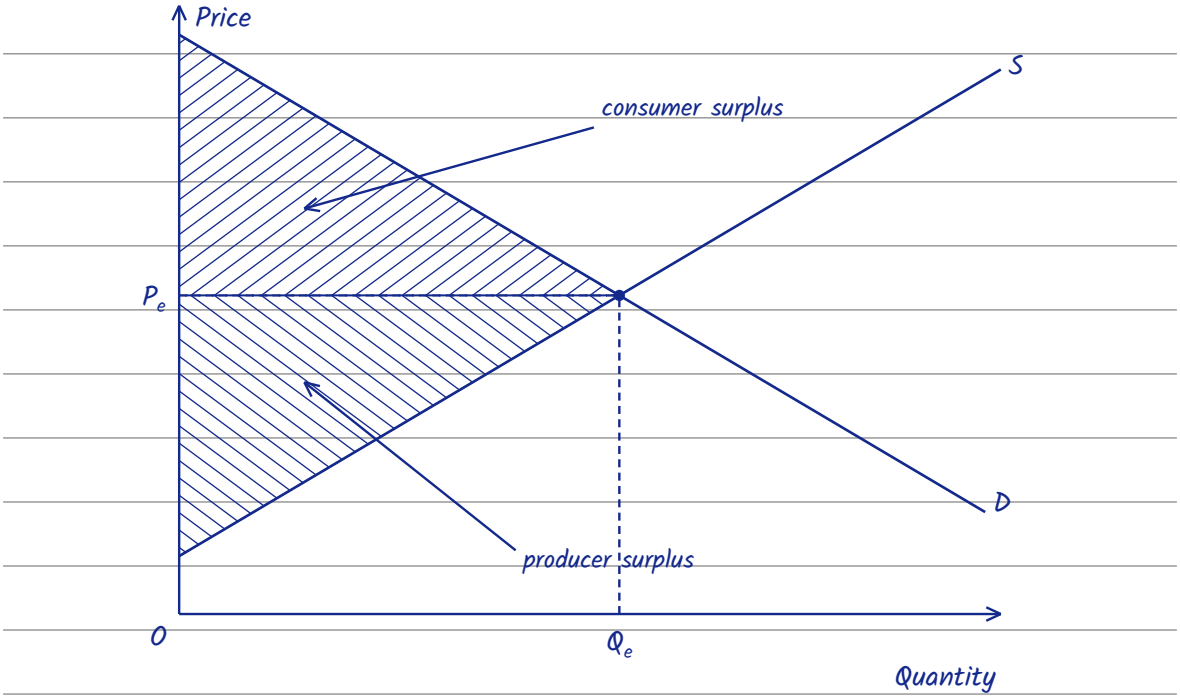
It could help farmers earn a living wage because they receive a guaranteed price above the market price, so each bean earns more income. The security of a known price reduces the instability caused by fluctuations in the world price and encourages farmers to maintain production and invest.

However, at P_{min} quantity supplied (Q_s) exceeds quantity demanded (Q_d), creating a surplus. Unless the government buys the surplus, farmers cannot sell all their beans, so their income may not rise much, and budget constraints may make buying the surplus impossible. The price may be set at the wrong level, it is costly to enforce, and buyers may go to other countries such as Ghana. Guaranteed prices may also make farmers complacent so they fail to improve productivity. An alternative, such as direct transfer payments or Fairtrade schemes, targets income at farmers without creating a surplus.

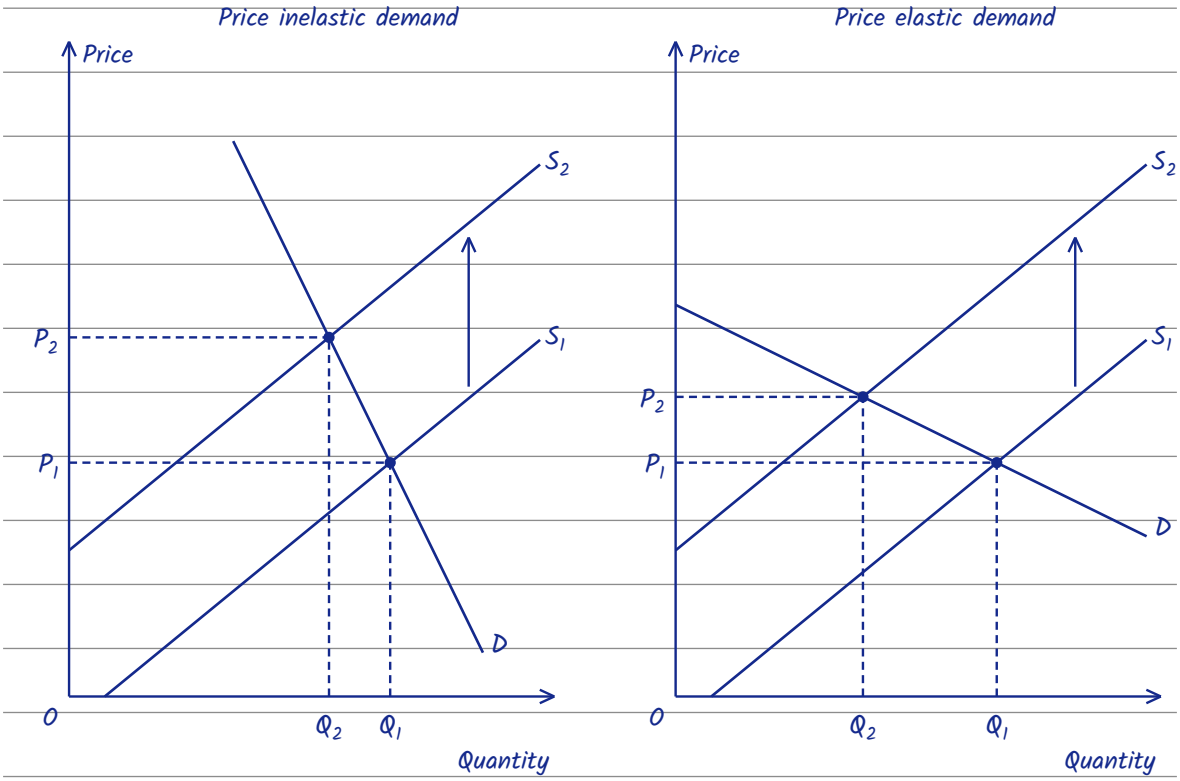
On balance, a minimum price is not the best way. It raises income only for farmers who can sell at that price and depends on the government financing the surplus; a combination of targeted income support and diversification is likely to be more effective and sustainable.

Question number	
1(e)	Continuing to specialise in cocoa beans allows Ivory Coast to use its comparative advantage, since its climate and experience mean it can produce cocoa at a low opportunity cost. Producers can become even more efficient and gain economies of scale. World demand for chocolate is growing, with sales forecast to rise by 58.8% between 2017 and 2026, so export revenue, employment and economic growth can increase. However, dependence on one primary product makes the economy vulnerable. The price of cocoa beans fluctuates widely, so export earnings and farmers' incomes are unstable, and a crop disease, bad weather or a fall in world demand could cause a sharp fall in income. Land used for cocoa is not available for food crops, increasing reliance on food imports, and over-farming can exhaust the soil. Jobs in cocoa farming are low paid, so specialisation may keep farmers in poverty, which is why the article suggests diversifying. The balance depends on the time period and how the export revenue is used. In the short run specialisation brings income that cannot easily be replaced, but in the long run the risks grow. Ivory Coast should continue to produce cocoa while using its revenue to diversify, including processing beans into chocolate to add value.
2(a)	Consumer surplus is the difference between the price consumers are willing to pay for a product and the market price they actually pay. It is the area below the demand curve and above the price. Producer surplus is the difference between the price producers are willing to accept for a product and the price they actually receive. It is the area above the supply curve and below the price. In the diagram, at equilibrium price P_e, consumer surplus is the upper shaded triangle and producer surplus the lower shaded triangle.

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Higher costs of production shift the supply curve to the left, from S1 to S2, so the price rises from P1 to P2 and quantity falls from Q1 to Q2. Producers do not always gain from the higher price. The price rises by less than the increase in costs, because part of the cost is absorbed by producers, so their surplus per unit falls.



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If demand is price inelastic (left diagram), quantity falls only slightly and most of the cost increase is passed on to consumers, so total revenue rises and producers lose little. If demand is price elastic (right diagram), the price rises only a little and quantity falls a lot, so total revenue falls and producers are clearly worse off. The price elasticity of supply also matters: if supply is inelastic, producers find it harder to cut output in response and bear more of the cost.

Therefore producers do not always gain when the price rises due to higher costs. Revenue may rise if demand is inelastic, but since costs have risen too, producer surplus usually falls; the extent of the loss depends on the values of PED and PES.

2(b)

Income elasticity of demand (YED) is the percentage change in quantity demanded divided by the percentage change in income. It is positive for normal goods, greater than 1 for luxuries, and negative for inferior goods. When incomes are falling, YED tells a business directly how its sales will be affected. A business selling a luxury such as foreign holidays, with a YED of +2, can expect sales to fall by 6% if incomes fall by 3%. A business selling an inferior good, such as budget supermarket brands, can expect demand to rise. So it can decide what to produce more of, cut stocks and output in time, change its prices or launch cheaper product ranges.

However, YED has limitations. It is an estimate based on past data and may not be accurate in a new recession; the same value does not apply to all households, as high-income consumers may not cut back at all; and a business may not be flexible enough to change its products quickly, so knowing YED does not always help.

Cross elasticity of demand (XED) is the percentage change in quantity demanded of good A divided by the percentage change in the price of good B. It is positive for substitutes and negative for complements. When incomes are falling, consumers

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become more price sensitive and switch to cheaper substitutes, and rivals often cut prices to protect sales. XED tells a business how much demand it will lose if a competitor cuts its price, so it can track and respond to rivals' actions. For complements, a business knows how its sales will be affected if demand for the complement falls, such as sales of petrol when fewer cars are bought.

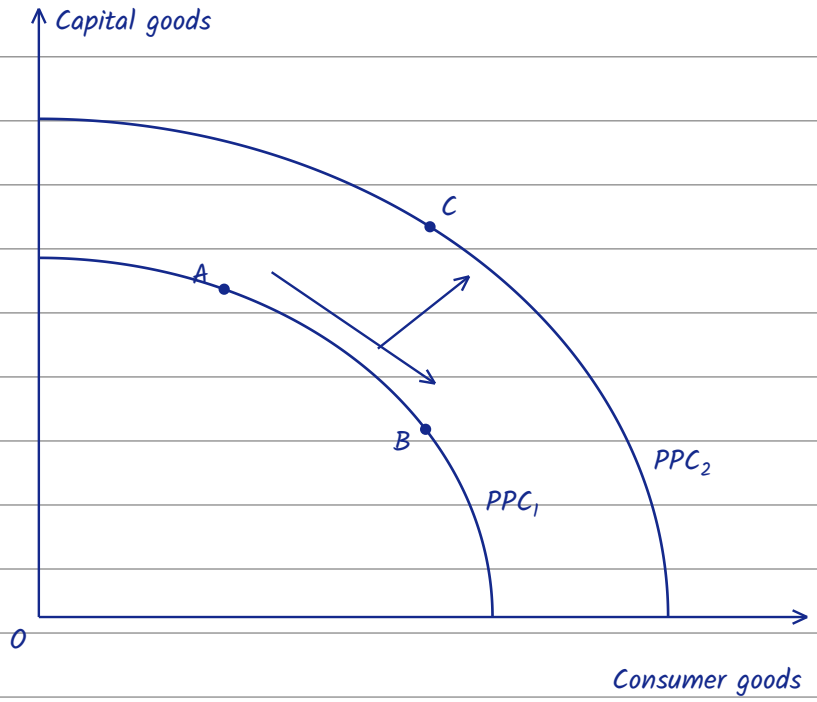
However, XED only helps if rivals actually change prices, and the data may be out of date, especially when market conditions change quickly in a downturn.

Which matters more depends on the type of product and market. For a luxury or inferior good, falling incomes are the main influence on demand, so YED matters most. For a necessity with a low YED sold in a competitive market, such as bread, sales depend more on rivals' prices, so XED matters more. It also depends on how far incomes fall and for how long.

In conclusion, when incomes are falling a business should usually be more concerned about YED, because it measures the effect of the change that is actually happening, but in highly competitive markets XED is equally important as rivals cut prices, so a business should use both.

3(a) A production possibility curve (PPC) shows the maximum combinations of two products an economy can produce when all its resources are fully and efficiently employed with the existing technology.

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A movement along the PPC, from A to B, happens when the economy decides to produce more of one product and less of the other, here more consumer goods and fewer capital goods, using its existing resources. A shift of the curve, from PPC1 to PPC2, happens when the productive capacity of the economy changes, for example because of more resources or better technology, so more of both products can be produced, such as at point C.

Opportunity cost is the next best alternative forgone. A movement along the PPC involves an opportunity cost: more consumer goods can only be made by giving up capital goods. If resources are equally suited to producing both products, the same amount of one product is given up for each extra unit of the other, so opportunity cost is constant and the PPC is a straight line. If resources are specialised, increasing amounts of one product must be given up for each extra unit of the other, so opportunity cost increases and the PPC is concave to the origin, as in the diagram.

Whether opportunity cost is equal depends on how easily resources can be transferred from one product to the other. Because most factors of production, such as skilled workers and specialised machinery, are better suited to some uses

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than others, producing more of one product will not normally incur an equal opportunity cost; it usually increases.

3(b) An outward shift of the PPC means that the productive capacity of the economy has increased, so more of all goods and services can be produced. Increasing the size of the labour force is one way to achieve this. More workers, from population growth, immigration, a higher retirement age or more women joining the labour force with better childcare, means more output can be produced if other factors of production are maintained, leading to economic growth and an outward shift of the PPC.

However, it is not always possible or necessary. Many economies have ageing populations and falling birth rates, so the labour force is shrinking, and immigration may be politically difficult. If there is not enough capital for the extra workers, diminishing returns set in and output rises little, or the extra workers may simply be unemployed, which moves the economy inside the PPC rather than shifting it.

Instead the PPC can shift outwards by improving the quality of labour. Education and training raise labour productivity, so the same number of workers produce more. An increase in capital, through investment in machinery and infrastructure, also shifts the PPC outwards, as does new technology, which raises the productivity of all factors, for example automation in manufacturing. The discovery of new natural resources increases the quantity of land, and more enterprise brings new firms and innovation that use resources more efficiently.

The importance of labour depends on the type of economy. A labour-intensive developing economy with a growing population may rely on more workers, but it needs capital to employ them productively. A high-income economy with a shrinking workforce, such as Japan, must rely on capital, technology and productivity. These alternatives also have limitations: investment and training take

Question number

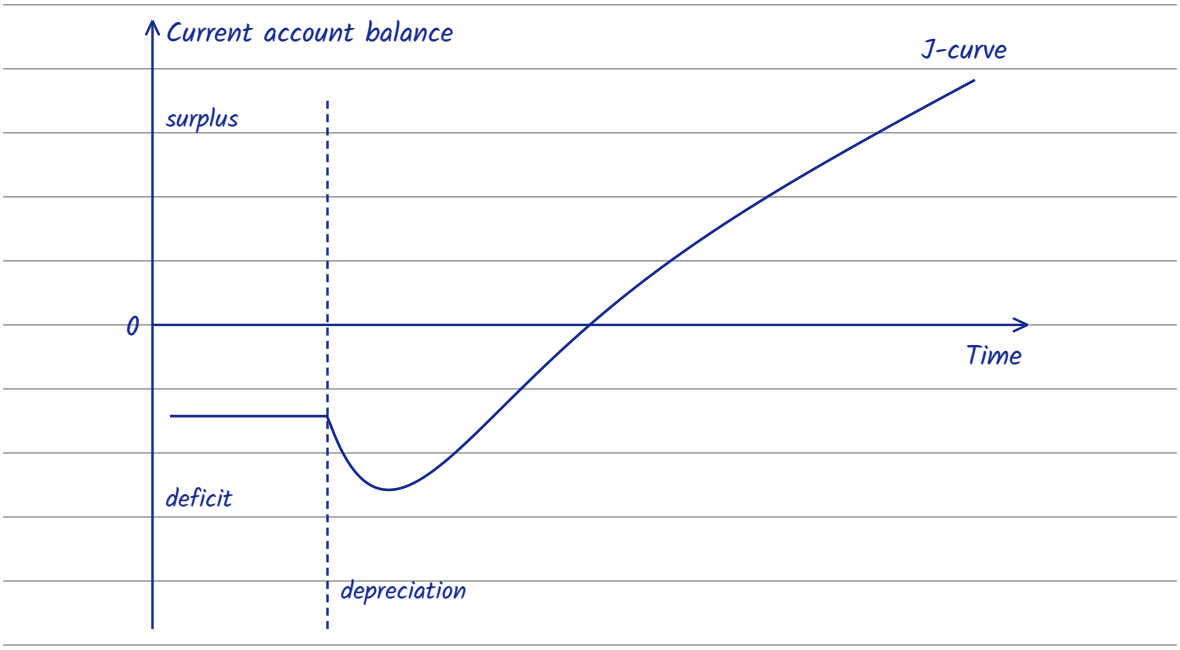
time and have an opportunity cost, and they depend on workers being willing to adopt new methods and on the availability of enterprise and finance.

In conclusion, it is not always necessary to increase the size of the labour force to shift the PPC outwards. Any increase in the quantity or quality of any factor of production, or an improvement in technology, will do so, and for many economies improving productivity is more important than adding more workers.

4(a) The current account of the balance of payments records a country's transactions with the rest of the world in goods, services and incomes. Trade in goods is the value of exports and imports of physical goods, such as cars, oil and computers. Trade in services is the value of exports and imports of invisible items, such as tourism, insurance and banking. Primary income is income from factors of production, such as profits, dividends and interest earned on overseas investments and wages earned abroad. Secondary income is current transfers, such as foreign aid and remittances sent home by workers living abroad.

A depreciation of the exchange rate makes exports cheaper in foreign currencies and imports more expensive in the domestic currency. Export revenue should rise and import spending fall, so the balance on trade in goods and services improves and may move into surplus. However, this requires the Marshall-Lerner condition: the sum of the price elasticities of demand for exports and imports must be 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.

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Other components also matter. A depreciation increases the domestic currency cost of interest and profit payments to foreigners on foreign currency debts, worsening the primary income balance, and a large deficit on income or secondary transfers may outweigh any improvement in trade. Higher import prices can also cause inflation that erodes the competitive gain. So a depreciation will not always lead to a surplus: it may reduce a deficit, but only if demand is price elastic and the other components do not offset it.

4(b) A current account deficit means the value of imports of goods and services plus income outflows exceeds the value of exports and income inflows. Supply-side policies aim to increase the productive capacity and efficiency of the economy, shifting LRAS to the right.

Examples include investment in education and training, which raises labour productivity and entrepreneurship, reducing unit costs; investment in infrastructure, such as ports and transport, which reduces firms' costs; deregulation and less red tape, which increases competition; and subsidies for research and development.

Lower costs and better quality make domestic goods more competitive at home

Question number

and abroad, so exports rise and imports fall. Supply-side policy tackles the underlying cause of many deficits, a lack of competitiveness, so the improvement is likely to last. It reduces the deficit without reducing economic growth or employment, and is less likely to provoke retaliation than protectionism.

However, supply-side policies take a long time to work: training workers or building infrastructure may take years, so they will not reduce a deficit in the short term. They are costly, with an opportunity cost, and the results are uncertain. Some, such as export subsidies, may break WTO rules and invite retaliation. If the economy grows faster, incomes rise and imports may increase.

Other policies can work more quickly. Contractionary fiscal or monetary policy reduces aggregate demand, so households have less income to spend on imports, but it causes lower growth and higher unemployment. Protectionist measures such as tariffs reduce imports quickly but raise prices and risk retaliation, while a depreciation makes exports cheaper but can cause inflation and depends on the Marshall-Lerner condition.

Which policy is best depends on the cause of the deficit. If it is caused by excess demand in a boom, contractionary policy is more appropriate; if it is caused by poor competitiveness, supply-side policy is the only lasting solution. It also depends on the time period and the government's finances.

In conclusion, supply-side policy is the best way to reduce a current account deficit in the long run, because it improves competitiveness without sacrificing growth, but because of time lags it should be combined with demand-side or exchange rate policies to reduce a deficit quickly.

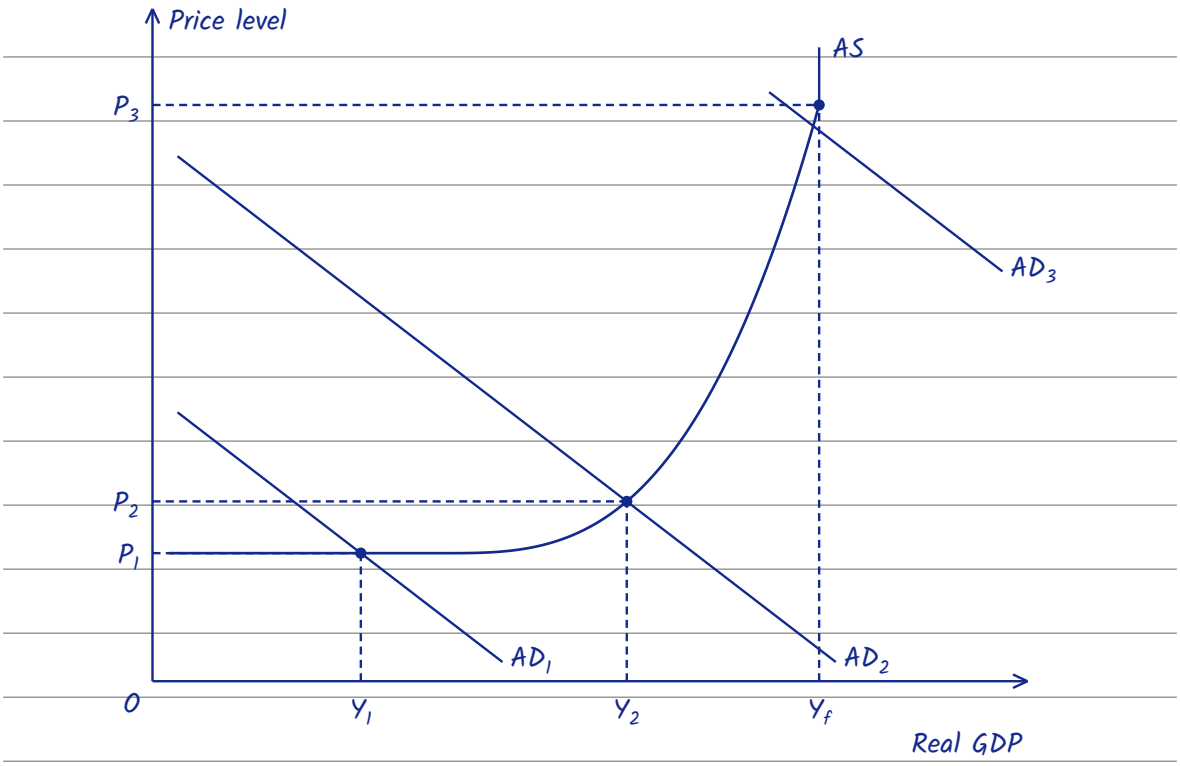
5(a)

Aggregate demand (AD) is the total planned spending on an economy's goods and services at each price level: $AD = C + I + G + (X - M)$. Consumption (C) may increase if interest rates fall, making borrowing cheaper and saving less rewarding, or if income tax is cut, raising disposable income, or if consumer confidence rises.

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Investment (I) may increase if interest rates fall, reducing the cost of borrowing for firms, or if firms expect higher future demand and profits, or because of new technology.

An increase in C or I shifts AD to the right, and the price level may rise, causing demand-pull inflation. Whether this happens depends on the position of AD in relation to AS.



When there is a lot of spare capacity, an increase from AD1 to AD2 increases real output from Y1 to Y2 with little rise in the price level, because firms can use unemployed resources without higher costs. As the economy approaches full capacity, bottlenecks and labour shortages raise costs, so a further increase in AD raises the price level more and output less. At full employment (Y_f) any increase, such as to AD3, only raises the price level to P3, causing inflation.

The effect also depends on the supply side. If higher investment adds to productive capacity, LRAS shifts right, and government spending on infrastructure or subsidies can do the same, reducing inflationary pressure. So an increase in AD will not always lead to inflation: it is most likely when the economy is near full

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capacity and the increase does not raise aggregate supply.

5(b) A high rate of inflation is a rapid, sustained rise in the general price level, such as 10% or more a year. It damages consumers in several ways. Their purchasing power falls, especially for those on fixed incomes, such as pensioners, and workers with weak bargaining power whose wages rise more slowly than prices. Savers lose if the interest rate is below the inflation rate. Fiscal drag pulls people into higher tax brackets if tax thresholds are not raised. Consumers face shoe leather costs of shopping around and keeping less cash, and uncertainty reduces confidence, so they may delay spending.

However, not all consumers lose. Those with debts gain because inflation reduces the real value of what they owe, and owners of assets such as houses may see their wealth rise. Workers in strong unions may secure wage increases above inflation.

Firms also suffer. They face menu costs of changing prices and higher costs of raw materials and wages. If inflation is higher than in other countries, their goods become less internationally competitive, so they lose sales at home and abroad. Uncertainty and inflationary noise make it hard to tell whether price changes reflect real changes in demand, leading to poor decisions and lower investment, and high inflation often leads to higher interest rates, raising borrowing costs.

However, some firms gain. If inflation is demand-led, sales are rising, and if the prices firms charge rise faster than their costs, profits rise. Firms with market power can pass on cost increases to consumers, and firms with large debts gain as the real value of their borrowing falls.

Who is damaged more depends on the cause of the inflation and the situation of each group. Cost-push inflation, from energy prices for example, squeezes firms' profits, while demand-pull inflation may benefit firms. Firms with market power can protect themselves better than consumers, but firms in competitive export

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markets cannot. Low-income consumers with no assets and fixed incomes are the most vulnerable of all.

In conclusion, the effects of high inflation are not always more damaging for consumers than for firms. Many consumers, particularly those on low and fixed incomes, suffer most, but firms can be equally or more damaged when inflation is cost-push and they face strong international competition.

Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/23**

Paper 2 AS Level Data Response and Essays **October/November 2025**

2 hours

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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.

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Section A

Answer all parts of Question 1.

1 Malaysia's uncertain economic prospects

Malaysia is an emerging middle-income country. Its increasing population is an important factor in promoting future economic growth. The country, however, faces two underlying problems. First, the fertility rate, the average number of children a woman can expect to give birth to, has fallen consistently as Malaysia's economy has developed. This rate is now below the critical level where a population replaces itself. Second, Malaysia has an ageing population, with an increasing proportion of its population over 65 years of age. In 2015 the average age of Malaysia's population was 28.2 years; in 2030 it is forecast to reach 34.1 years. Malaysia's forecast total population to 2027 and its ageing population from 2017 to 2022 are shown in Figs. 1.1 and 1.2 below.

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Fig. 1.1 Total population of Malaysia, 2017 to 2027

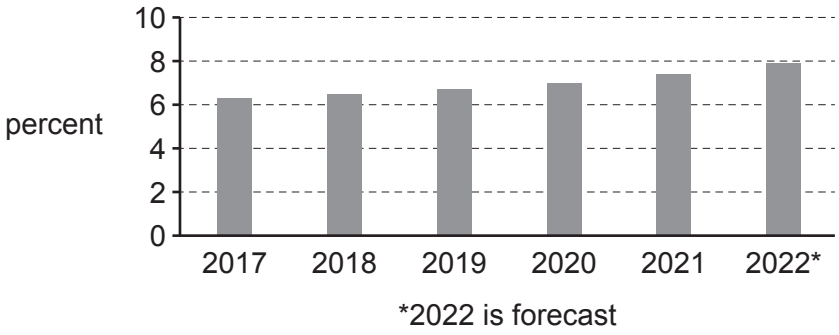


Fig. 1.2 Share of population older than 65 years in Malaysia, 2017 to 2022

The key issue for Malaysia's government is whether it is prepared for this fundamental shift in its population. There is plenty of scope for optimism. The economy appears to have recovered from the shock of the COVID-19 pandemic. Its growth rate in 2021 and the 2022 forecast was above the government's target of 5.1%, with substantial growth in exports of electrical and electronic goods, palm oil, gas and oil supplies. Unemployment is below 4% and the current account of the balance of payments was projected to have a record surplus in 2022.

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Economists, however, fear that Malaysia's government and its people are not ready to meet the challenges of an ageing population. In a recent survey, 70% of respondents felt it was the duty of the young to take care of the elderly, but they were also concerned that the economy could not cope with the pressure on its human capital and other resources. More resources will have to be allocated to meet the needs of the elderly.

It was further argued that Malaysia needed a proper plan for dealing with this situation. According to one economist, free childcare for working parents was essential and tax incentives should be used to keep more elderly workers in employment.

Source: Saw Yee Fung, Low rates impact on Malaysia's human capital and economic development, The Star (KL) 15 October 2022.

(a) Use the information in Figs. 1.1 and 1.2 to compare the change in Malaysia's total population from 2017 to 2022 with the change in its ageing population from 2017 to 2022. [2]

(b) Explain **one** example of 'what to produce' in Malaysia that may have to change in order to meet the needs of its ageing population. [2]

(c) With the help of a production possibility curve (PPC) diagram, consider the extent to which Malaysia's productive capacity is likely to change with its projected change in total population. [4]

(d) Assess whether the Malaysian government should provide free childcare to working parents. [6]

(e) Excluding net exports, assess the likely impact of the change in Malaysia's total population on aggregate demand. [6]

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Section B

Answer **one** question.

EITHER

2 **(a)** In 2022 the supply of root ginger from Nigeria, Africa's biggest producer, fell by 20%. Market demand was expected to grow by more than 5%.

With the help of a demand and supply diagram, explain how the market equilibrium for root ginger in Nigeria is likely to change **and** consider how certain you are of the new market price. [8]

(b) Assess the ways in which producers of root ginger might be able to stabilise their incomes. [12]

OR

3 **(a)** The Gini coefficient for South Korea was estimated to be 0.39 in 2019 and 0.33 in 2022.

Explain what this data means, how it might be used by the government of South Korea **and** consider its usefulness. [8]

(b) Assess why it is easier for a government such as that of South Korea to redistribute income rather than redistribute wealth. [12]

Section C

Answer **one** question.

EITHER

4 **(a)** For your economy or for one that is known to you, explain **three** causes of inflation **and** consider which of these causes is likely to be most important in 2025. [8]

(b) Assess whether supply-side policy or demand-side policy is the better way of reducing this inflation. [12]

OR

5 **(a)** Explain **two** reasons why an economy may have a deficit on the current account of its balance of payments **and** consider whether its government is likely to be concerned about this deficit. [8]

(b) Assess whether it is better to use protectionist policies or contractionary policies to reduce a deficit on the current account of the balance of payments. [12]

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

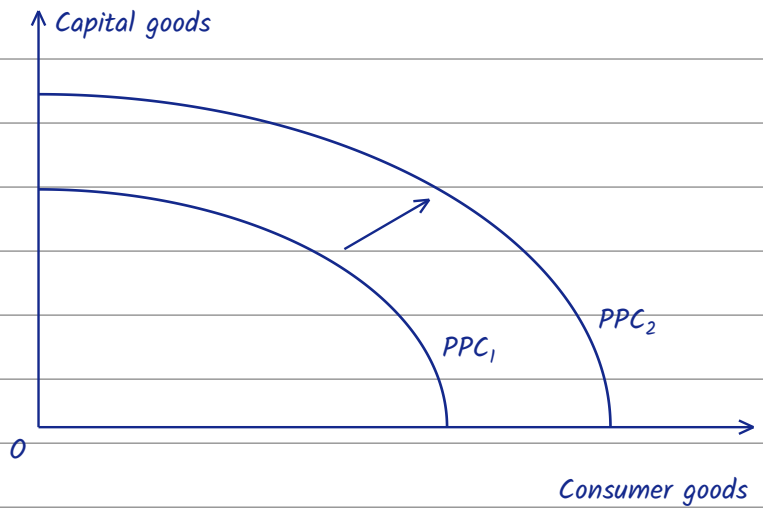
Question number

Answers for paper 9708/23

1(a) Both Malaysia's total population and its ageing population increased between 2017 and 2022. However, the share of the population older than 65 rose from about 6.3% to about 7.8%, so the ageing population increased at a faster rate than the total population.

1(b) Malaysia may need to produce more healthcare and care services for the elderly, such as hospitals, nursing homes, medical equipment and medicines. An older population needs more medical attention and long-term care, so resources must move away from goods and services for younger people, such as schools and baby products.

1(c) Malaysia's total population is projected to increase, which increases the size of the labour force. With more workers, productive capacity rises, so the PPC shifts outwards from PPC1 to PPC2 and more of both consumer goods and capital goods can be produced.



Question number	
	However, the extent of the shift may be small. The fertility rate is below replacement level and a growing proportion of people are over 65, so if the retirement age does not change, more workers will retire and the labour force may grow slowly or even fall, limiting the outward shift. The size of the shift will depend on whether Malaysia improves productivity, for example through technology or retraining older workers.
1(d)	Free childcare would make it easier for both parents to work, raising household income and living standards, and it would especially help low-income families, reducing poverty and income inequality. With childcare costs removed, parents could save or spend more on other goods and services. More people in work would increase output, consumption and tax revenue, supporting economic growth, and it may encourage couples to have more children, helping to raise Malaysia's low fertility rate and the future labour force. However, free childcare has a high opportunity cost: the government spending could instead be used for healthcare and pensions, which an ageing population needs. A zero price distorts the price mechanism, causing overconsumption and inefficient use of resources, and may drive out private providers, reducing quality and competition. If it is financed by higher taxes, this may discourage work and investment. On balance, the government should provide free childcare, but it should be targeted, for example at low-income working parents, because the gains in employment, growth and the future labour force are important for an ageing economy, while targeting keeps the opportunity cost and distortion to the market lower.
1(e)	Excluding net exports, aggregate demand is C + I + G. A larger total population means more consumers, so spending on goods and services rises and consumption

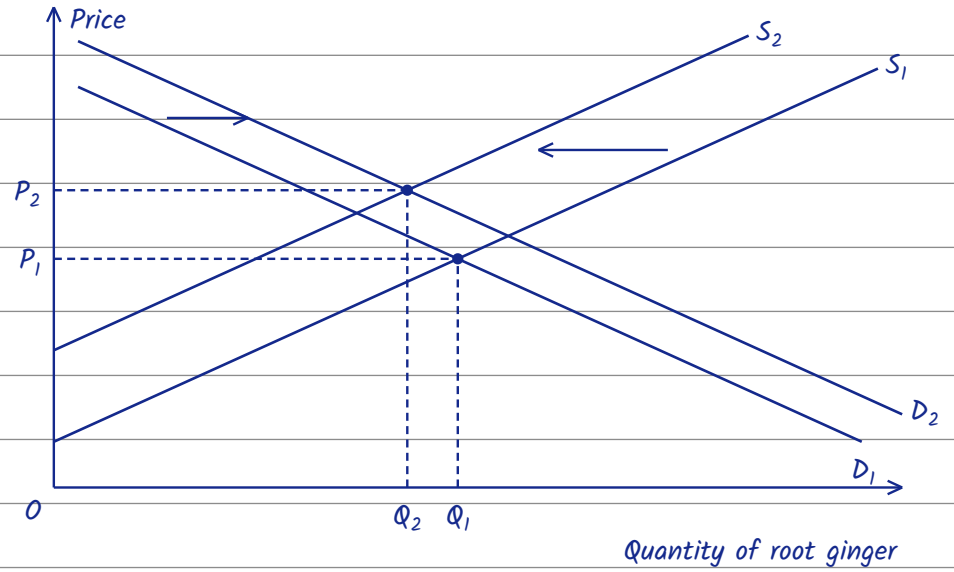
Question number

increases. Population growth creates demand for housing and infrastructure, encouraging firms to invest, so investment rises. The government will need to spend more on healthcare, education and other public services, increasing government spending. A bigger workforce also increases total income, allowing more consumption, so AD shifts to the right.

However, the increase may be limited. If population growth leads to higher unemployment, many people will have little income, limiting consumption. Because the population is ageing, people may save more for retirement, and elderly people on pensions often spend less, so consumption rises by less. Higher demand may cause inflation, reducing real incomes, and strained government budgets may limit spending.

Overall, the change in total population is likely to increase AD, mainly through higher consumption and government spending, but because the population is growing slowly and ageing, the increase is likely to be small and gradual rather than large.

2(a) Market equilibrium is the price and quantity at which quantity demanded equals quantity supplied, so there is no tendency for the price to change. Initially the market for root ginger is in equilibrium at P1 and Q1.



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The 20% fall in supply, for example because of a poor harvest or crop disease, shifts the supply curve to the left, from S1 to S2. At the original price there is now excess demand, so buyers compete for the limited ginger and the price is bid up. The expected increase in demand of more than 5%, perhaps because of its popularity as a health food, shifts the demand curve to the right, from D1 to D2, creating further excess demand at the original price, which also raises the price. The new equilibrium is at P2 and Q2.

I am certain that the price will rise, because both changes push the price upwards. However, I cannot be certain how much it will rise or what will happen to quantity. That depends on the relative size of the two shifts: since supply falls by 20% and demand rises by about 5%, the supply shift is larger, so the quantity traded is likely to fall, as in the diagram. The size of the price rise also depends on the price elasticities of demand and supply: if demand is price inelastic, the price will rise sharply. And demand is only expected to grow, so the forecast may be wrong. So I am certain of the direction of the price change but not of the new market price.

2(b)

The incomes of root ginger producers are unstable because supply varies with weather and disease, and because demand and supply are price inelastic in the short run, so small shifts cause large changes in price, as in 2022. Producers can stabilise their incomes in several ways.

First, producers can diversify, using some of their land to grow other crops, so a poor ginger harvest or low price is offset by income from other products. They can also add value by processing ginger, for example drying it or making ginger powder and oil, which can be stored and sold when prices are higher. However, other crops may be less profitable, may suffer the same weather, and processing requires capital and skills that small farmers may lack.

Second, the government can help. A subsidy provides financial support that helps

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producers cover costs and maintain stable incomes, and makes ginger farming more profitable. But subsidies are expensive for the government to maintain long term, have an opportunity cost and may encourage overproduction, which lowers market prices.

A minimum price guarantees producers a price above the equilibrium price, stabilising their earnings and encouraging consistent production. However, it creates a surplus, as quantity supplied exceeds quantity demanded, so the government may have to buy the excess ginger, which is costly, and producers who cannot sell do not benefit.

A buffer stock scheme sets a minimum and a maximum price. In good harvests the agency buys ginger to stop the price falling; in poor harvests, such as 2022, it releases ginger to stop the price rising. This smooths out price fluctuations and so stabilises incomes. However, it requires significant storage and management costs, fresh ginger can spoil, and if the price band is set wrongly the scheme runs out of money or stocks.

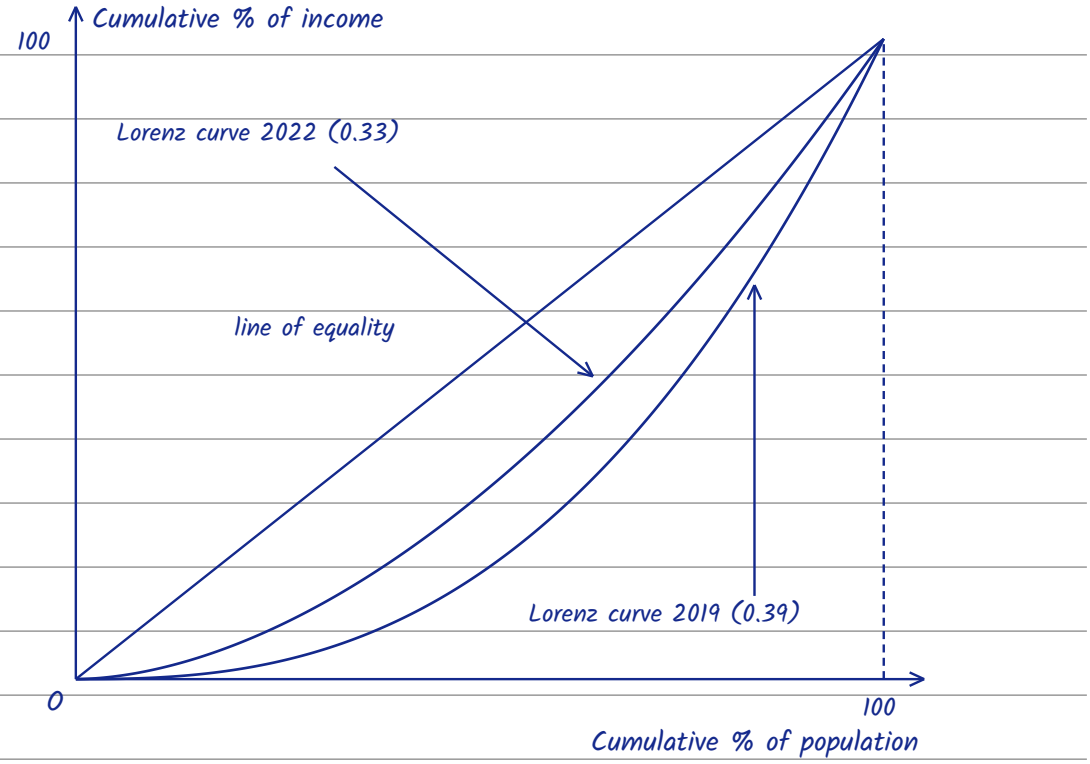
Which method works best depends on the circumstances. Price stability does not guarantee income stability: if supply falls with price held constant, income still falls. Government schemes depend on the budget available, while diversification depends on the land and skills of farmers.

In conclusion, the most sustainable way for producers to stabilise their incomes is to diversify and add value through processing and storing dried ginger, because this does not depend on government finance. Government buffer stocks or subsidies can help in the short run, but they are costly and difficult to manage for a perishable crop.

3(a) The Gini coefficient is a measure of income inequality derived from the Lorenz curve. It is the ratio of the area between the line of equality and the Lorenz curve to the total area under the line of equality. It ranges from 0, complete equality, to

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I, complete inequality. The fall from 0.39 in 2019 to 0.33 in 2022 means income became more evenly distributed in South Korea, so the Lorenz curve moved closer to the line of equality.



The government could use the data to evaluate the success of its policies to reduce inequality, such as progressive taxation, transfer payments and minimum wages. It could guide future decisions, such as whether to increase social welfare spending or change tax rates to maintain or further reduce inequality, and allow comparison with other countries. Its usefulness, however, depends on the accuracy of the data: incomes in the informal economy and top incomes are often under-reported, and estimates may be revised.

The Gini coefficient is useful for showing changes in overall inequality over time and across countries, but it does not show which income groups have gained or lost, since different Lorenz curves can give the same value. It ignores wealth inequality and access to education and healthcare. So it is a valuable summary indicator, but it should be used alongside other data, such as income shares of each group, when making policy.

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3(b)

Income is a flow of money received over a period of time, such as wages, rent, interest and profits. Wealth is a stock of assets owned at a point in time, such as property, shares and savings. Both are unequally distributed, but wealth is usually much more unequal than income.

It is easier to redistribute income because governments can use the existing fiscal system. A progressive income tax takes a higher proportion of income from high earners, and transfer payments such as unemployment benefits, pensions and child benefits raise the incomes of the poor. Income is received regularly and recorded through wages and salaries, with tax deducted by employers, so the government can measure it accurately and adjust tax rates and benefits quickly each year in the budget. This is likely to have contributed to the fall in South Korea's Gini coefficient.

However, redistributing income is not always easy. High earners may avoid or evade tax, or move abroad, reducing the effectiveness of redistribution. High marginal tax rates and generous benefits may reduce incentives to work and invest, lowering growth and tax revenue.

Wealth can be redistributed through inheritance tax, property tax, capital gains tax or an annual wealth tax, which target accumulated assets rather than annual income, and by helping lower-income groups to acquire assets through housing schemes, education and grants for small firms. But wealth is difficult to measure and value, especially private businesses, art and offshore accounts. Assets are often mobile, so they can be moved abroad to avoid tax, and people may be asset-rich but cash-poor, unable to pay a wealth tax without selling their home. Wealthy individuals and families who own large businesses often have political influence and legal means to resist or reduce wealth taxes. Redistributing wealth also takes a long time, as inheritance taxes only apply when assets are passed on.

Therefore the difficulty depends on the administrative capacity of the government

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and the type of asset. Some wealth, such as land and property, is immobile and registered, so it can be taxed fairly easily. South Korea has a developed tax system, which makes both more feasible than in many economies.

In conclusion, it is easier for South Korea to redistribute income than wealth, because income is regularly recorded and can be taxed and supplemented through existing systems, whereas wealth is hard to value, mobile and politically protected. However, because wealth generates future income, redistributing income alone may not reduce inequality in the long run.

4(a) Inflation is a sustained rise in the general price level. For the UK, three causes of inflation are as follows.

Demand-pull inflation occurs when aggregate demand increases faster than aggregate supply, for example because of higher consumer spending or government spending, or lower interest rates. For example, a cut in income tax increases disposable income and consumption, so AD rises and, if the economy is near capacity, the price level rises.

Cost-push inflation occurs when firms' costs of production rise and they raise prices to protect profits. In the UK in 2025, employers' National Insurance contributions increased in April and the National Living Wage rose by 6.7%, raising labour costs, while energy, water and food prices also rose.

Imported inflation occurs when the prices of imported goods and raw materials rise, or when the exchange rate depreciates, making imports more expensive.

Expectations can also cause inflation: if workers expect high inflation, they demand higher wages, creating a wage-price spiral.

In 2025, UK inflation rose to around 3.8%, almost twice the 2% target, while economic growth was weak, so demand was not excessive. This suggests that cost-push factors, especially higher labour costs and regulated prices, were the most important cause. However, it is difficult to identify a single cause, as causes

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interact: higher wages raise costs but also spending. On balance, cost-push inflation is likely to have been the most important cause in the UK in 2025.

4(b) Demand-side policy aims to reduce aggregate demand. The Bank of England can raise interest rates, which increases the cost of borrowing and the reward for saving, so consumption and investment fall. The government can raise taxes or cut spending, reducing disposable income and AD. Lower AD reduces demand-pull pressure and can reduce inflation expectations, so firms and workers moderate price and wage rises. Higher interest rates can also strengthen the pound, making imports cheaper. These policies can act fairly quickly, especially monetary policy. However, the UK inflation in 2025 was mainly cost-push. Reducing AD when costs are rising lowers output and employment as well as prices, risking stagflation, and the UK economy was already growing slowly. There are time lags of up to two years before interest rate changes have their full effect, and higher rates increase mortgage payments, which can feed into wage demands. Contractionary fiscal policy is politically unpopular.

Supply-side policy aims to increase aggregate supply. Investment in training and technology raises labour productivity, so firms can produce more with the same resources, lowering unit labour costs. Better transport infrastructure reduces distribution costs, and investment in domestic renewable energy reduces dependence on imported gas, protecting the UK from energy price shocks. Increasing competition reduces firms' ability to raise prices. Shifting AS to the right reduces inflation while raising output and employment, tackling the cause of cost-push inflation.

However, supply-side policies take a long time to work, so they are not effective in reducing inflation in the short term. They are expensive, with an opportunity cost, and success is not guaranteed. External factors, such as rising world oil prices, cannot be controlled by domestic supply-side policy.

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Which is better depends on the cause of the inflation and the time period. For demand-pull inflation, demand-side policy is more appropriate; for cost-push inflation, supply-side policy addresses the cause. Since UK inflation in 2025 was mostly cost-push and growth was weak, using strongly contractionary demand-side policy would be costly in lost output and jobs.

In conclusion, supply-side policy is the better way of reducing this inflation in the long run, because it lowers costs without reducing growth. However, as it acts slowly, the Bank of England must keep interest rates high enough in the short run to stop expectations and second-round wage effects, so the two policies work best together.

5(a) The current account of the balance of payments records trade in goods and services, primary income and secondary income. A deficit occurs when the value of imports of goods and services plus income outflows exceeds the value of exports and income inflows.

One reason is low international competitiveness. If a country has high labour costs, low productivity, high inflation or a high exchange rate, its exports are expensive abroad and imports are cheap at home, so exports fall and imports rise. A second reason is strong domestic growth. When incomes rise quickly, consumers buy more imports, especially if the marginal propensity to import is high, while firms sell more at home rather than exporting, so the deficit grows.

The government is likely to be concerned. A persistent deficit puts downward pressure on the exchange rate, making imports more expensive and causing inflation. The deficit must be financed by borrowing from abroad or selling assets, increasing foreign debt and future interest payments, and it may reduce confidence among foreign investors, limiting the capital inflows needed for growth. It may also mean jobs are lost in industries competing with imports. However, the government may not be concerned if the deficit is small and temporary, or if it is caused by

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	imports of capital goods that will increase future productive capacity and exports. The level of concern therefore depends on the size of the deficit as a percentage of GDP, how long it lasts, what causes it and how it is financed. A large, persistent deficit caused by poor competitiveness is a serious concern, whereas a small one financed by foreign direct investment is not.
5(b)	Protectionist policies include tariffs, which are taxes on imports, and quotas, which limit the quantity of imports. They raise the price or reduce the availability of imports, so spending on imports falls and the current account deficit is reduced, by switching spending from foreign to domestic goods. They protect domestic industries from foreign competition, which may allow local firms to grow, achieve economies of scale and potentially export more in the future. They can work quickly and tariffs raise government revenue. However, they raise prices for consumers, reducing consumer welfare, and increase costs for firms that use imported inputs, which can make exports less competitive. Other countries may retaliate with their own trade barriers, reducing exports, so the deficit may not improve at all. Protection may also make domestic firms inefficient, and it may break WTO rules. Contractionary policies, such as higher interest rates, higher taxes or lower government spending, reduce aggregate demand. With lower incomes, households spend less on everything, including imports, so the deficit falls. They may also reduce inflation, which makes exports more price competitive over time. However, they reduce spending on domestic goods as well as imports, so economic growth slows and unemployment rises. Lower confidence can reduce investment, weakening future competitiveness. Higher interest rates may attract hot money inflows, causing the exchange rate to appreciate, which makes exports dearer and imports cheaper, partly offsetting the benefit. Their effect on imports also depends on the marginal propensity to import.

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Which is better depends on the cause of the deficit. If the deficit is caused by excessive domestic demand, contractionary policy targets the cause. If it is caused by unfair foreign competition, protection may be justified, for a short time. It also depends on the likelihood of retaliation and the state of the economy: in a recession, contractionary policy would be very damaging.

In conclusion, contractionary policy is usually the better choice because it reduces the deficit without the risk of retaliation and helps control inflation, although it has a cost in lower growth. Protectionism may work more quickly but risks retaliation and higher prices, and neither tackles poor competitiveness, which requires supply-side policy in the long run.

Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/24**

Paper 2 AS Level Data Response and Essays **October/November 2025**

2 hours

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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.

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Section A

Answer all parts of Question 1

1 Will stronger economic growth in the United States (US) lead to high inflation?

The US has experienced stronger economic growth than countries in Europe and elsewhere since the COVID-19 pandemic. In terms of Gross Domestic Product (GDP), it had particularly strong growth over the fourth quarter of 2023 of 3.3%. This far exceeded economists' expectations of 2%. This means that annual growth for 2023 was 2.5% which was better than other high-income economies. It is on target to do the same in 2024 as shown in Fig 1.1.

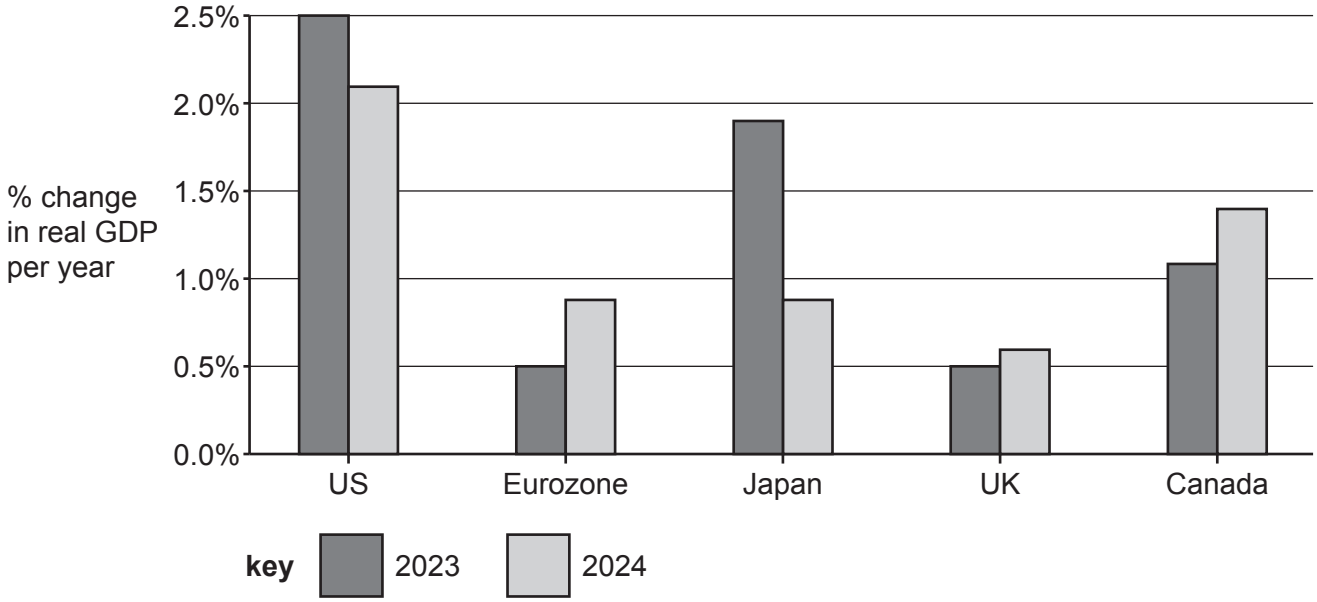


Fig. 1 International Monetary Fund (IMF) economic growth forecasts for 2023 and 2024

Economists have suggested that the strong economic growth in the US was caused by both demand and supply factors. In 2020, the US government responded to the COVID-19 pandemic by injecting US$5 trillion into the economy. Spending in many areas included more generous unemployment benefits and grants to small firms. This huge financial stimulus, much bigger than other countries, has been credited with maintaining consumer spending which represents 70% of aggregate demand.

On the supply side of the economy, existing flexible labour markets enabled firms to make workers redundant. This encouraged firms to invest in new technologies, leading to increased productivity and continued expansion in the long run. As firms expanded, they employed more workers causing disposable incomes to rise. Finally, the US is a net exporter of energy and therefore firms did not suffer the huge increase in energy costs faced by firms in Europe caused by the conflict in Ukraine. This has allowed the US to keep inflationary pressure under control.

In March 2024, however, the rate of inflation in the US rose much faster than expected as its level of unemployment fell, leading to an increase in consumer spending. Although this may lead to further economic growth and the benefits this brings, there are costs associated with inflation that may need to be dealt with. One policy that could be used is to increase interest rates, but US interest rates were already at their highest level for more than two decades because of earlier inflationary pressures. The hope had been that interest rates might start to fall, but now there are

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fears that any cuts in interest rates will be delayed or even worse, it might even be necessary to increase them further.

Sources: Adapted from BBC News articles: US economy sees surprisingly strong growth, 13 February 2024, US inflation jumps, 11 April 2024 and US jobs boom raises doubts about rate cuts, 5 April 2024

(a) Compare the forecast rates of economic growth for the US and Eurozone between 2023 and 2024. [2]

(b) Explain **one** reason why the IMF uses percentage change in real GDP and not percentage change in nominal GDP when measuring economic growth. [2]

(c) Explain, with the help of a diagram, why an increase in productivity in US firms may reduce the price of their products and consider whether this will always be the outcome. [4]

(d) Assess whether the costs of inflation are always likely to be greater than the benefits of inflation for the US. [6]

(e) Assess the extent to which maintaining interest rates at a high level will be the best policy for the US to control inflation. [6]

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Section B

Answer **one** question.

EITHER

2 **(a)** Explain what is meant by the incidence of an indirect tax **and** consider the extent to which it is possible for the incidence to pass from a producer of a good to a consumer of that good. [8]

(b) Assess the extent to which a government should subsidise the production of merit goods to increase the consumption of these goods. [12]

OR

3 **(a)** Explain what determines elastic and inelastic price elasticity of supply (PES) **and** consider the extent to which the value of PES may differ between an agricultural good and a manufactured good. [8]

(b) Firms will often try to estimate elasticity values to judge the possible success of decisions to change prices or to introduce new products.

Assess the extent to which an understanding of income elasticity of demand (YED) may be more useful than cross elasticity of demand (XED) in increasing the income from sales for a firm. [12]

Section C

Answer **one** question.

EITHER

4 **(a)** Using **two** tools of protection, explain what is meant by protectionism **and** consider the extent to which these two tools may benefit an economy. [8]

(b) Assess the extent to which the principle of comparative advantage should be the main factor to consider when countries decide whether to trade with each other. [12]

OR

5 **(a)** Explain the difference between structural unemployment and cyclical unemployment **and** consider the extent to which structural unemployment is likely to be more damaging to an economy than cyclical unemployment. [8]

(b) Low unemployment is a macroeconomic policy objective for a government.

Assess the extent to which this is most likely to be achieved by supply-side policy. [12]

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

Question number

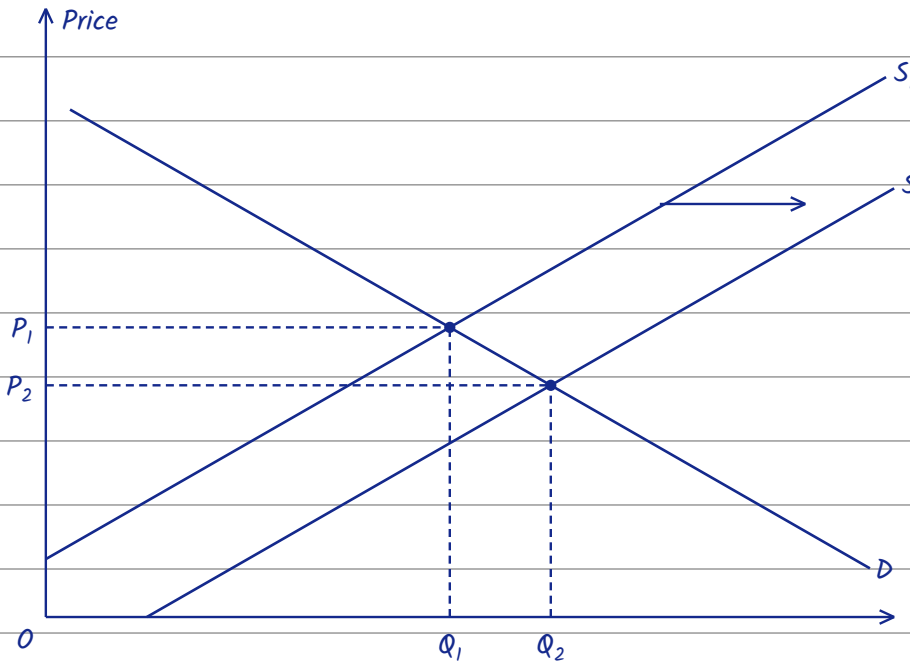
Answers for paper 9708/24

1(a) Both the US and the Eurozone are forecast to have positive economic growth in 2023 and 2024, and the US rate is higher than the Eurozone rate in both years (2.5% compared with 0.5% in 2023). However, the US growth rate is forecast to fall, to about 2.1% in 2024, whereas the Eurozone growth rate is forecast to rise, to about 0.9%.

1(b) Nominal GDP is measured at current prices, so it rises when prices rise even if output does not, whereas real GDP removes the effects of inflation. Using real GDP shows the true change in the volume of output, so it gives a more meaningful comparison of growth between years and between countries with different inflation rates.

1(c) An increase in productivity means more output per worker, so production is more efficient and unit costs fall. This shifts the supply curve to the right from S1 to S2, so at the original price there is excess supply and the price falls from P1 to P2, while quantity rises from Q1 to Q2.

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However, this will not always be the outcome. Firms with market power may keep prices unchanged and take the lower costs as extra profit, and other costs, such as wages in a tight US labour market, may rise and offset the productivity gain. Demand is also rising strongly in the US, which pushes prices up, so prices may not fall.

1(d) Inflation has costs. Menu costs and shoe leather costs rise, people on fixed incomes and lenders lose as the real value of their income and loans falls, and fiscal drag pulls people into higher tax brackets. If US inflation is higher than in other countries, US goods become less internationally competitive. Uncertainty makes firms reluctant to invest, and it forces the Federal Reserve to keep interest rates at their highest for two decades.

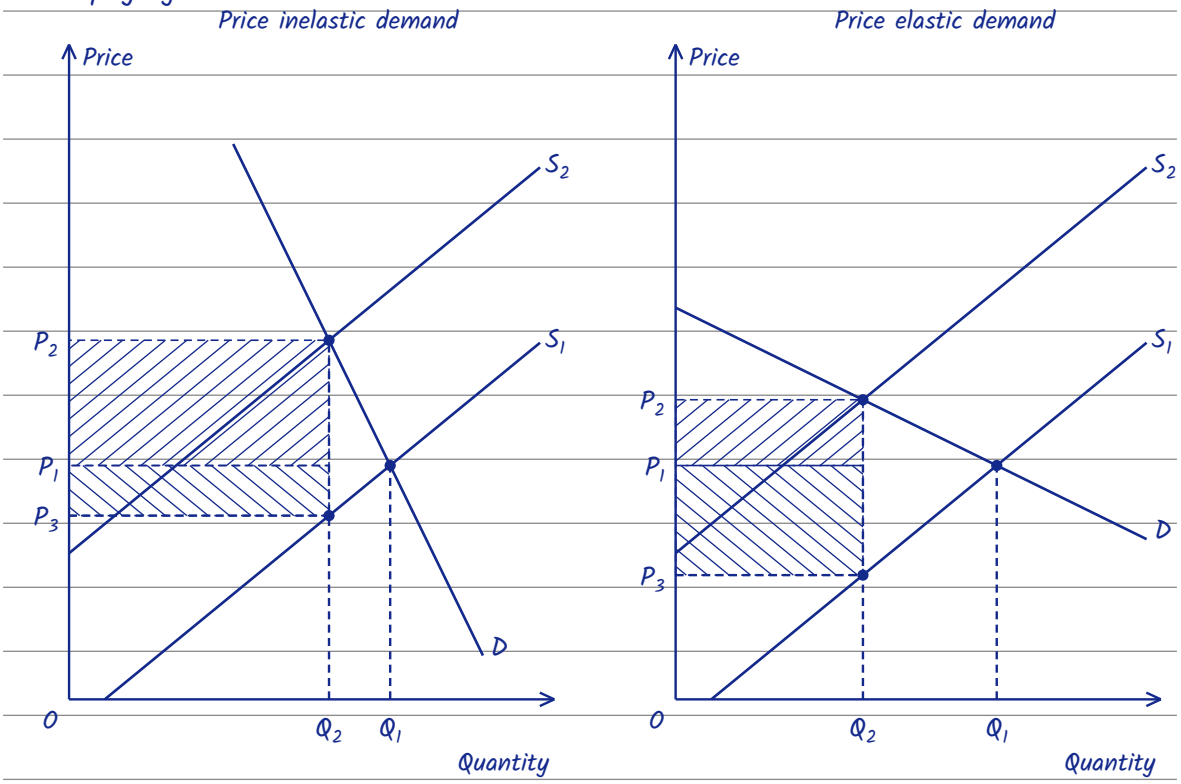
However, inflation also has benefits. Low and stable inflation is often a sign of a growing economy, and rising prices and profits encourage firms to produce more and employ more workers, as shown by falling US unemployment. Borrowers gain because the real value of their debts falls, including the government's large debts after its US$5 trillion stimulus.

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	Whether costs outweigh benefits depends on the rate of inflation, whether it is prolonged and how it compares with other countries. US inflation appears to be mainly demand-led, from rising consumer spending and falling unemployment, rather than rising costs, since the US did not suffer the huge energy cost increases seen in Europe. So while inflation stays moderate and accompanies strong growth, the benefits may outweigh the costs, but if it accelerates the costs will be greater. The costs are therefore not always greater than the benefits.
1(e)	Maintaining high interest rates is a contractionary monetary policy. It keeps the cost of borrowing high for households and firms and increases the reward for saving, so consumption on credit and investment are lower. This reduces aggregate demand and so reduces demand-pull inflationary pressure, and keeps inflation expectations down. High rates may also keep the dollar strong, making imports cheaper. However, if high rates are maintained for a long time they may reduce economic growth and increase unemployment, reversing the US's strong performance. A strong dollar reduces the international competitiveness of US exports. Rates are already at a two-decade high, so further effects may be small, and there are long time lags. High rates would also be inappropriate if inflation were caused by cost-push factors. Alternatives include contractionary fiscal policy, though cutting spending or raising taxes is politically difficult, and supply-side policies to raise productivity, which the data shows is already increasing but which work slowly. Because the data suggests US inflation is largely the result of rising AD rather than rising costs, keeping interest rates high is likely to be the best policy in the short term, provided the Federal Reserve does not keep them high for so long that it causes a recession.
2(a)	An indirect tax is a tax on spending on goods or services, paid to the government

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by the producer or seller. It can be specific, a fixed amount per unit, such as an excise duty on petrol, or ad valorem, a percentage of the price, such as VAT. Indirect taxes are often used to raise revenue or to reduce consumption of demerit goods, and they are regressive because they take a larger proportion of the income of the poor. The incidence of an indirect tax is the extent to which the burden of the tax is borne by the producer and the consumer.

A tax raises firms' costs, so the supply curve shifts upwards by the amount of the tax, from S1 to S2. The price rises from P1 to P2. The part of the tax paid by consumers is the rise in price, P1 to P2 (upper shaded area), and the part paid by producers is P1 to P3 (lower shaded area), where P3 is the price producers receive after paying the tax.

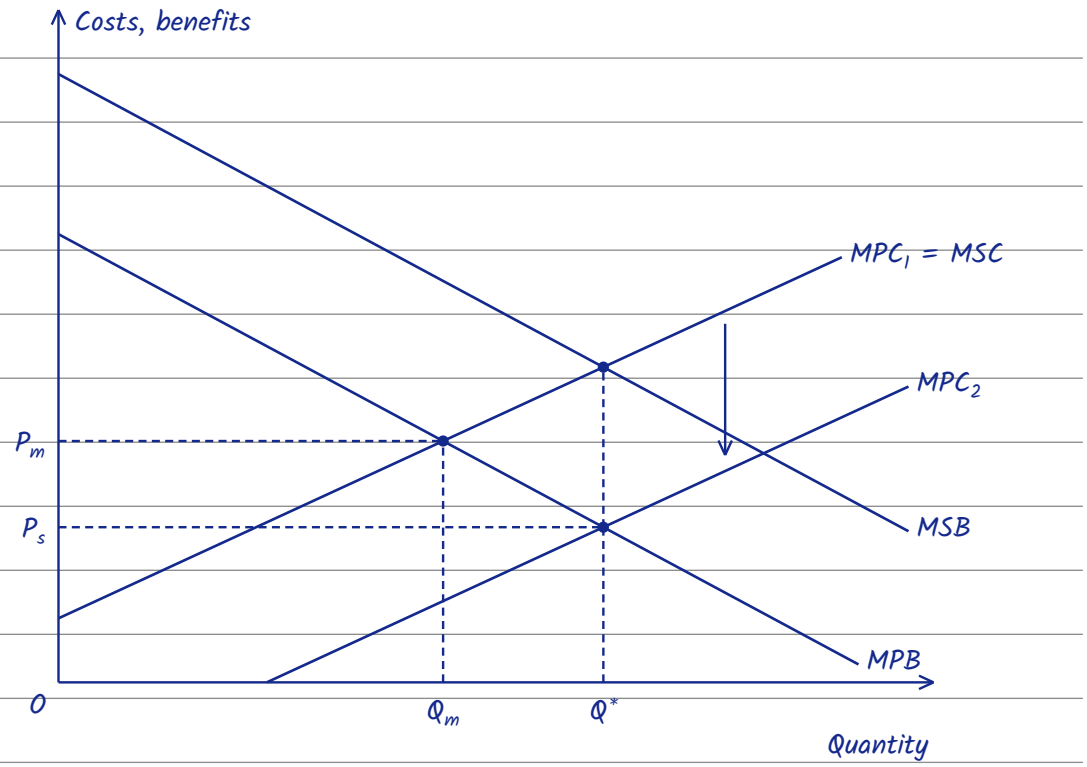


If demand is price inelastic (left), consumers do not reduce their purchases much when the price rises, so the producer can pass most of the tax on to consumers in a higher price; the consumer burden is larger than the producer burden. If demand is price elastic (right), a higher price causes a large fall in quantity demanded, so the producer cannot raise the price much and must absorb most of the tax.

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The extent to which the incidence can be passed on therefore depends on the PED, and also on the PES. It is more possible to pass the tax on to the consumer when demand is price inelastic, as with petrol and cigarettes. Only if demand were perfectly inelastic would the whole tax be passed on, so in practice the burden is usually shared between producer and consumer.

2(b) A merit good is a good that is under-consumed if left to the market, because consumers have imperfect information and underestimate its private benefits, and because it creates positive externalities, such as vaccinations and education. In the diagram, consumers buy Q_m where MPB = MPC, but the socially optimal output is Q^* where MSB = MSC.



A subsidy is a payment from the government to producers that reduces their costs. The cost curve shifts down from MPC1 to MPC2 (MPC – subsidy), so the price consumers pay falls to P_s and consumption rises from Q_m to Q^*. If the subsidy equals the external benefit, the allocation of resources becomes socially optimal. A subsidy keeps the market working, so consumers still choose, and it can

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be targeted at particular goods or groups.

However, a subsidy has disadvantages. It is costly for the government, with an opportunity cost, and may require higher taxes. It is very difficult to measure the external benefit, so the subsidy may be set at the wrong level, causing government failure. Producers may keep part of the subsidy as profit rather than cutting prices. Most importantly, if the cause of under-consumption is imperfect information, a lower price may not increase consumption much, because people still do not value the good; for example, parents who do not understand the benefits of vaccination may not vaccinate their children even when it is cheap.

Other policies may be more effective. Information provision, such as health campaigns, tackles the cause of under-consumption by increasing MPB, although its effect is slow and uncertain. Direct provision, free at the point of use, ensures everyone can consume the good, as with state schools, but is very costly and may be inefficient. Regulation, such as compulsory education up to a certain age, guarantees consumption but limits freedom of choice.

The best policy depends on the cause of the under-consumption, the price elasticity of demand and the government's budget. A subsidy works well where price is the main barrier and demand is price elastic.

In conclusion, a government should subsidise merit goods to some extent, because it lowers price and raises consumption at a lower cost than free provision, but a subsidy alone is unlikely to be enough. It should be combined with information provision and, for essential goods like education, direct provision or regulation.

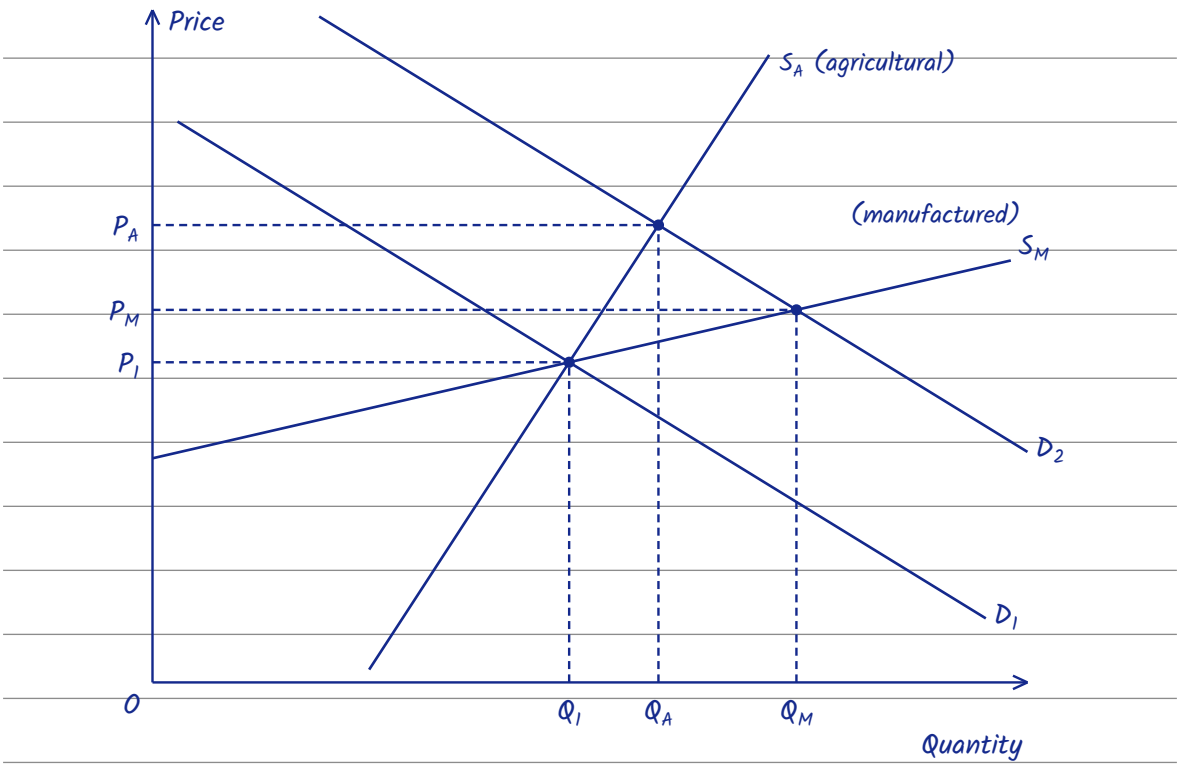
3(a) Price elasticity of supply (PES) measures the responsiveness of quantity supplied to a change in the price of a product: PES = % change in quantity supplied ÷ % change in price. Supply is elastic when PES is greater than 1, so quantity supplied changes by a larger percentage than price, and inelastic when PES is less than 1, so it changes by a smaller percentage.

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PES is determined by the time period, as supply is more elastic in the long run when firms can add capacity; the availability of spare capacity; the level of stocks; how perishable the product is; the time taken to produce it; and how easily factors of production can be moved into the industry.

Agricultural goods tend to have inelastic supply. Crops take months to grow, so farmers cannot quickly respond to a higher price, land is fixed in the short run, and many products, such as fruit, are perishable and difficult to store.

Manufactured goods tend to have more elastic supply, because factories may have spare capacity and can add shifts, stocks of finished and unfinished goods can be held, and production is quick. In the diagram, the same rise in demand from D1 to D2 increases quantity much more for manufactured goods (Q1 to Q_M) than for agricultural goods (Q1 to Q_A), while the price of agricultural goods rises much more.



However, the difference is not always as great. Storable crops such as grain can be held in silos, and greenhouses make supply more elastic, while manufactured goods with complex supply chains, such as semiconductors, or factories at full capacity,

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have inelastic supply. Overall, agricultural goods are usually more price inelastic in supply than manufactured goods, mainly because of their perishable nature and long production time, unless better ways are found to store them.

3(b) Income elasticity of demand (YED) is the percentage change in quantity demanded divided by the percentage change in income. It shows whether a product is a normal good (positive YED, a luxury if greater than 1) or an inferior good (negative YED). A firm can use YED to predict how its sales revenue will change as incomes change. If incomes are forecast to rise by 3% and its product has a YED of +2, it can expect sales to rise by about 6%, so it can plan output and introduce more luxury products. In a recession, a firm can introduce cheaper ranges whose demand rises as incomes fall, protecting its revenue. YED also helps a firm choose which markets to enter, such as fast-growing economies.

Cross elasticity of demand (XED) is the percentage change in quantity demanded of good A divided by the percentage change in the price of good B. It is positive for substitutes and negative for complements, and its size shows how close the relationship is. A firm can use XED to predict how its revenue will change when rivals change their prices: if XED with a rival brand is high, a rival's price cut will reduce its sales a lot, so it may need to match the cut. It can also increase revenue from complements, for example by selling games consoles cheaply to increase sales of games, and judge whether a new product would take sales from its existing ones.

Both measures have limitations. They are estimates based on past data, they change over time as tastes change, and they assume other things remain equal, which is rarely true. Firms also cannot control incomes or rivals' prices. For decisions to change the firm's own price, price elasticity of demand is more useful than either.

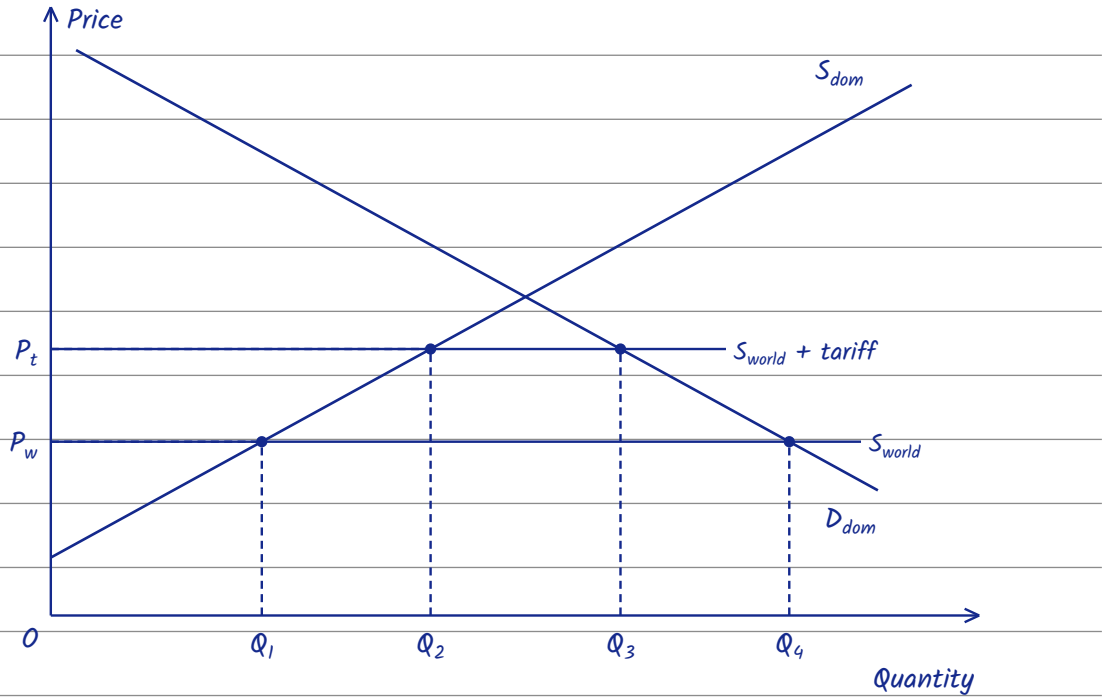
Which is more useful depends on the decision and the market. For long-term

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planning and new product launches, YED is more useful, because incomes determine the size of the market. For short-term pricing decisions in a competitive market, such as an oligopoly, XED is more useful, because rivals' prices change frequently. A monopoly has few substitutes, so XED is less relevant to it.

In conclusion, YED is likely to be more useful than XED in increasing income from sales when the economy is changing and the firm is deciding what products to introduce, but XED is more useful for firms in highly competitive markets setting prices. Neither is always more useful, and firms gain most by using both together with PED.

4(a) Protectionism is the use of measures by a government to protect domestic industries from foreign competition by restricting imports. One tool is an import tariff, a tax on imported goods. In the diagram, the tariff raises the domestic price from the world price P_w to P_t, so domestic production rises from Q1 to Q2 and imports fall from Q1Q4 to Q2Q3. A second tool is an import quota, a limit on the quantity of a good that can be imported, which reduces supply from abroad, raising the domestic price and giving domestic firms a larger share of the market.



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	Both tools can benefit an economy. By reducing imports, they can improve the current account, they protect jobs in domestic industries, allow infant industries to grow until they can compete, and protect strategic industries such as food and defence. A tariff also raises government revenue, which a quota does not. However, the benefits may be limited. If demand for imports is price inelastic, a tariff reduces imports only slightly. Both tools raise prices for consumers and costs for firms that use imported inputs, protected firms may become inefficient, and other countries may retaliate, reducing exports and jobs in export industries. So these tools may benefit an economy in the short term, particularly for infant or strategic industries, but in the long run retaliation and inefficiency mean the benefits are likely to be small.
4(b)	A country has a comparative advantage in a good when it can produce it at a lower opportunity cost than another country. For example, if Country A gives up 2 units of cloth to make 1 unit of wheat, while Country B gives up 4 units of cloth, A has a comparative advantage in wheat and B in cloth. If each specialises in the good in which it has a comparative advantage and they trade, at terms of trade between their opportunity costs, total world output increases and both countries can consume beyond their own PPCs. This is why comparative advantage should be an important factor. Specialisation leads to an efficient allocation of resources, an increase in world output and employment, economies of scale, lower prices and a wider choice of products for consumers. However, the theory rests on assumptions that do not always hold: constant costs, no transport costs, perfect mobility of factors within each country and free trade. High transport costs can wipe out the gains, and diseconomies of scale can raise costs. Over-specialisation is risky, as countries become dependent on a few products whose prices fluctuate, and workers in industries that decline may

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become structurally unemployed.

Other factors are also important. Strategic and security considerations mean countries want to produce their own food, energy and defence equipment, and the COVID-19 pandemic and the conflict in Ukraine showed the dangers of relying on other countries for essential goods. Political relationships, trade agreements and membership of trading blocs, such as the EU, influence who countries trade with. Exchange rates, quality, brand reputation and reliability matter as well as cost. Countries may also protect infant industries to develop a future, dynamic comparative advantage, and environmental and labour standards are increasingly important.

The importance of comparative advantage therefore depends on the type of good. For most ordinary consumer and manufactured goods, comparative advantage should be the main factor, because it maximises efficiency and living standards. For strategic goods, political and security considerations may matter more.

In conclusion, comparative advantage should be the main starting point when countries decide whether to trade, because it explains the gains from trade, but it should not be the only factor; strategic, political and practical factors such as transport costs mean it is not always the main one.

5(a) Unemployment is a situation where people who are willing and able to work cannot find a job. Structural unemployment occurs because of long-term changes in the structure of the economy, as patterns of demand and supply change, so some industries decline. Workers who lose their jobs do not have the skills needed in growing industries or live in the wrong area, for example coal miners when mines close. Cyclical unemployment occurs because of a lack of aggregate demand, for example during a downturn or recession in the economic cycle, when firms cut output and need fewer workers.

Structural unemployment may be more damaging because it is more likely to be

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long term: workers need retraining or must move, which takes time, and older workers may never find work again. It is often concentrated in particular regions, causing local poverty and decline. Cyclical unemployment, on the other hand, affects the entire economy, with job losses across many industries, and reduces incomes, spending and tax revenue, so in a deep recession it can affect far more people. Both lead to a loss of income for the unemployed, wasted output and higher government spending on benefits.

Which is more damaging depends on the timescale, the number of people affected and how easily workers can retrain. Cyclical unemployment usually falls when the economy recovers and can be reduced by expansionary policy, while structural unemployment needs slow supply-side solutions. On balance, structural unemployment is likely to be more damaging in the long run, while cyclical unemployment may be more damaging in a deep recession.

5(b) Supply-side policies aim to increase the productive capacity of the economy by improving the quantity and quality of factors of production and the efficiency of markets. Several can reduce unemployment. Education and training give workers the skills that employers need, reducing structural unemployment. Better information about vacancies, through job centres and online services, reduces frictional unemployment. Reducing unemployment benefits or income tax increases the incentive to take a job, and investment in infrastructure in depressed regions attracts firms and creates jobs. Supply-side policy can therefore reduce unemployment without causing inflation, because AS increases rather than AD.

However, supply-side policies have limitations. They take a long time to work: training programmes may take years before workers find jobs. They are costly, with an opportunity cost, and success is not guaranteed, as workers may be unwilling to retrain or move. Cutting benefits may increase poverty. Most importantly, they do not create demand for labour: if unemployment is cyclical, more skilled workers will

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still not find jobs because firms do not need them.

Demand-side policies may be more appropriate for cyclical unemployment.

Expansionary fiscal policy, such as extra government spending or lower income taxes, and expansionary monetary policy, such as lower interest rates, increase aggregate demand. Firms need more workers to produce the extra output, so unemployment falls, and the multiplier effect increases the impact. However, these policies can cause demand-pull inflation if the economy is near full capacity, increase the budget deficit and government debt, and have time lags; lower interest rates may not work if confidence is very low.

Which policy is most likely to achieve low unemployment depends on the type of unemployment. Structural and frictional unemployment are best reduced by supply-side policies, while cyclical unemployment is best reduced by demand-side policies. It also depends on the time period and the state of the government's finances.

In conclusion, low unemployment is most likely to be achieved by supply-side policy in the long run, because it deals with structural causes and does not cause inflation, but in a recession demand-side policy is more effective, so a combination of both is most likely to achieve the objective.