

AQA A-LEVEL ECONOMICS • 7136

ECONOMICS



EXAM QUESTION PACK

3.2.2.5 DETERMINANTS OF SHORT-RUN AGGREGATE SUPPLY

SCORE

/160

PERCENTAGE

%

STEMUP

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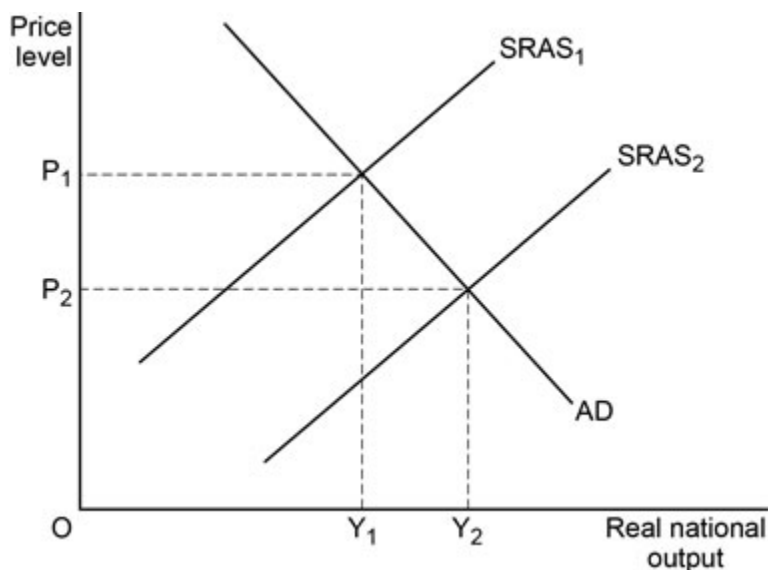
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1.

The diagram below shows the aggregate demand (AD) and two short-run aggregate supply (SRAS) curves for an economy.



All other things being equal, which one of the following is most likely to cause the short-run aggregate supply curve to shift from $SRAS_1$ to $SRAS_2$?

- A A fall in the size of the labour force
- B An increase in imports
- C An increase in the value of the multiplier
- D Lower world commodity prices

☐
☐
☐
☐

[1 mark]

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%.

Explain the main causes of a rise in inflation.

[15 marks]

3.

After a period of inflation below the target rate, the Consumer Price Index (CPI) inflation rate was recorded as -0.1% in early 2015. The Governor of the Bank of England wrote: 'A temporary period of falling prices, driven by large adjustments in a few specific components of the CPI, is a fundamentally distinct phenomenon from 'deflation'...The UK is not experiencing 'deflation'.'

Explain the possible causes of deflation in an economy.

[15 marks]

4.

'Oil, as a form of energy, reigns supreme but it has brought significant problems to economies in terms of inflation in particular, and the potential for economic instability in general.'

Discuss how rising oil prices might affect the macroeconomic performance of an economy.

[25 marks]

5.

Extract F (line 21) asks: 'Why are productivity rates in other economies important for the UK?'

Using the data and your knowledge of economics, evaluate the significance of productivity improvements in the UK **and** in other EU economies for the performance of the UK economy.

[25 marks]

6.

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]

7.

Extract C (lines 21 – 22) states: 'Any kind of deal between the EU and ASEAN economies is still a long way off, and the UK must wait to see how new trade deals affect its macroeconomic performance.'

Using the data and your knowledge of economics, evaluate the extent to which international agreements to increase free trade are likely to be beneficial to the UK's macroeconomic performance.

[25 marks]

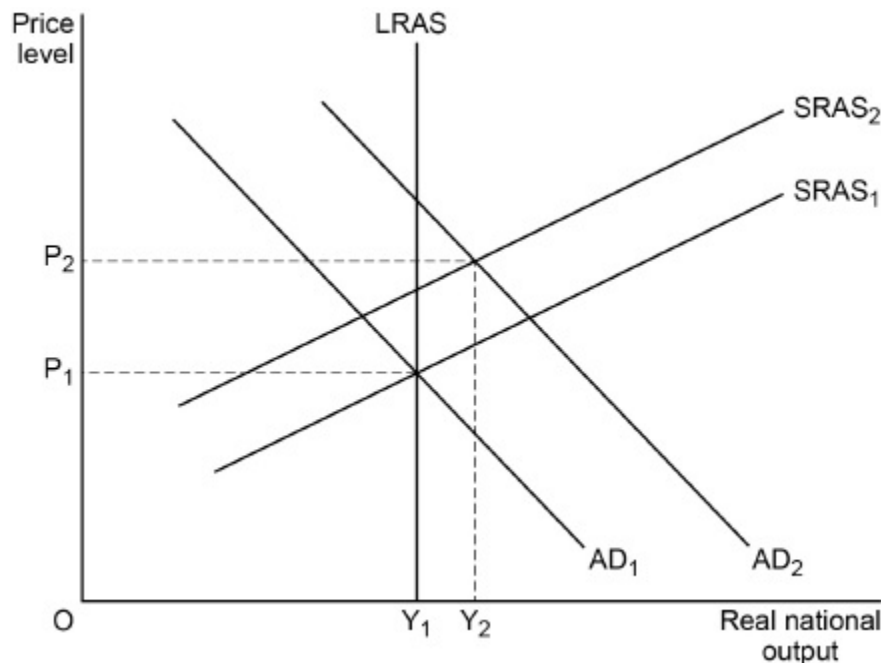
8.

Explain the term 'comparative advantage' (**Extract B**, line 17) **and**, with the help of a diagram, analyse **two** causes of increased globalisation in the world.

[9 marks]

9.

The diagram below shows two aggregate demand (AD) curves, two short-run aggregate supply (SRAS) curves, and the long-run aggregate supply (LRAS) curve for an economy.



The increase in the price level from P_1 to P_2 raises the rate of inflation above the target rate set by the government. In an attempt to bring inflation back to its target rate, the central bank announces a change in interest rates. Other things being equal, this is most likely to

- A create upward pressure on the exchange rate.
- B increase bond prices.
- C make business loans more affordable.
- D reduce the cost of servicing the national debt.

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☐
☐

[1 mark]

10.

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]

11.

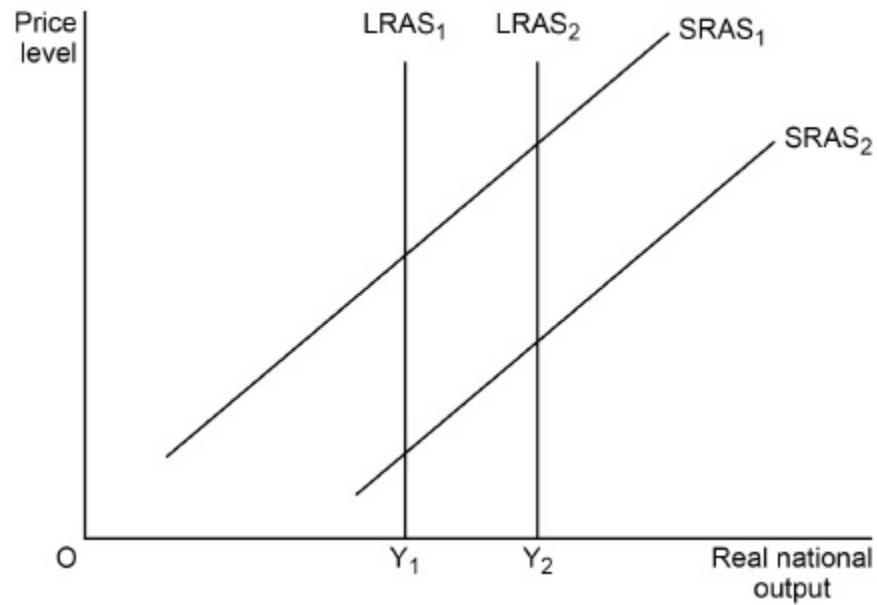
Extract E (lines 9–10) states ‘Improvements in productivity on the supply side of the economy could actually lead to more deflation.’

With the help of a diagram, explain how improvements in productivity could cause deflation.

[9 marks]

12.

The diagram below shows two long-run aggregate supply (LRAS) and two short-run aggregate supply (SRAS) curves for an economy.



All other things being equal, which one of the following is most likely to explain the movement to the right of both the short-run and long-run aggregate supply curves?

- A A large increase in the availability of renewable energy within the economy
- B An increase in employment and a depreciation of the exchange rate
- C An increase in the natural rate of unemployment and the level of money wage rates
- D A supply-side shock to the economy which increases the rate of inflation

☐☐☐☐

[1 mark]

Mark schemes

1.

D

[1]

2.

Relevant issues include:

- definitions/explanations: inflation, cost-push inflation, demand-pull inflation, the general price-level, price indices
- explaining possible causes of rises in demand-pull inflation through an increase in the components of AD such as:
 - increased consumption due to the falling unemployment
 - increased investment due to falling interest rates
 - increased government spending due to a discretionary policy to raise welfare spending, e.g. pensions
 - increased exports due to higher economic growth in a trade partner
 - decreased imports and increased exports due to a depreciation in the currency
 - a rise in the money supply supporting the monetarist view and using the Fisher equation
- explaining possible causes of rising cost-push inflation through an increase in the costs of the factors of production such as:
 - rising wage costs
 - rising raw material costs
 - rising commodity prices such as oil
- explaining external shocks which may impact upon inflation
- explain microeconomic issues which may impact upon inflation such as rising housing costs affecting the RPI measure or possible collusion in energy markets affecting domestic fuel prices
- explaining possible short-run reasons for increases in prices and long-run reasons.

The use of relevant diagrams to support the analysis such as rising AD/AS should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 15 marks
3	A good response provides an answer that: - is well organised and develops a selection of the key issues that are relevant to the question - shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors - includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response - includes well-focused analysis with clear, logical chains of reasoning.	11 – 15 marks
2	A reasonable response provides an answer that: - focuses on issues that are relevant to the question - shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present - includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response - includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	6 – 10 marks
1	A weak response provides an answer that: - has identified one or more relevant issues - has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely - has very limited application of relevant economic principles to the given context and/or data to the question - might have some limited analysis but it may lack focus and/or become confused.	1 – 5 marks

[15]

3.

Explanation

For defining / explaining

- Deflation / Inflation
- Malign / Benign deflation
- Methods of measurement (CPI/basket of goods)

Up to 2 marks per definition or explanation to a maximum of 4 marks

Award 1 mark for each step in a logical chain of reasoning:

For example: The use of supply-side policies (1 mark) such as subsidies for research and development (1 mark) may lead to the creation of improved efficiency in production techniques (1 mark) which may lead to improvements in productivity (1 mark) and therefore increase the output per worker (1 mark) which may mean fewer workers are needed to produce the same amount of goods (1 mark) which will reduce the average unit cost (1 mark). This may be passed on to customers in the form of lower prices (1 mark) will lead to a fall in cost-push inflationary pressure (1 mark) and potentially benign deflation (1 mark). Other examples include: Falling oil and other commodity prices, any component of aggregate demand falling for a reason such as high interest rates affecting consumption, lack of confidence reducing investment, increased international competition, government attempts to reduce the budget deficit by spending cuts or recession in the Eurozone damaging exports.	Up to 15 marks
Use of diagrams to help support explanations, e.g. AD falling, SRAS increasing, LRAS increasing	Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 4 marks.
Reference to the UK and/or other economies.	1 mark per reference to a maximum of 2 marks

[15]

4.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and / or other issues in the time available.

Issues and areas for discussion include:

Introduction:	- reference to the quote in the question - the recent experience of rising oil prices - criteria for assessing macroeconomic performance
Developing a response to the question:	- the implications of this for the pattern of production - consequences for the balance of payments on current account - inflation - the impact of inflation on jobs - the impact of inflation on economic growth - rising oil prices and business and consumer confidence - implications for government revenue and expenditure - the impact on export performance
Evaluation:	- whether the oil price increases are simply building on past price increases or whether they represent a supply-side shock of which there has been little or no recent experience - whether or not petrol taxes are reduced to compensate for higher oil prices - mature economies having less dependency on oil - whether price increases are sustained over a long period of time - whether, as in the UK's case, an economy is also an oil exporter as well as an importer - whether rising economic growth and inflation-reducing forces are in evidence to dull the impact of rising oil prices
Also give credit for:	- relevant use of evidence and examples from the UK / other economies - diagrams

[25]

5.

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	Good analysis <u>and</u> good evaluation	22 to 25 marks <i>Mid-Point 24 marks</i>
Level 4	Good analysis <u>but</u> limited evaluation OR Reasonable analysis <u>and</u> reasonable evaluation	17 to 21 <i>Mid-Point 19 marks</i>
Level 3	Reasonable including some correct analysis <u>but</u> very limited evaluation	10 to 16 <i>Mid-Point 13 marks</i>
Level 2	Weak with some understanding	4 to 9 <i>Mid-Point 7 marks</i>
Level 1	Very weak	0 to 3 <i>Mid-Point 2 marks</i>

Issues and areas for discussion include

Introduction	• Productivity improvements • The EU economy • Macroeconomic performance.
Developing the response to the question: (Application)	• Improvements to infrastructure & investment (Extract E) • Difficult to improve productivity in some jobs (Extract E) • Links to living standards (Extract E) • Links to wages (Extract E) • Improvements in skills (Extract E) • Improvements to competitiveness (Extract F) • Solutions to unemployment problems (Extract F) • Boosts to welfare and lower prices (Extract F) • Product and process innovation (Extract F) • Structural weakness and lack of investment (Extract F)
(Analysis)	Arguments why productivity improvements may benefit the UK • Improvements in efficiency • Lower unit costs for firms and potential for increased profits • Improved competitiveness and the impact on the current account of the balance of payments • If UK productivity improvements can be achieved it may attract FDI and improve the capital account of the balance of payments • Higher wages • Economic growth • Possible boosts to tax revenue Arguments why productivity improvements may not benefit the UK • Productivity improvements may not require as many workers and impact on unemployment • Other countries may become more competitive at the UK's expense • If other countries are more competitive then it may divert FDI • Productivity improvements don't necessarily improve living standards • Other issues such as exchange rates may distort productivity gains • Opportunity cost of supply-side policies • Difficulties in measuring the impact of supply-side policies
Evaluation	• Potential conflicts between macroeconomic goals are traditionally reduced through productivity improvements. However, due to globalisation this may not always be the case • The UK's membership of the EU allows productivity improvements to be shared easily due to the free movement of workers and capital although this doesn't appear to have helped the UK's current membership • Knowledge transfer and process innovation have improved between economies however, the UK has still remained behind • Competitiveness relies on many other factors which are not covered by productivity • Consideration of UK's decision to leave the EU <i>Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is</i>

	<i>important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.</i>
Also give credit for	• Reference to the UK / other economies • Diagrams • An overall judgement on the issues raised

It will only be possible for candidates to consider a few of the above. They may also discuss other issues not mentioned above.

[25]

6. The anticipated diagram would make appropriate use of diagrams, e.g. LRAS shifting right, SRAS shifting right, PPF's or AC curves.

Relevant issues include:

- Definition of investment.
- Explaining this in terms of a business entity in one country gaining ownership in another.
- Explaining the difference between FDI and portfolio investment.
- Increased foreign direct investment (FDI) by possibly bringing new technology or production processes into an existing firm which may reduce the need for labour to gain the same output and therefore boosts labour productivity.
- Improvements to infrastructure carried out by government capital spending such as improvements to motorways may allow transport costs to fall allowing the company to produce the same output for lower cost and boosts to efficiency and productivity.
- Research and development and increased competition due to FDI.
- Different forms of transport and communication links for infrastructure.

[9]

7. In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	Good analysis <u>and</u> good evaluation	22 to 25 marks <i>Mid-Point 24 marks</i>
Level 4	Good analysis <u>but</u> limited evaluation OR Reasonable analysis <u>and</u> reasonable evaluation	17 to 21 <i>Mid-Point 19 marks</i>
Level 3	Reasonable including some correct analysis <u>but</u> very limited evaluation	10 to 16 <i>Mid-Point 13 marks</i>
Level 2	Weak with some understanding	4 to 9 <i>Mid-Point 7 marks</i>
Level 1	Very weak	0 to 3 <i>Mid-Point 2 marks</i>

Issues and areas for discussion include

Introduction	• Macroeconomic performance • Trade • Free trade or trading blocs
Developing the response to the question: (Application)	• Focussing on improving trade in services (Extract B) • Sharing technology (Extract B) • Boosting exports, competition and investment (Extract B) • Improving international relations (Extract B) • Growth of Asian economies in comparison to slow EU growth (Extract C) • Problems for trade unions and environmental issues (Extract C) • Regional inequality (Extract C) • Unfair competition from state subsidised industry (Extract C) • Increasing power of MNCs in comparison to elected government (Extract C)
(Analysis)	Arguments why free trade agreements may benefit the UK: • Effects of increased export opportunities on output and employment • Effects of increased inward investment on output and employment • Impacts on the price of imports / semi-manufactures • Economies of scale and the effects on price level • Boosts to productivity and output • Benefits of competitive markets and sharing of technologies • Boosts to international relations • Improved choice / quality • Comparative advantage and the gains from trade. Arguments why free trade agreements may damage the UK: • The UK is unable to use protectionist policies such as quotas, tariffs, export subsidies • Possibly open to more external shocks • Sunrise / sunset industry arguments • May be subject to increased price fluctuations / instability • Loss of potential tariff revenue (although this is not directly received in the EU) • Cultural and strategic industry arguments • May be unable to protect against “dumping” • Environmental issues with increased transportation • Unclear growth and employment effects • Problems for small business in comparison to MNCs • May give an impetus to further deregulation / privatisation.
Evaluation	• The UK being unable to negotiate their own deals due to EU membership at the moment, however after we leave the EU it can conduct its own negotiations. • The EU currently not having deals in place in comparison to other economies • Benefits and costs depending on the various stakeholders points of view and short-term benefits, such as lower prices, may have long-term costs such as increased structural unemployment

	- Regions of the UK may experience different impacts - Trade deals may be done which don't directly involve the UK but could benefit it or could potentially damage it such as the TPP - References to UK's current situation affecting trade <i>Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.</i>
Also give credit for	- Reference to the UK / other economies - Diagrams - An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss issues not discussed above.

[25]

8.

Anticipated diagrams might utilise the SRAS shifting right, micro diagrams demonstrating falling costs, removal of tariffs/quotas.

Relevant issues include:

- A relevant definition of comparative advantage.
- The difference between acquired and natural comparative advantage.
- The difference between absolute advantage and comparative advantage.
- A numerical example / diagram.
- Improved communication through developments in technology, such as the internet has allowed individuals to order goods across international borders.
- Further to this, international pay sites such as PayPal facilitate the easy exchange of currency with minimal transaction costs which has increased the volume of goods and services traded abroad.
- The work of the WTO
- Removal of protectionism
- Creation of trading blocs
- Economies of scale
- The role of MNC's
- Financial liberalisation
- Containerisation
- Reduced transport costs.

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9.

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10.

Areas for discussion include:

- definitions/explanations: burden of taxation, taxation, direct/indirect taxation, fiscal policy
- explaining the burden of taxation, expressed, for example, as a % of GDP
- describing the current forms of taxation used in the UK and recent changes
- explaining the principals of taxation such as equity
- giving examples of the various direct and indirect taxes
- identifying the differences between progressive, regressive and proportional tax
- the redistributive impact of direct and indirect taxation
- how falling direct taxes may:
 - incentivise work
 - reduce tax avoidance/evasion
 - influence consumption
 - influence investment
 - any other relevant point
- how rising indirect taxes may:
 - affect inflation
 - reduce consumption of demerit goods
 - affect SRAS
 - affect consumption decisions
 - affect wage demands
- evaluating the size of the shift
- evaluating empirical evidence
- evaluating the period of time over which the shift takes place
- policy myopia and political ideology affecting decisions
- the Laffer curve.

The use of relevant diagrams such as the Laffer curve to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 25 marks
5	Sound, focused analysis and well-supported evaluation that: • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	21 – 25 marks
4	Sound, focused analysis and some supported evaluation that: • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	16 – 20 marks
3	Some reasonable analysis but generally unsupported evaluation that: • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these are not well-supported by arguments and/or data.	11 – 15 marks
2	A fairly weak response with some understanding that: • includes some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • includes some limited application of relevant economic principles to the given context and/or data to the question • includes some limited analysis but it may lack focus and/or become confused • includes some evaluation which is weak and unsupported.	6 – 10 marks
1	A very weak response that: • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which, at best, is very weak • includes attempted analysis which is weak and unsupported.	1 – 5 marks

[25]

11.

Level of response	Response	Max 9 marks
3	• is well organised and develops one or more of the key issues that are relevant to the question • shows sound knowledge and understanding of relevant economic terminology, concepts and principles • includes good application of relevant economic principles and/or good use of data to support the response • includes well-focused analysis with a clear, logical chain of reasoning • includes a relevant diagram that will, at the top of this level, be accurate and used appropriately	7 – 9 marks
2	• includes one or more issues that are relevant to the question • shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles and/or data to the question • includes some reasonable analysis but it might not be adequately developed and may be confused in places	4 – 6 marks
1	• is very brief and/or lacks coherence • shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • demonstrates very limited ability to apply relevant economic principles and/or data to the question • may include some very limited analysis but the analysis lacks focus and/or becomes confused • may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects.	1 – 3 marks

An AD/AS diagram is expected, showing a rightward shift of the AS curve, this can either be LRAS or SRAS.

Relevant issues include

- definitions/explanations: productivity, supply side, deflation, price level
- possible causes of increased productivity
- relating productivity to supply-side policies (interventionist or market-based)
- linking productivity to average costs/costs of the factors of production
- linking productivity to increases in the long-run productive potential
- explaining the link between falling costs of production and the general price-level.

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12.

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