AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



EXAM QUESTION PACK

3.2.2.4 AGGREGATE DEMAND AND THE LEVEL OF ECONOMIC ACTIVITY

SCORE	PERCENTAGE
/251	%

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1. Explain how the data in **The Balance of Payments Extract D** show that increasing growth in real GDP frequently leads to an increased deficit in the balance of trade in goods and services.

[4 marks]

2. In the past few years, CPI inflation has often differed by more than 1% from its 2% target. In the winter of 2015 the UK experienced a brief period of deflation but, more recently, inflation has been over 3%.

Evaluate the view that inflation is always preferable to deflation.

[25 marks]

3. **The Balance of Payments**

Extract E: Re-balancing the UK economy

The UK government wants to re-balance the economy more towards investment, manufacturing and exports, and away from consumption and government spending. Manufacturing only accounts for around 11% of what is produced in Britain, while the service sector accounts for over three-quarters of UK GDP.

Britain, which until recently exported more to Ireland than to the combined BRIC economies (Brazil, Russia, India, and China), wants to export more to emerging economies and help its companies access the fastest-growing markets in the world.

In 2012, Britain's trade deficit hit its highest level since 2007. The hope was that with sterling having lost about a quarter of its value since the financial crash five years previously, this depreciation would have boosted exports in the same way that it did during the early 1990s, when the pound depreciated after a sterling crisis. The last time that Britain had a trade surplus was towards the end of that decade, in 1997.

Source: news reports, February 2014

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4.

Brazil: The Hot ‘BRIC’

Extract B: Brazilian economy

Brazil has a mixed economy with abundant natural resources. It has been the world's largest producer of coffee for the last 100 years and it will shortly become one of the world's top ten oil producers. Brazil also has a strong manufacturing sector. For example, it is a likely source of the A4 paper you use in your printer, and its Bandeirante Corporation has long competed with aerospace giants as a world-class manufacturer in the niche market of short-haul commuter aircraft. By value, it ranks as the 23rd largest exporter in the world. However, the discovery of oil off the coast of Brazil has led to an appreciating currency; this makes life more difficult for domestic manufacturers.

Brazil is the world's fifth largest country by both population and total area. It has grown rapidly over the last thirty years and is now the world's seventh largest economy. It has the fourth largest car market in the world. From 1980 to 2011, Brazil's Human Development Index increased by 30.8%. However, Brazil is also well known for its inequality, and there is much rural and urban poverty. Many of its large cities contain crowded and deprived slum districts known as favelas. Brazil's health care system ranks 125th out of 190 countries.

Brazil currently dominates Foreign Direct Investment (FDI) into Latin America and in 2011 it attracted about one third of all the FDI into the region. FDI creates jobs and contributes to improvements in human capital as foreign companies often invest in their workforce. New investment has a multiplier effect and the resultant growth in GDP generates higher tax revenues for the Brazilian Government. However, there are also the environmental effects to consider. Many overseas companies that are located in Brazil export part of their output but some of their profits are sent abroad.

Source: News reports, October 2013

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5. **The Balance of Payments**

Extract D: UK trade figures and real GDP growth 2006 - 2012

	UK trade balance			Real GDP (% change on previous year)
	Trade in goods (£ million)	Trade in services (£ million)	Balance of trade in goods and services (£ million)	
2006	-76 842	41 643	-35 199	2.8
2007	-90 535	53 802	-36 733	3.4
2008	-94 261	61 689	-32 572	-0.8
2009	-82 933	59 560	-23 373	-5.2
2010	-98 585	65 733	-32 852	1.7
2011	-100 092	76 832	-23 260	1.1
2012	-108 700	75 319	-33 381	0.3

Source: news reports 2014

6. 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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7. Using **Brazil: The Hot 'BRIC'**, explain how Brazil is likely to benefit from inward investment by a UK car manufacturer.

[15 marks]

8.

Brazil: The Hot 'BRIC'

Extract D: News report – Is Brazil in trouble?

In June 2013, more than a million citizens across Brazil took to the streets to protest against political corruption, poor healthcare, inadequate schools, substandard public transport and crumbling infrastructure. This is in a country which is reported to be spending $13.3 billion to host the 2014 World Cup and $18 billion to host the 2016 Olympic Games.

In February 2014, the Brazilian currency, the real, is also making the headlines. In recent months it has collapsed against the pound. A year ago, visitors to Brazil would have got 2.70 real for £1 but now the rate stands at 3.61 to the pound. The fall in the value of the real is in response to a widening budget deficit and fears that the government's credit rating will be reduced. In response, the central bank has raised its base interest rate to 10.75%.

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9. Which one of the following macroeconomic policies is a Keynesian economist most likely to recommend as a means of stimulating recovery for an economy that has been in recession for several years?

A Increasing taxes to finance increased government expenditure. ⬭

B Increasing the money supply to maintain very low interest rates. ⬭

C Increasing government expenditure financed by increased government borrowing. ⬭

D Cutting government expenditure to balance its budget. ⬭

[1 mark]

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10.

Brazil: The Hot 'BRIC'

Extract C: How does Brazil compare with the UK?

Selected data for the UK and Brazil (2013 unless otherwise stated)

	UK	Brazil
GDP (PPP)	$2.39 trillion	$2.42 trillion
Real GDP per head (PPP)	$36,600	$12,100
Real GDP growth per capita (2000–2012)	1.14% per annum	2.27% per annum
Average growth (2000–2012)	1.72% per annum	3.41% per annum
Human Development Index (HDI)	0.875 (World ranking 26)	0.730 (World ranking 85)
Unemployment	7.7%	5.5%
Inflation	2.7%	6.2%
Current account of the balance of payments (%GDP)	–2.41%	–3.83%
Public sector debt (%GDP)	91.1%	59.2%
Budget balance (%GDP)	–7.4%	+1.6%
Industry %GDP	20.5%	26.4%
Services %GDP	78.9%	68.1%
Gini coefficient	34.0	54.7
Share of income of the poorest 10% of the population	2.1%	0.8%
Share of income of the richest 10% of the population	28.5%	42.9%
Years of schooling	16 yrs	14 yrs
Literacy rate	99%	90.4%
Life expectancy	80.3 yrs	73.0 yrs
Infant mortality rate	4.5 per thousand live births	19.8 per thousand live births
Population	63.4 million	201.0 million

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Population, % over 65	17.3%	7.3%
Population, % under 15	17.3%	24.2%

Source: The World Factbook 2013–14. Washington, DC: Central Intelligence Agency, 2013.

Note: PPP = purchasing power parity

11.

Brazil: The Hot 'BRIC'

Extract A: Who are the BRICs?

The BRIC label was first coined by the investment bank Goldman Sachs and refers to a group of four large developing countries (Brazil, Russia, India and China), distinguished from other promising emerging markets by their potential to rank among the world's largest and most influential economies by the mid-21st century. Their potential is largely due to their natural resources, the size and structure of their population, their attitudes to investment and trade, and their capacity for technological progress. The four BRIC economies have a combined population of over 2.8 billion, about 40% of the world's population. They also produce more than a quarter of the world's output.

Analysts have suggested that, to enable a country to realise its potential for growth, there is a number of conditions that need to be met. These include:

- a suitable level of human capital, for example, in relation to education, inequality and life expectancy
- a stable macroeconomic environment, for example, as reflected in indicators of inflation, growth and government borrowing
- access to current technologies such as the Internet and mobile communications
- a stable political environment including the rule of law and the absence of widespread corruption.

Source: News reports, October 2013

12.

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]

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13.

Government policy

Extract E: Rising rates?

The Bank of England warned that interest rates might rise as early as next year as its chief economist said the desire to keep borrowing costs low for several years could be damaged by stronger than expected growth. Spencer Dale, one of the nine members of the interest rate-setting Monetary Policy Committee, said the UK may soon be growing at an annual rate of between 3 and 4% and the Bank could not be certain when it might need to tighten policy.

Following guidance issued by the Bank in August, the City is expecting interest rates to remain on hold at their record low of 0.5% until at least 2015. But Dale said that in certain circumstances an increase could happen as soon as 2014. "The big message is that monetary policy is going to remain loose for a considerable period of time. I can't be sure whether that means it will be tightened in 2015 or 2016."

The Bank said in August that, unless there was a risk from inflation or an over-heating property market, it would only start thinking about raising interest rates when unemployment had come down to 7% from 7.7% currently, something it did not expect until 2016. But the recovery in the economy, seen since the spring, has left many in the City convinced that the Bank will be forced to take action before then.

Dale said he welcomed the fact that the housing market was recovering, and saw no immediate threat of a house price bubble. It was 'great' for the construction sector that more houses were being built, and the increase in mortgage approvals would boost demand for professional services and lead to greater labour mobility. "It is good for consumption, because there is quite strong evidence that when people move home they go out and change the carpets and buy new furniture."

Source: News reports, 2013

14.

In 2013, two key aims of the UK Government were: to move the budget deficit towards a surplus over the course of the Parliament and to ensure that the main burden of deficit reduction would be through reduced government spending, rather than increased taxation.

Explain the possible demand-side consequences of an increase in taxation in the UK.

[15 marks]

15.

Government policy Extract E (lines 4−6) states ‘the UK may soon be growing at an annual rate of between 3 and 4% and the Bank could not be certain when it might need to tighten policy.’

With the help of a diagram, explain why interest rates may need to rise if growth rates increase.

[9 marks]

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16. Assuming that the value of the marginal propensity to consume is 0.6, which of the following changes in national income would result from an increase in exports of £19bn?

A £31.7bn ⬭

B £47.5bn ⬭

C £76bn ⬭

D £114bn ⬭

[1 mark]

17. **Extract F** (lines 4 – 6) states: 'some are now arguing that further improvements in the unemployment statistics can only be gained through improvements in the supply-side of the economy, rather than relying on demand.'

To what extent do you agree that a further reduction in the UK's unemployment rate is most likely to be achieved by improvements in the supply-side rather than the demand-side of the economy? Use the data and your own knowledge of economics, to justify your answer.

[25 marks]

18. It is now nearly a decade since the financial crisis caused a recession in the UK. In March 2009, the Monetary Policy Committee (MPC) set the UK Bank Rate at 0.5%, which was a record low, in order to stimulate economic growth.

Explain the main features of a recession.

[15 marks]

19. In January 2009, £1 could buy approximately 1.04 euros on the foreign exchange market. By July 2015, £1 could buy approximately 1.44 euros.

Explain the factors that may lead to a rise in the exchange rate of a currency.

[15 marks]

20. Explain the term 'foreign direct investment' (**Extract E**, line 7) **and**, with the help of a diagram, analyse how foreign direct investment **and** improvements to infrastructure may boost productivity.

[9 marks]

21. The Government has ruled out the possibility of a rise in VAT before 2020 but other indirect taxes may increase. It has also stated that the personal income tax allowance will be increased from £10 800 in 2015/16 to £12 500 by 2020, and plans to cut the main rate of corporation tax from 20% to 17%.

Evaluate the economic consequences for the UK economy of a significant shift in the burden of taxation from direct taxes to indirect taxes.

[25 marks]

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Explain how changes in both government spending **and** taxation might affect the level of economic activity.

[15 marks]

23. **Extract F** (lines 19–20) states 'What is not clear is what should be done if low inflation turns to bad deflation.'

Using the data in the extracts and your knowledge of economics, evaluate the view that monetary policy is the most effective way of tackling deflation in developed economies such as the UK and Japan.

[25 marks]

24. **Extract F** (lines 10–12) states 'The Austrian economist, Friedrich Hayek, highlighted artificially low interest rates and excessive credit creation as being the main causes of cyclical instability.'

Using the data in the extracts and your knowledge of economics, evaluate the view that maintaining low interest rates for a sustained period of time may be damaging to the UK's macroeconomic stability.

[25 marks]

25. The marginal propensity to consume (MPC) in an economy is 0.5. If the MPC increases by 20% the new value of its multiplier will be

A 2.0 ⬭

B 2.5 ⬭

C 5.0 ⬭

D 10.0 ⬭

[1 mark]

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