AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



EXAM QUESTION PACK

3.2.2.1 THE CIRCULAR FLOW OF INCOME

SCORE	PERCENTAGE
/87	%

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1. An economy is in a state of macroeconomic equilibrium. The levels of investment, savings, exports and imports are shown below.

Injections into and withdrawals from the circular flow of income	
Investment	£200 bn
Savings	£200 bn
Exports	£300 bn
Imports	£400 bn

It can be inferred from the data in the table above that

A government expenditure equals taxation. ⬭

B the budget surplus equals the balance of payments deficit. ⬭

C the government has a budget deficit. ⬭

D the government has a budget surplus. ⬭

[1 mark]

2. **The Global Context Extract B** (lines 13 −15) refers to the possible benefit to the UK and other economies if countries hosting major sports competitions become more open to investment in the long term.

Explain the term 'investment' **and** analyse **two** possible economic benefits for the UK when it is investing overseas.

[9 marks]

3. **Essay 2**

In 2018, the European Commission estimated that Bulgaria and Romania were both experiencing positive output gaps whilst the UK was experiencing a negative output gap. Persistent output gaps can cause problems for economies which may be addressed by supply-side improvements.

Explain the main problems for an economy of having a large positive output gap.

[15 marks]

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4.

THE GLOBAL CONTEXT

Extract B: Winners and losers

The debate over the consequences of globalisation for individual countries continues. Inevitably, there will be benefits and costs, winners and losers. For example, whilst the UK has experienced deindustrialisation, its service sector has been successful in world markets.

As the debate continues, one aspect of globalisation cannot be disputed: that the greater integration of economies has meant that major events occurring in one part of the world will have an impact not just on the affected country or region but are now much more likely to have global significance.

Some events are known about well in advance of them actually happening. Major sports competitions are an example. In 2012, for instance, the UK will host the Olympic Games. Similarly, Russia and Qatar will host the football World Cup in 2018 and 2022 respectively. The economic impact of such events on host countries is likely to be positive. For other countries, the immediate impact is likely to be more limited. However, the UK and other economies could benefit if these events make the host countries more open to trade and investment in the long term.

Other events are far less predictable or are completely unpredictable. For example, how might the UK cope with a disruption to gas and oil supplies if relations with Russia deteriorate or political turbulence in the Middle East escalates? What path to recovery will the UK take following the devastating effects of the 2008 US financial crisis?

Generalisations about the economic impact of natural disasters are often unhelpful. Hurricane Katrina in 2006, which caused billions of dollars of damage in the New Orleans area of the USA, had minimal economic impact on the rest of the world. However, the Japanese earthquake and tsunami in 2011 are on a different scale. Japan accounts for 7% of world GDP. There are fears that the scale of the damage may lead to a return to recession in Japan, as fearful Japanese consumers spend less and save more. Global supply chains originating in Japan, such as car components supplied to the rest of the world, have been severely disrupted. The UK, as well as Japan's other trading partners, will struggle to maintain exports to the Japanese market until stability is restored.

Like any other country, the UK needs to have a strong economy to be able to respond successfully to all types of global event and to secure sustained economic growth. Important factors include high productivity, resource mobility, innovation, skilled labour, a strong infrastructure in its widest sense and general flexibility in the economy. The ability to make use of these supply-side qualities will, however, also depend on aggregate demand. The impact of major global events on UK aggregate demand will inevitably vary considerably, positively or negatively, with unknown consequences for macroeconomic performance.

Source: news reports, 2010/11

5.

The Global Context Extract B (lines 1−3) states: 'some economists are predicting that the US will play a leading role in driving world economic growth and, as the country which is the UK's main export partner, this may provide an injection into the UK's circular flow of income.'

Explain the term 'circular flow of income' **and** analyse how economic growth in the US may lead to increased national income in the UK.

[9 marks]

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6. **THE GLOBAL CONTEXT**

Extract B: Will growing inequality damage the US economy?

Some economists are predicting that the US will play a leading role in driving world economic growth and, as the country which is the UK's main export partner, this may provide an injection into the UK's circular flow of income. However, since the 2008 financial crash, there has been debate in the US over whether or not economic growth can be strengthened and, if so, how best to achieve this. Within this debate, there are growing concerns about the specific issue of income inequality. The top 1% of earners have received 95% of the increase in income since the financial crisis. Since 2009, the top 1% have seen their incomes rise on average by 31.4%, whereas the rest of the population has seen a rise of only 0.4%.

The economist, Joseph Stiglitz, has highlighted inequality as one of the prime reasons why the US has continued to struggle to recover. His basic argument is that the rich have a lower marginal propensity to consume (the proportion of any increase in income spent) and a higher marginal propensity to save (the proportion of any increase in income not spent) than the poor.

Such inequality also creates unsustainable 'property-price bubbles' as wealthy individuals increase the demand for property to let out on the rental market which further fuels inflation. Tax receipts, which could be injected into the economy, also end up being reduced, as the rich are able to exploit loopholes to avoid payment of tax. For this reason, Stiglitz argues that it is necessary for the US Government to intervene to deal with inequality. If the incomes of the poor were raised, increased consumption would occur. This argument is refuted by Paul Krugman, who states that there are some European economies with much lower income inequality which are also in a mess.

Source: News reports, 2013

7. Which one of the following is an injection into the circular flow of income of the UK?

A UK households buying goods from UK firms out of their current income ⬭

B The purchase of raw materials by UK firms from abroad ⬭

C UK firms retaining some of their income as profit ⬭

D The government spending money on old age pensions ⬭

[1 mark]

8. Taking into account the news report, **Brazil: The Hot 'BRIC' Extract D** and the original evidence, do you recommend that the company should invest in Brazil? Justify your recommendation.

[25 marks]

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9. In an economy, the marginal propensity to consume is 0.6. All other things being equal, which one of the following statements is correct?

A A £5 billion reduction in the economy's national income will result in a £3 billion fall in consumption ⬭

B If injections into the circular flow of income equal £20 billion, national income will equal £32 billion ⬭

C If injections into the circular flow of income rise by £10 billion, national income will rise by £6 billion ⬭

D When the economy's national income equals £100 billion, consumption will equal £60 billion ⬭

[1 mark]

10. An injection into an economy, with a marginal propensity to consume of 0.8, leads to a total increase in national income of £350 million. What was the value of the initial injection?

A £35 million ⬭

B £70 million ⬭

C £120 million ⬭

D £280 million ⬭

[1 mark]

11. **Extract F** (lines 7–8) states: 'Economists said the data reinforced the view that the slump in South Korea's trade-reliant economy would continue beyond this year'.

Using the data in the extracts and your knowledge of economics, evaluate policies which could be used to boost South Korea's exports and increase its trade surplus.

[25 marks]

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