



Skoolumy

CAMBRIDGE A LEVEL ECONOMICS TOPICAL ESSAY QUESTIONS

AGGREGATE DEMAND AND AGGREGATE SUPPLY

PAST QUESTIONS

1. Vietnam's exports of fruit and vegetables to exceed US\$4 billion

The value of Vietnam's fruit and vegetable exports reached US\$1.3 billion in the first four months of 2018, a year-on-year increase of 30%, according to the Vietnam Ministry of Agriculture. With a high export growth rate in the past four years, the sector is expected to exceed the export target of US\$4 billion set for 2018.

A government spokesperson stated that because world trade in fruit and vegetables is worth US\$230 billion a year, with an annual growth rate of 3% to 5%, there is more scope for Vietnam to increase its fruit and vegetable exports. The spokesperson said that Vietnam must use more land to grow crops to export and build additional modern food processing facilities to take advantage of these opportunities.

The increase in the export of fruit and vegetables will add to Vietnam's current account balance. Fig. 1.1 below shows the balance of the current account of the balance of payments for Vietnam from Q1 2016 to Q2 2018.

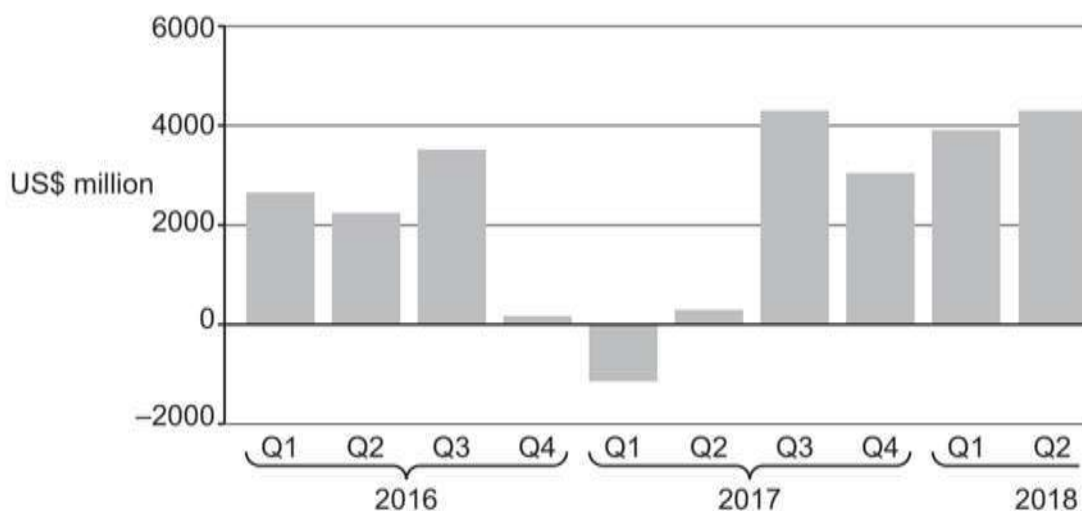


Fig. 1.1 Vietnam's current account balance, Q1 2016 to Q2 2018 (US\$ million)

Source: tradingeconomics.com, accessed October 2019

Despite its impressive results in exporting fruit and vegetables, Vietnam faces possible risks because it relies very heavily on China, its biggest fruit and vegetable

importer. China accounted for 77% of Vietnam's exports of fruit and vegetables in the first four months of 2018 while the United States, its second biggest importer, accounted for just 2.8% and Japan, its third biggest importer, accounted for 2.7%. Some analysts believe that Vietnam's agricultural sector in general, and fruit and vegetable producers in particular, should explore other potential countries for their exports.

According to the Vietnam Fruit and Vegetable Association, fruit and vegetable exporters face additional costs in complying with administrative burdens on trade, such as strict hygiene and food safety regulations. Vietnam's producers need to ensure that product quality is as high as possible and production costs as low as possible if they are to succeed.

Source: adapted from Vietnam News, 7 May 2018

Using aggregate demand and aggregate supply analysis, discuss the possible impact on Vietnam's economy of a sustained increase in its net exports. [6]

2. United States reduces dependence on foreign oil

In 2001, a United States (US) energy report warned that by 2020 the US could be importing two-thirds of its oil. If US oil consumption continued rising and production continued falling, imports would increase from 10 million barrels per day to about 17.5 million per day.

The forecasts were both wrong. US oil production has soared while consumption has fallen. It now looks more likely that the US will have only limited, if any, net oil imports by the end of the decade. China has now replaced the US as the world's largest oil importing economy.

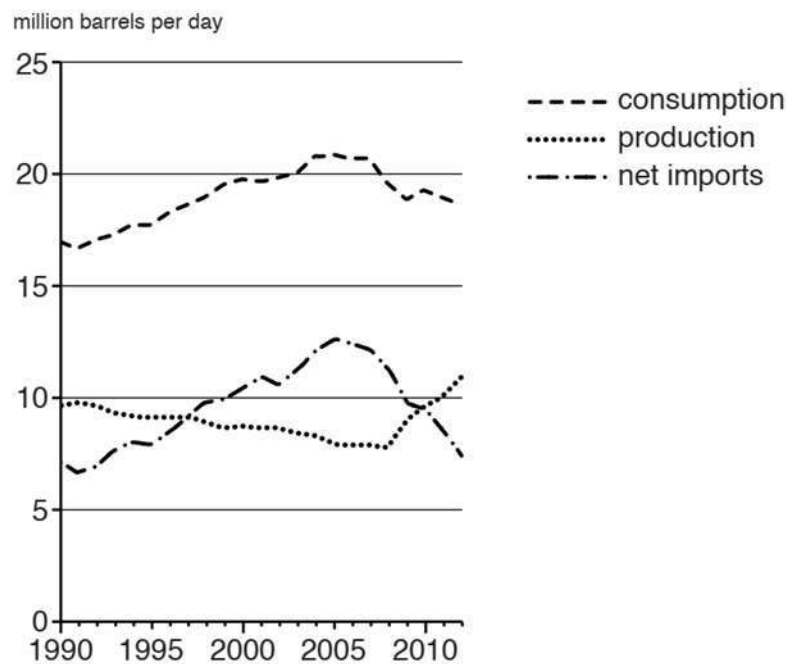
A new technique, known as hydraulic fracturing (fracking), has allowed access to new sources of oil in the US. As a result, US crude oil production has risen by 50% since 2008. In addition, the US now produces significant quantities of biofuel from

corn ethanol. This is a substitute for gasoline (petrol) obtained from crude oil and its production has increased by more than 300% in recent years.

In addition to new US oil supplies, what has been happening to demand is just as important. Falling enthusiasm for cars among younger Americans has reduced the country's need for oil.

Fewer young people are learning to drive and there have been declines in vehicle ownership per household and the total distance driven. At the same time, US cars are now more fuel-efficient.

Fig. 1: US oil consumption, production and net imports (1990–2012)



Source: Adapted from the US Energy Information Administration 'Energy Review'

Table 1: Annual average price of gasoline (petrol) in US

Year	US\$ per gallon including taxes
2007	2.85
2008	3.32
2009	2.40
2010	2.84
2011	3.58
2012	3.70
2013 (March)	3.79

Source: US Energy Information Administration

(a) With reference to Fig. 1, explain the trend in US net imports of oil after 2005. [3]

(b) Discuss how reducing dependence on foreign oil might affect aggregate demand in the US economy and the impact of this on prices and employment in the US. [6]

3. The Fiji economy: a positive outlook

Fiji is a small island country in the Pacific with a population of 860 000. In 2014 its economy was reported to be continuing to grow steadily. It remained on course for a fifth consecutive year of expansion, boosted by high tourist arrivals and visible export earnings, particularly from sugar. The factors that were expected to restrict growth in 2015 included ongoing dry weather conditions causing lower output of agricultural goods, with the exception of sugar.

Table 1: Selected economic indicators for Fiji

	2014 estimate	2015 forecast
Economic growth rate %	3.3	3.0
Inflation rate %	3.0	3.5
Current account balance as % share of GDP	−6.0	−7.0

Source: Asian Development Bank, 2014

Consumption remained strong in the first five months of 2014, and imports of consumer goods, mainly vehicles, rose by 15.6%. Personal remittances increased, boosting consumption expenditure.

The tourism sector – Fiji’s main source of foreign exchange – continued to perform strongly. Visitor arrivals increased by 4.0% year-on-year, with 4.6% more visitors from Australia and 11.6% more from New Zealand, but there was a significant fall in visitor arrivals from Japan.

Sugar production increased, aided by government investments in new technology that improved efficiency of production and reduced price.

Despite higher growth, inflationary pressures were eased by declining international commodity prices. However, annual average inflation in 2014 was not expected to fall below 3.0%, as economic activity was expected to revive. In addition, continuing dry weather was affecting the food supply.

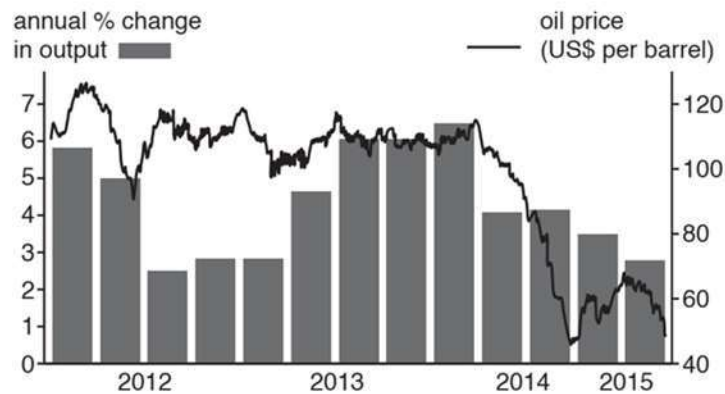
Despite the positive growth outlook, increased investment is needed to improve productivity and address supply-side capacity constraints.

Source: Asian Development Outlook 2014 Update

Using aggregate demand and aggregate supply analysis, explain why inflationary pressures remained subdued in Fiji despite higher growth. [3]

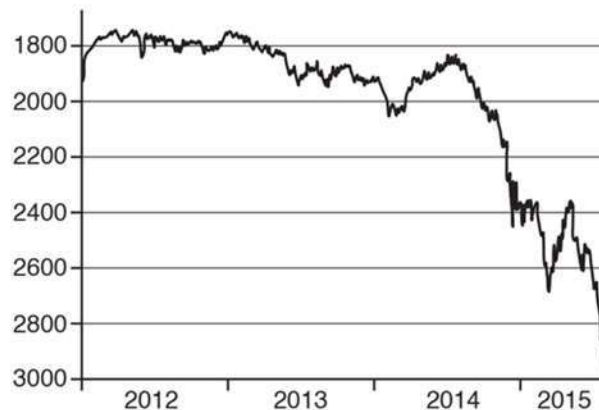
4. Fall in price of oil but Colombia can look forward to growth

Fig. 1: Colombia's growth and the oil price



Source: Thomson Reuters Datastream

Fig. 2: Colombian peso against the US dollar (peso per US\$), inverted scale



Source: Thomson Reuters Datastream

Over the past year, the halving of crude oil prices has hit Colombia and much of South America hard. Venezuela's economy, for example, is expected to shrink by 7% this year. Colombia's national oil production was running at 1 million barrels a year, accounting for half of its exports and a fifth of government revenues. In Puerto Gaitan, which only a year ago was the centre of Colombia's oil industry, the town's population had tripled to 45000 in just a few years. Property prices had soared and hotels overflowed. Today, though, business profits have fallen, leading to a fall in spending by entrepreneurs. "For Sale" signs now hang over Puerto Gaitan's closed stores, car parks in shopping malls are empty and 10000 people have left the town. Towns throughout Colombia are experiencing similar problems.

Colombia's government is feeling the effects as well. Every US\$1 drop in the oil price per barrel cuts an estimated US\$200 million from government revenues. As a result, the government has cut spending and raised taxes to keep its budget deficit down. More worryingly, the collapse in the price of oil has opened a large current account deficit equivalent to 7% of national income. Yet not all is bleak. Colombia's economy is forecast to grow this year. And unlike in neighbouring Venezuela, where oil accounts for more than 90% of exports, there is concern but no panic.

Firstly, the peso's depreciation could reverse Colombia's current account problems, boosting traditional exports such as coffee, textiles, car parts and flowers — if not to its immediate neighbours, then to the United States. Colombia produces oil, but it is not only an oil-producing country. Secondly, Colombia's government is having peace talks with Marxist rebels to end the country's five decades of unrest. The government's military expenditure will be reduced and estimates suggest that this 'peace dividend' could add as much as 2 percentage points to growth.

Source: The Financial Times, 2015

Use the information to explain how each of the components of aggregate demand in Colombia has been affected by the fall in the price of oil. [6]

5. (a) Explain three of the components of aggregate demand and consider the extent to which they may be increased without leading to inflation. [8]

(b) The Chinese government has re-emphasised its commitment to rebalancing the economy from one focused mainly on investment and exports to one aiming to increase the proportion spent on domestic consumption.

Assess the extent to which it would be possible to achieve this by fiscal policy alone. [12]

6. (a) With the help of a diagram, explain how increases in aggregate demand affect the level of real output and the price level in an economy and consider when such increases may become a problem. [8]

(b) Assess whether increases in aggregate demand are the best way of reducing unemployment in a high-income country. [12]

MARK SCHEME

Table A: AO1 Knowledge and understanding and AO2 Analysis

Level	Description	Marks
3	- A detailed knowledge and understanding of relevant economic concepts is included, using relevant explanations. Explanations are supported by examples, where appropriate. - The response clearly addresses the requirements of the question and explains economic issues, and fully develops these explanations. - Analysis is developed and detailed and makes accurate and relevant use of economic concepts and theories. Where necessary, there is accurate and relevant use of analytical tools such as diagrams and formulae, and these are fully explained. - Responses are well-organised, well-focused and presented in a logical and coherent manner.	6–8
2	- Knowledge and understanding of some relevant economic concepts is included, using explanations and examples that are limited, over-generalised or contain inaccuracies. - The response addresses the general theme of the question and the relevant economic issues, with limited development. - Analysis is generally accurate with some development but little detail. Uses analytical tools such as diagrams and formulae where necessary. Use of these tools is partially accurate or not fully explained. - Responses are generally logical and coherent but are sometimes lacking in focus or organisation.	3–5
1	- A small number of relevant knowledge points are included and the response is limited by significant errors or omissions. - The response has little relevance to the question. - Analysis where provided is largely descriptive. Use of analytical tools such as diagrams and formulae, where necessary, may contain significant errors or be omitted completely. - Responses show limited organisation of economic ideas.	1–2
0	No creditable response.	0

Table B: AO3 Evaluation

Level	Description	Marks
2	- Provides a justified conclusion or judgement that addresses the specific requirements of the question. - Makes developed, reasoned and well-supported evaluative comment(s).	3–4
1	- Provides a vague or general conclusion or judgement in relation to the question. - Makes simple evaluative comment(s) with no development and little supporting evidence.	1–2
0	No creditable response.	0

1. For an explanation of the potential advantages of a sustained increase in net exports using AD/AS analysis. (Up to 3 marks)

For an explanation of the potential disadvantages of a sustained increase in net exports using AD/AS analysis. (Up to 3 marks)

Reserve 1 mark for a conclusion

2. (a) The trend is downward (1 mark) because consumption is falling [1 mark] and production is rising. (1 mark)

If the explanation is not clearly linked to Fig. 1, even if it is a valid explanation, then there is a maximum mark of 2.

(b) For knowledge and understanding of $AD = C + I + G + (X - M)$. (1 mark)

For knowledge and understanding of AD equally consumption + investment + government expenditure – net exports. (1 mark)

For analysis showing that ‘reducing dependence on foreign oil’ would increase aggregate expenditure through an increase in net exports’. (Up to 2 marks)

For evaluation showing judgment about how the impact upon prices and employment depends upon the interaction of aggregate demand and aggregate supply in the U.S. economy. (Up to 2 marks)

3. For aggregate demand analysis that explains the potential impact of economic growth upon prices through increasing aggregate demand. [Up to 2 marks]

For aggregate supply analysis that explains how declining international commodity prices would increase aggregate supply to prevent price rises. [Up to 2 marks] [3 marks maximum]

4. For explaining how each component is affected with due reference to the data.

Consumption has fallen because of the fall in incomes and the rise in taxes. (Up to 2 marks)

Investment has fallen because of the fall in activity (Puerto Gaitan). (Up to 2 marks)

Government expenditure has fallen because of the fall in government revenues. (Up to 2 marks)

Net exports have fallen because of the fall in oil prices and export revenues. (Up to 2 marks)

(6 marks maximum)

(If only 3 components are explained, then 5 marks maximum)

Guidance:

Candidates need to interpret the data to explain how each of the four components has been affected.

5. (a) up to 3 marks for AO1 Knowledge and understanding

up to 3 marks for AO2 Analysis

up to 2 marks for AO3 Evaluation.

AO1 Knowledge and Understanding (max 3 marks)

For a clear and accurate explanation of three components of aggregate demand i.e., consumer spending, investment, government spending and / or net exports (1 x 3).

AO2 Analysis (max 3 marks)

For an analysis that explains that one cause of inflation is a situation where AD rises more than AS (1) but also considers why this may or may not occur e.g., the economy is operating at less than capacity, some of the increase in AD also increases AS etc.

(up to 2 marks)

Note. If both scenarios are considered, then full marks may be awarded. For one-sided answers, maximum mark of 1.

AO3 Evaluation (max 2 marks)

For an answer that clearly considers both sides (1) leading to a valid conclusion (1).

AO1 Knowledge and understanding 3

AO2 Analysis 3

AO3 Evaluation 2

(b) AO1 and AO2 out of 8 marks.

AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

- The analysis must focus on the usefulness of using fiscal policy to rebalance the economy in the way suggested. Domestic consumption can be boosted by a number of fiscal policies including policies on taxation and government spending, but the main problem would be achieving this in a sustainable way.
- This analysis must be compared with alternative policies including supply-side policies and monetary policies plus fiscal policies with a supply-side content.

Level 1 responses will be assertive and lacking in explanations / mainly descriptive and/or or mainly lacking in relevance to the question.

Level 2 responses may contain some inaccuracies and will be one sided.

Analysis will be explained at least in part and will be largely relevant to the question.

Level 3 responses will consider alternative policies / concepts etc. and will be balanced. Explanations of points raised will be offered and will be accurate and relevant to the question.

AO3 Evaluation

- For a full evaluation of more than one type of policy that clearly assesses and compares the potential usefulness of them to rebalance the Chinese economy leading to a valid conclusion.

Accept all valid responses.

AO1 Knowledge and understanding and AO2 Analysis 8

6. (a) up to 3 marks for AO1 Knowledge and understanding up to 3 marks for AO2 Analysis

up to 2 marks for AO3 Evaluation.

AO1 Knowledge and understanding (max 3 marks)

- An understanding of the components of AD i.e., $C+G+I+X-M$. (1)
- An accurately labeled AD/AS diagram showing the initial equilibrium point. (1)
- That also shows a shift or shifts to the right of the AD curve and the subsequent changes in the price level and real GDP. (1)

AO2 Analysis (max 3 marks)

- For an explanation of why AD might increase. (1)
- For an explanation of why this increase may not cause problems such as inflation e.g., because of the shape of the AS curve, because AS may increase in line with AD if the increase is due to an increase in I . (1)
- For an explanation of why it may cause problems e.g., the economy is at full capacity and AS cannot increase. (1)

AO3 Evaluation (max 2 marks)

For valid evaluation e.g., a recognition that increases in AD may result in an inflationary increase in the price level beyond the full employment level of output.

Reserve 1 mark for a justified conclusion.

Please use a text box to show the mark split e.g., 3 2 1

AO1 Knowledge and understanding 3

AO2 Analysis 3

AO3 Evaluation 2

(b) AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

- An understanding of what is meant by unemployment and the main types in a high-income economy.
- For a recognition that increases in aggregate demand arise normally from fiscal and / or monetary policy.
- An analysis of how policies to increase AD e.g., by reducing taxes, increasing government spending, reducing interest rates etc., may reduce cyclical unemployment but may not reduce structural unemployment.
- An analysis of how supply side policy may reduce unemployment by influencing AS e.g., through training and education, deregulation etc., but has limitations e.g., it is a long-term approach and may be costly and does not address the issue of falls in AD responsible for cyclical unemployment

Level 1 responses will be assertive and lacking in explanations / mainly descriptive and/or or mainly lacking in relevance to the question.

Level 2 responses may contain some inaccuracies and will be one sided. Analysis will be explained at least in part and will be largely relevant to the question.

Level 3 responses will consider alternative policies / concepts etc. and will be balanced. Explanations of points raised will be offered and will be accurate and relevant to the question.

L2 max if no reference to high-income countries

AO3 Evaluation

For a clear assessment as to whether increases in AD compared with increases in AS are the best way to reduce unemployment in a high-income economy leading to a justified conclusion.

N.B. if no reference to a high-income country, no evaluation marks may be awarded

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation. Please use a text box to show the mark split e.g., L2 5 L1 2

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4