Skoolumy

CAMBRIDGE A LEVEL ECONOMICS TOPICAL ESSAY QUESTIONS

CURRENT ACCOUNT

PAST QUESTIONS

1. Malaysian Trade

Tables 1 and 2 show selected data about Malaysia's international trade and were produced by the Department of Statistics and the Central Bank. Table 1 is valued in Malaysian ringgits (RM) and US dollars (US$). The figures in Table 2 are valued in Malaysian ringgits (RM).

Table 1 Current account balance

	(RM billions)		(US$ billions)	
	2000	2001*	2000	2001*
Current balance	31.2	22.1	8.2	5.8

Table 2 Exports and imports (RM billions) of visible items

	2000	2001*
Gross exports,	373.3	391.5
of which		
Manufactures	317.9	344.9
Minerals	26.8	20.8
Agriculture	22.9	20.0
Gross imports,	312.4	338.7
of which		
Capital goods	47.1	52.0
Intermediate goods	230.6	246.6
Consumption goods	17.4	18.8

*Forecasts

(a) (i) What change was forecast for the current balance between 2000 and 2001? [2]

(ii) How did the visible items, shown in Table 2, contribute to this change? [2]

(b) How might economic theory explain the composition of visible exports? [2]

(c) Should the Malaysian government be concerned about the figures for visible imports? [4]

(d) Identify two other pieces of data needed to calculate the overall balance of payments. [2]

2. (a) Explain how a country's balance of payments is organised to account for all its international transactions. [8]

(b) A country has a deficit on the current account of its balance of payments. Discuss whether this is necessarily harmful to the country. [12]

3. The Lagos economy is working

Nigeria discovered oil 50 years ago and is now the world's sixth biggest oil exporter. The recent increase in global oil prices has had a very large positive effect on the country's balance of trade and has also improved the country's terms of trade.

Lagos is the largest city in Nigeria, with a population of over 20 million, and has undergone a successful economic transformation in recent years. It has used the private sector to become the most productive and dynamic part of Nigeria's economy. The owner of one of Nigeria's largest companies has stressed the enormous economic progress that the country has made in recent years: "I'm a great believer in Nigeria because the opportunities here are enormous." His company's success shows what private enterprise can achieve in a mixed economy especially if it is provided with the right incentives by the government.

Most Nigerian entrepreneurs are operating in Lagos and entrepreneurship has certainly played a key role in the modern Lagos economy. Start-up initiatives have been encouraged and the need to be innovative has been increasingly recognised, leading to the development of new goods, services and markets. The city is the centre of thriving music, fashion, film and technology industries that have significant influence throughout Africa.

A ‘free trade zone’ on the edge of Lagos has been established where private sector firms pay no business taxes to the government and there are now numerous start-up enterprises that are thriving. The government aims to lower costs, reduce bureaucracy and make the economy more flexible and efficient with the hope of boosting trade. The zone is located next to a deep sea port and has good road connections with both the rest of Nigeria and other countries in the region.

Lagos is an important transport hub, with three major ports and West Africa’s most important international airport. In 2016 the output of Lagos was valued at US$136 billion while Nigeria’s total national output was valued at US$405 billion.

A former governor of the Nigerian central bank, has stated: “Since 2000, Lagos has been transformed. In terms of an improved infrastructure and a supportive economic environment, the government has given firms a greater opportunity to thrive.”

Source: Adapted from The Financial Times, 26 March 2018

(a) Calculate the percentage of Nigeria’s national output that is accounted for by Lagos. [1]

(b) Distinguish between a country’s balance of trade and its terms of trade. [3]

4. 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.

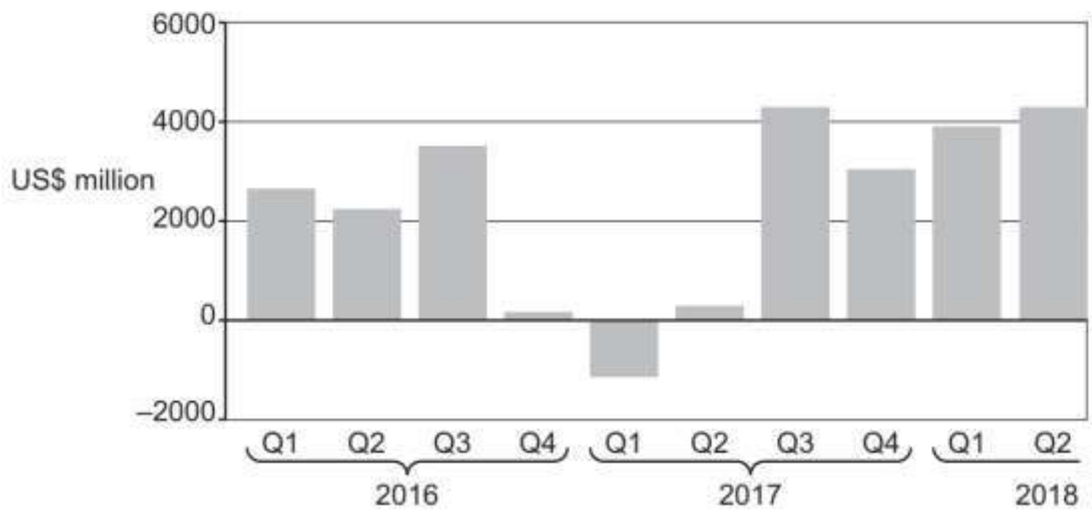


Fig. 1.1 Vietnam's current account balance, Q1 2016 to Q2 2018 (US$ million)

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

(a) Describe the overall trend in Vietnam's current account balance between Q1 2017 and Q2 2018. [1]

(b) Calculate the value of Vietnam's exports of fruit and vegetables to China in the first four months of 2018. [1]

5. Explain how a significant rise in the general price level will affect the current account of the balance of payments of an economy and discuss whether this is likely to turn a deficit into a surplus. [12]

6. 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

How and where would revenue from tourist arrivals in Fiji be recorded in Fiji's balance of payments? [2]

7. Trade tensions between China and the United States

At a World Economic Forum meeting in Switzerland in 2017, the Chinese President re-affirmed his country's commitment to free trade and pledged never to start a protectionist 'trade war' or to benefit from a devaluation of its currency, the yuan. Meanwhile, the United States (US) President stated that the 'America First' doctrine means increased protectionism and he repeatedly threatened to impose tariffs and import quotas on Chinese goods.

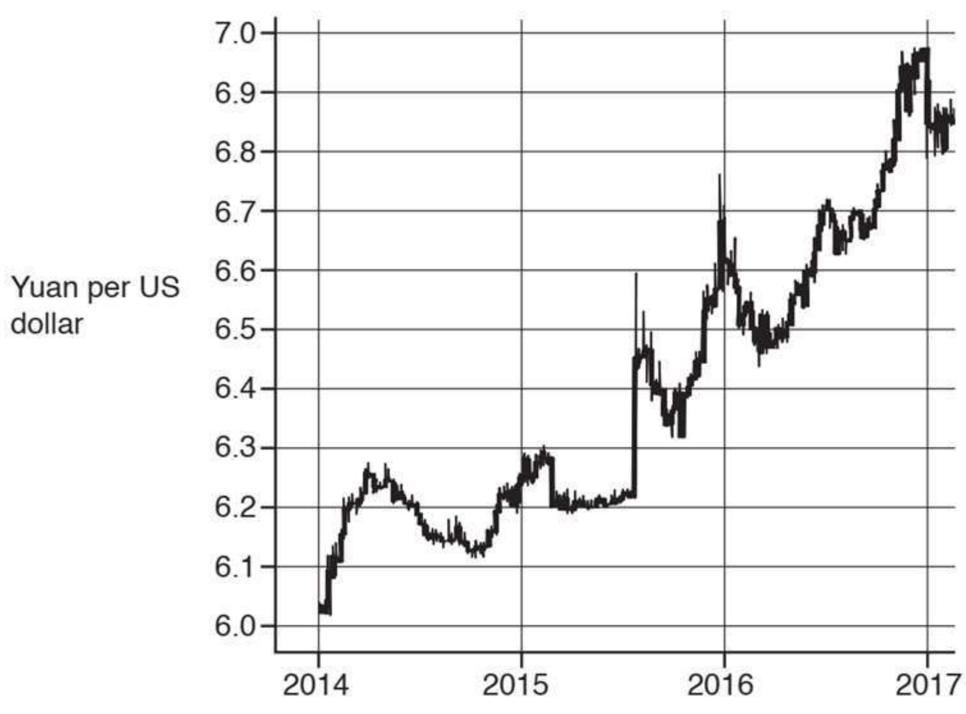
During 2016, the value of the US dollar rose against most currencies. In contrast, the Chinese yuan weakened significantly from 6.20 yuan per US dollar at the end of 2014 to 6.95 yuan at the end of 2016. The US President has accused China of intentionally devaluing the yuan in order to boost China's export competitiveness. Despite strong downward pressure on its currency, China has attempted to keep the yuan–US dollar exchange rate relatively stable, costing more than US$2 trillion of its official foreign exchange reserves. China has stated that it does not want the yuan to fall in value any more than the US does, but no country has complete over its exchange rate.

China, like Japan and Germany, usually has a current account surplus on the balance of payments, but China's current account surplus as a percentage of GDP fell in 2016 and the International Monetary Fund expects it to decrease further, as exports continue to fall.

There are three policy paths that a country can follow with regard to its exchange rate: a completely free float, a managed float or a fixed (pegged) exchange rate. Each of these has various advantages and disadvantages. At present, China's policy is a managed float, but some economists have argued that it is the yuan–US dollar exchange rate that is regarded as being especially important and so it might be better if China decided to fix (peg) the yuan to the dollar. Fig. 1.1 shows the yuan–US dollar exchange rate over three years.

Source: Adapted from China Daily, 10–12 February 2017

Fig. 1.1: Yuan–US dollar exchange rate, 2014–2017



Source: Trading Economics

Explain two effects of the fall in China's current account surplus for China's economy. [4]

8. Discuss whether a current account deficit is always a serious economic problem for a country. [12]

9. (a) Explain how the different international transactions of a country are recorded in its balance of payments account. [8]

(b) Discuss the use of tariffs and quotas as policies to reduce a current account deficit. [12]

10. Trade developments between Australia and Thailand

Table 1 Trade in goods between Australia and Thailand in 2002, all valued in Australian Dollars (A$)

Australian Exports	A$m	Australian Imports	A$m
Total	2510	Total	3140
Of which:		Of which:	
Gold	412	Vehicles	541
Aluminium	348	Petroleum	259
Cotton	186	Heating / cooling equipment	240
Dairy products	137	Seafood	221
Crude petroleum	115	Computers	113

In October 2003, Australia signed a trade agreement with Thailand. Under this, more than half of Thailand's 5000 import tariffs on Australian goods were abolished immediately and others were reduced. These tariffs covered Australian exports worth more than A$700 million in total. Thailand would abolish the remaining tariffs by 2020. An independent survey predicted that by 2023 these actions would raise the GDP of Australia by A$12 000 million and that of Thailand by A$46 000 million.

Table 2 Some of the immediate changes in Thailand's tariffs on Australian goods

Product	Old Tariff	New Tariff
Beef	51%	40%
Wheat	12-20%	0%
Wine	55%	40%
Large cars	80%	0%
Small cars	80%	30%

(a) Calculate the balance of trade in goods between Australia and Thailand in 2002. [2]

(b) What differences were there in the types of goods traded between the two countries? [2]

(c) Explain what might have caused these differences. [4]

11. (a) Explain the difference between expenditure-switching and expenditure-dampening policies as a means of correcting a balance of payments disequilibrium. [8]

(b) Outline the current account position of your country or another economy you have studied.

Discuss its ability to improve its performance on the current account. [12]

12. (a) Explain what is meant by a current account deficit. [8]

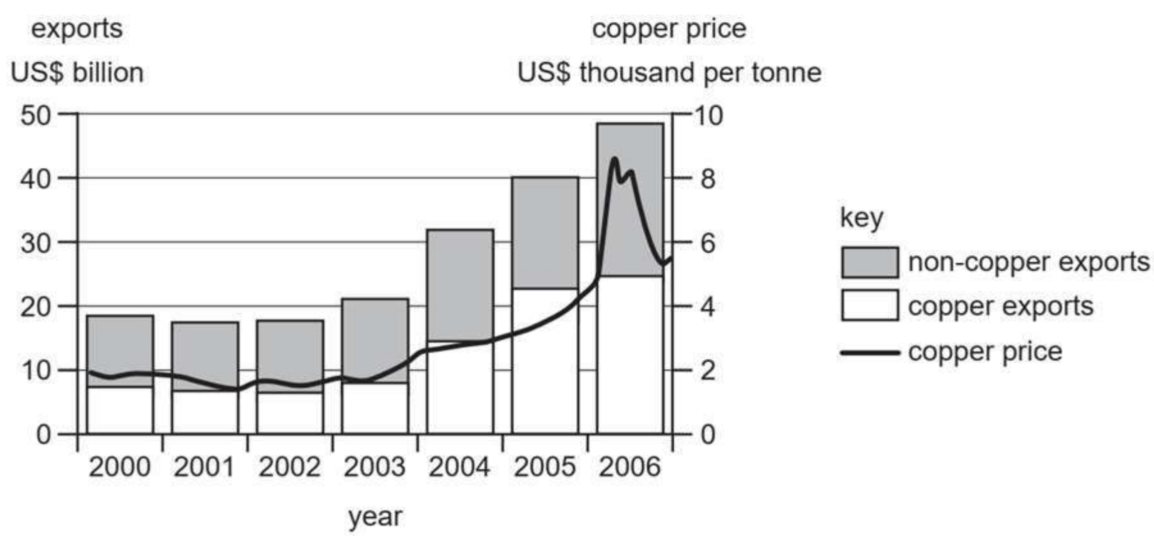
(b) Discuss the effectiveness and desirability of imposing tariffs to correct a current account deficit. [12]

13. The importance of copper production in Chile

Chile is a major producer and exporter of copper. For Chile, copper is a vital export and makes a major contribution to its trade. The Central Bank of Chile forecast a visible trade surplus of US$17 billion for 2006, two thirds higher than in 2005. Changes in world copper prices in 2006, a year of global growth, were an important influence on Chile's trade performance. However, one problem that Chile faced in 2006 was a strike for higher wages and better conditions at Escondida, the world's largest copper mine, where 8% of world copper was mined.

Figure 1 shows the contribution of copper to Chile's export revenue and changes in world copper prices.

Fig. 1: Chile's export revenue and world copper prices, 2000-2006



(a) (i) Calculate Chile's approximate visible trade balance in 2005. [2]

(ii) What information in addition to that in Fig. 1 would be required to calculate Chile's current account balance in 2006? [4]

(b) (i) How did the importance of copper as part of Chile's exports change between 2002 and 2005? [2]

(ii) Discuss whether it is desirable for a country to specialise in the production and export of a single good. [6]

14. Assess whether contractionary fiscal policy is likely to be the best way to reduce a current account deficit on the balance of payments. [12]

15. Will an increase in exports lead Sri Lanka back into economic growth?

In May 2022, Sri Lanka had to admit that it was unable to pay its debts to other countries for the first time in its history. As a result, in February 2023 it was forced to obtain a loan of US$3bn from the International Monetary Fund (IMF). The question is now, can Sri Lanka trade its way out of trouble?

The main problem faced by Sri Lanka for many years has been a lack of international competitiveness. Despite a growth in exports between 2000 and 2018, over the same period, they fell as a share of the economy from 39% to 23% of Gross Domestic Product (GDP). As a result, the country has found itself unable to earn enough foreign currency to pay for essential imports of food and fuel.

Table 1.1: Sri Lanka balance of trade in goods and services, US$ million, January 2022 to January 2023.

January 2022	March 2022	May 2022	July 2022	September 2022	November 2022	January 2023
–858	–762	–404	–123	–205	–450	–410

For many years, Sri Lanka has enjoyed a comparative advantage in growing and exporting tea. However, the ban on imports of fertilisers in 2021 which cut yields by a fifth and an overreliance on outdated methods of production have had a disastrous impact. Another major export is textiles, but these rely heavily on imported raw materials that have rapidly increased in price following the COVID-19 pandemic and the conflict in Ukraine. So, what alternatives exist for Sri Lanka?

Unlike in other Asian nations, Sri Lanka does not appear to have a plan to develop any new comparative advantage. Probably the most likely option would appear to be to take full use of its position at the centre of Indian Ocean shipping lanes by developing its ports. Sri Lanka could become a major shipping hub which would extend opportunities for exports. For example, approximately a third of the world's oil is transported across the Indian Ocean.

Other options include allowing the Sri Lankan rupee to depreciate to boost exports because it is felt that the currency is overvalued. There are also suggestions that all import tariffs should be removed. Sri Lanka is currently one of the most protected economies in the World and removing tariffs may help attract much needed foreign investment and encourage local industries to become more efficient.

The question now is, could the introduction of these options lead Sri Lanka back into economic growth?

Source: Adapted from Ben Chu, Economics Editor, BBC Newsnight article and tradingeconomics.com, February 2023

Using Table 1.1:

(a) Identify the overall trend in Sri Lanka's balance of trade in goods and services between January 2022 and January 2023. [1]

(b) Calculate the percentage change in Sri Lanka's balance of trade in goods and services between January 2022 and January 2023. [1]

16. Assess whether an economy will always benefit from having a surplus on the current account of its balance of payments. [12]

17. Can economic growth in Chile reduce income and wealth inequality?

Chile is the world's biggest copper producer with 28% of global copper production and the second biggest producer of lithium with 22% of world production. Overall, mining contributes 11% of the country's Gross Domestic Product (GDP) and more than 50% of the value of the country's total exports. World copper and lithium prices have increased quickly since 2020. This has led to strong growth in GDP which is expected to increase by 3.5% in 2022, exceeding earlier estimates of 2.5% as world demand is expected to grow following the Covid-19 pandemic. Fig 1.1 shows the world price of copper in United States dollars (US$) per pound (lb) weight. A pound is 454 grammes.

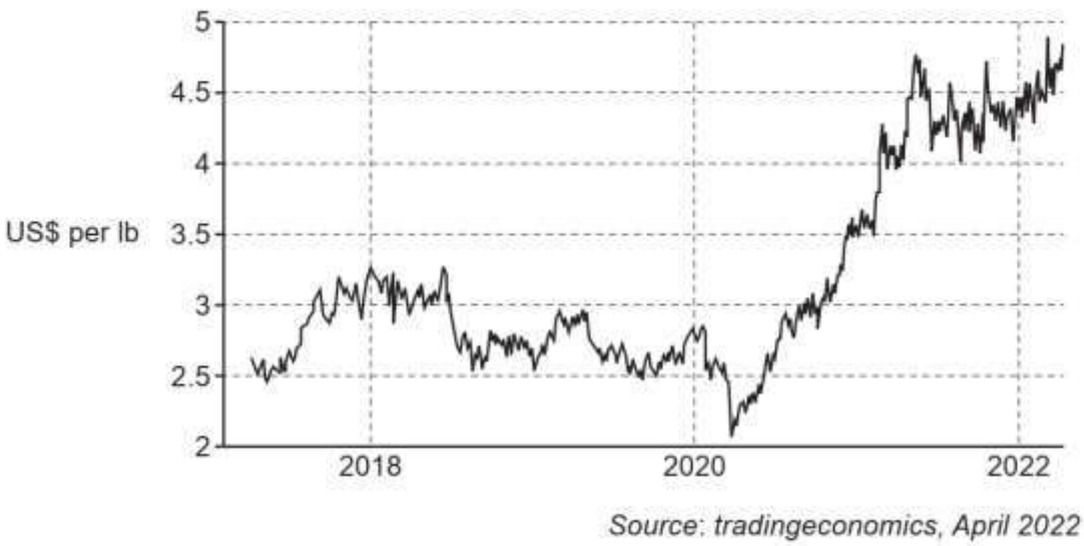


Fig 1.1: World copper price, 2017 to 2022

Economic growth in Chile has also been helped by the world's highest rate of vaccination against Covid-19 and a rapid economic recovery from the pandemic which has led to a large increase in consumer spending.

However, the trade in goods surplus has fallen substantially in February 2022. This is mainly because of a 9.2% fall in the revenue from copper exports due to the higher prices and a fall in world demand during the Covid-19 pandemic. There has also been a 38.3% increase in the value of imported consumer goods. As a consequence, the current account deficit has widened substantially to US$7.5bn in the first quarter of 2022 from a deficit of US$1.1bn in the first quarter of 2021 despite a surplus of US$50m in the secondary income account.

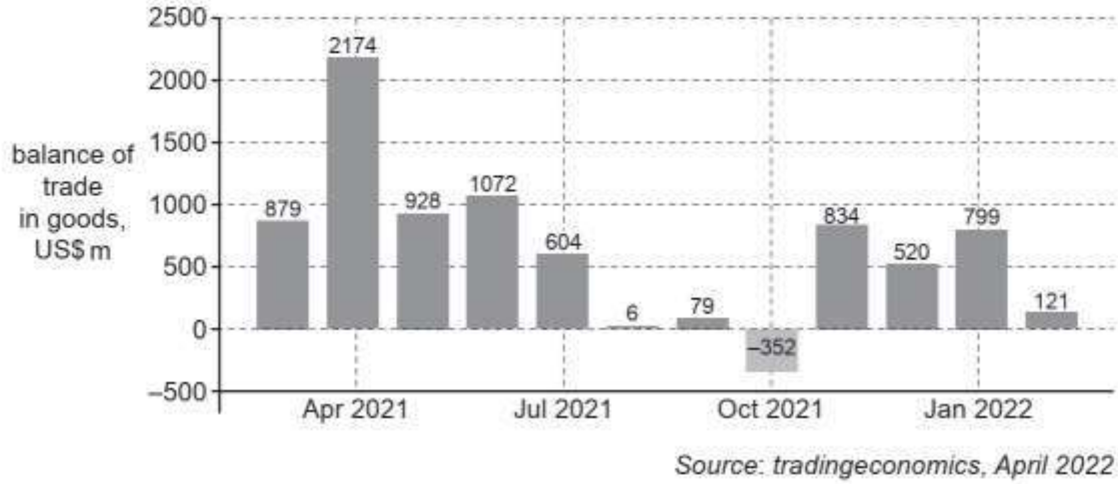


Fig 1.2: Chile's balance of trade in goods, March 2021 to February 2022

One of the main benefits of Chile's increased prosperity in recent years has been a decline in the number of people living at or below the minimum income level of US$5.50 per day. However, Chile remains the most unequal country in the list of largely developed countries according to the Organisation for Economic Co-operation and Development (OECD) with an income gap 65% wider than the OECD average. In addition, although the Gini coefficient has fallen from 52.1 to 44.4, this is still higher than lower-income countries such as Haiti and El Salvador.

To try and reduce this inequality in income and wealth, the Chilean government has increased its expenditure on education from 3% of GDP in 1997 to 5.4% in 2018. Further recognition of the importance of education as a merit good is shown by the government increasing its education spending by 3.4% each year since 2018. Chile has also recently made all college tuition free of charge. It is hoped that this will reduce the gap in the quality of education received by the wealthiest and poorest students and open up opportunities for everyone.

Sources: Adapted from reuters.com 2 February 2022,

trade.gov/country-commercial-guides/chile-mining, 25 January 2022,

bcentral.cl/inicio and statista.com, April 2022

(a) Identify two possible reasons why the current account on the balance of payments in Chile is in deficit in the first quarter of 2022 despite the surplus on the balance of trade in goods. [2]

(b) Consider the likely success of one policy that Chile could use to reduce the imports of consumer goods. [4]

18. Assess whether supply-side policies are the most effective way to correct a deficit on the current account of the balance of payments of an economy. [12]

19. (a) Explain how import tariffs might correct an imbalance in the current account of the balance of payments and consider whether these tariffs are the best way of correcting such an imbalance. [8]

(b) A country has a persistent deficit on the current account of its balance of payments.

Assess the likely consequences for the domestic and external economy of this 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. (a) (i) Decrease/worsen (1), by RM 9.1b/$US2.4b/29% (1), lower surplus (2), - two aspects

(a) (ii) All imports rose (1), less growth of exports (1), supporting data (1), fall in 2 exports (1), two aspects

(b) Comparative advantage (1), reference to factor endowment linked to products (1), Industrialisation (1), reference to composition of exports (1)

(c) Yes – rising faster than exports, dependency issue, nature of goods

No – covered by exports, reflect comparative advantage, further output

Awareness of two sides for (4), 1 side (3) max

(d) Capital account (1), financial account (1), errors and omissions/balancing item (1), individual components, e.g., investment flows (1), transfers (1)

2. (a) The accounts are arranged to show the total international transactions, arranged by their differing nature and debit or credit effects. The current account deals with the exports and imports of goods (visibles) and services (invisibles). It also includes income from investments (inflow and outflow) and transfers of income. Its final element is current transfers such as payments to international institutions. The capital account records the transfer of ownership of fixed assets. The financial account relates to short-term and long-term investment, both portfolio and real, and the movement of reserves. A balancing item is included to account for the errors and omissions in collecting the data.

Knowledge of the nature of the current account	up to 3 marks
Knowledge of the non-current sections	up to 3 marks
Explanation of the organisation of the account	up to 2 marks

(b) Deficit occurs when outflow of various current items exceed inflows. The cause of the deficit, its size and its likely duration decide whether it will be harmful. On the current account a deficit on goods may be bad if long-running and the result of a lack of competitiveness. On the other hand it may just reflect rising standards of living and be covered by other inflows. If the goods are capital rather than consumption later benefits may offset a current outflow. Weakness in services may simply reflect comparative advantage. Strong foreign reserves may be able to finance a temporary deficit. However, if a deficit is long-term and cannot be financed without excessive international borrowing, the depletion of international reserves or exceptional policy measures the position is an undesirable disequilibrium.

Understanding of the nature of deficit	up to 2 marks
Discussion of a non-harmful deficit	up to 6 marks} to a max

Discussion of the harmful effects of a deficit up to 6 marks} of 10 marks

3. (a) US$136 billion/US$405 billion = 33.58024% (1 mark)

(b) For an explanation of a country's balance of trade, i.e. the difference in the value of the exported and imported goods and services (1 mark)

For an explanation of a country's terms of trade, i.e. the difference in the average prices of exports and imports (index number showing the average price of exports divided by the index number showing the average price of imports × 100/1) (1 mark)

For an explicit distinction between the two concepts, stressing that one involves values and one involves prices. (1 mark)

4. (a) A deficit at the beginning of the period, followed by surpluses OR

Generally increasing/improving balance over the period (one exception)

(1 mark)

(b) US$1 billion

(US$1.001 billion) (1 mark)

(Line one gives the total as US$1.3bn and the fourth paragraph says that China accounts for 77% of this.)

Candidates do need to refer to billion, but not necessarily to US$

5. For analysis of the fact that a significant rise in the general price level will make export prices rise and import prices fall. The impact on the current account depends upon the price elasticity of demand for exports and imports and candidates should refer to the Marshall Lerner condition. Candidates may also refer to how capital flows are influenced with the effect on interest payments and so on.

For analysis of the impact of a rise in the general price level upon the deficit.

(Up to 8 marks).

For evaluation of the effect upon the deficit being affected by factors such as the relative inflation rate, the time period and the J-curve effect.

For evaluation of whether this is likely to turn the deficit into a surplus. (Up to 4 marks).

6. A credit [1 mark] in the services section of invisibles/the trade in services/the current account (accept any one of these) [1 mark].

7. For example:

• If there is a decline in the demand for exports, resources could be diverted to produce goods for domestic consumption.

• There could be a reduction in inflationary pressure if there is a fall in aggregate demand.

• If the fall in the surplus is due to an increase in imports, it could lead to a higher standard of living.

• A lower demand for exports could lead to an increase in unemployment.

• There could be a decrease in GDP and economic growth.

(Up to 2 marks for each effect)

4 marks maximum

Guidance

A disadvantage of having a persistent current account surplus is that one country's surplus is another country's deficit. The country with the deficit may decide to introduce protectionist methods, potentially damaging the extent of international trade.

8. A current account deficit occurs when financial outflows from goods, services, income and transfers outweigh inflows. This may be a serious problem if it is the result of a fundamental disequilibrium, if it requires unusual policy measures, if it is long term and if it is not possible to finance it without excessive borrowing or rundown of reserves. However, it may not be significant if it alternates with surplus years, there are sufficient reserves to cover it, if it will enable longer term development (via the importing of capital goods) and if it is a small percentage of GDP. Other economic problems (inflation or unemployment) may be more significant depending upon economic conditions.

For understanding of a current account deficit	4 marks
For discussion of circumstances when it is serious	4 marks
For discussion of circumstances when it is not serious	4 marks

9. (a) The transactions involve trade in goods and services, incomes from work and investment, profits and dividends (IPD), government and private transfers (remittances), direct investment, portfolio investment and short-term capital flows. The items are recorded as inflows (+) or outflows (-) and divided between the current account (goods and services, income and transfers) and the capital and financial accounts.

Understanding nature of international transactions up to 3 marks

Explanation of the recording of the items in the balance of payments up to 5 marks

(b) Current account deficit means more outflows than inflows on trade, transfers and income. Tariffs are a tax on imports while quotas are a limit on quantity of imports. A tariff will raise revenue and be more effective the higher the price elasticity of demand and will operate through the market system. A quota will be effective when demand and supply are inelastic, will work with more certainty and benefit is more likely to accrue to the importer. Both methods involve intervention in the free market and may attract retaliation, there may be difficulty in setting the right level, they will have administrative costs and will be ineffective if the cause of the deficit is the performance in the income or transfer sections.

Understanding of current deficit, tariff and quota up to 3 marks

Analysis of the operation of tariffs and quotas up to 4 marks max. 12

Discussion of their merits and drawbacks up to 6 marks

10. (a) Australian deficit (1) or Thai surplus (1) of A$.630m (1)

(b) Australia exports mainly minerals and farm products (1), Thailand exports mainly manufactured or processed (1), credit comment on petroleum, seafood or restricted data.

(c) Absolute and comparative advantage (1), meaning (1), differences in factors of production (1), application e.g. Australia land rich, Thailand capital/technology rich (2).

11. (a) Disequilibrium involves persistent deficit or surplus problems, which are not sustainable. Switching intends to move domestic and foreign expenditure more towards domestic production. It includes tariffs, quotas and subsidies and should mean more exports and fewer imports. Dampening involves reducing the level of total spending so reducing imports and forcing domestic producers to export. Deflationary fiscal and monetary policy would be used.

Understanding of the terms (4)

Details of the two types of policy (4)

(b) The position on trade in goods and services, income and transfers needs to be identified in terms of surplus or deficit. Policies to improve competitiveness through price and quality, to introduce new exports and reduce imports, to gain access to new markets, to influence income and transfer flows need to be specified. The ability to implement these policies successfully depends upon the background conditions, the effectiveness of the policies, costs, expertise, influence and external obstacles. Cases may vary markedly between countries.

Analysis of current account position (4)

Consideration of policies for improvement (4)

Discussion of ability to effect an improvement (4)

12. (a) The current account involves the trade in goods (visible) and services (invisible), flows of income and current transfers. A deficit results when total outflows exceed total inflows.

Understanding of deficit up to 2 marks

Explanation of the elements of the current account up to 6 marks

(b) Tariffs are a tax, specific or ad valorem on imported goods and may be targeted. They push up the price of the good and reduce the quantity demanded of imports, so helping domestic producers and reducing the outflow of currency. They allow a breathing space for structural adjustment. Dumping can be prevented. They raise revenue for the government. Tariffs might not be effective in reducing quantity demanded when demand is inelastic and they will not be relevant to dealing with a deficit resulting from income and transfer flows. They interfere with the operation of the market, reduce the benefits of trade, may breach international obligations and may provoke retaliation.

The impact of a tariff can be shown in a diagram.

Understanding of a tariff up to 4 marks

Analysis of the benefits of a tariff up to 6 marks } max of
Discussion of the problems of a tariff up to 6 marks } 10 marks

13. (a) (i) Surplus (1), $10 billion (1)

(ii) Visible import figures, service figures, income flows, current transfers.

1 mark per item to max (4).

(b) (i) Increased (1), from under to over 50% (1) or from approx 40% to 60% of total (1)

(ii) Benefits of specialisation include comparative advantage, increased output and efficiency, international competitiveness, reduced unit costs.

Disadvantages include restricted job opportunities, vulnerability to changes in price, competition and technology, need to import, resource depletion.

One side to maximum of four marks.

14. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

• Understanding of the terms fiscal policy/current account deficit.

• How contractionary fiscal policy might reduce a current account deficit – this may include increased taxation might reduce imports/reduce demand-pull inflationary pressure resulting in improved international price competitiveness.

• An explanation of the limitations of fiscal policy – impact on domestic growth, unemployment.

• An explanation of an alternative policy – monetary and/or supply side policies, minimum prices, regulation backed by fines.

AO3 Evaluation

• Consideration that fully assesses the relative effectiveness of the policies analysed in reducing a current account deficit and arrives at a reasoned conclusion concerning whether fiscal policy is the 'best' approach.

Accept all valid responses.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

15. (a) The trade deficit has fallen / declined / decreased / reduced (1)

(b) (Deficit has fallen) by 52% (1).

Guidance:

The answer MUST refer to the trade deficit and the fact that it has fallen for the first mark i.e., not simply improved.

Accept answers in the range 51% to 53% for part (a).

16. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

Potential **benefits**:

• A country will have surplus foreign exchange which it could use to invest in other countries.

• A high level of exports could lead to an increase in jobs in the export sector.

• Lower spending on imports may mean that people are buying more domestic goods which could also increase employment.

• It could stimulate economic growth.

Potential **disadvantages**:

• A current account surplus could be a sign of weak domestic demand with lower consumer spending and this could reduce domestic employment.

• It could lead to lower economic growth.

• The surplus could have been caused by a recession in the economy.

• It can contribute to lower output and employment in those countries with a current account deficit.

Level 1 responses will be assertive and lacking in explanations/mainly descriptive and/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

• Considers the potential benefits and disadvantages of the surplus.

• Considers the size of the surplus and the possible reasons for it.

• In conclusion, will an economy always benefit from having a surplus?

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

17. (a) The data also states the secondary account is in surplus so the primary account (1) and /or the balance of services (1) must show a deficit.

Guidance:

Please also accept valid references to any of the components of the primary account i.e., net income from investments made abroad, earnings made by residents working abroad being in deficit. (1 max if no additional reference to services)

Do **not** accept references to components of the secondary account e.g., transfers, government aid.

Alternative approach:

Many candidates have answered why the current account deficit has grown rather than why it is in deficit in the first quarter of 2022. This is by reference to the final paragraph on page 2 of the data e.g., the fall in revenue from copper exports, the increase in the value of imported consumer goods and the impact of the pandemic.

For any accurate reference to one / all of these factors (1) plus (1) **only if** an accurate reference is also made to the deficit in the primary account **OR** the balance of services.

(b) Allow any valid policy that may reduce the expenditure on imports.

Identification of policy (1), an explanation of how it may reduce the expenditure on imports. **(up to 2 marks).**

- For example, identification of a tariff (1). This will increase the price of imports (1) which may have the effect of reducing the demand/level of imports (1).
- For example, identification of a quota (1). This will limit the number of goods that can be imported (1) which will of reduce the demand/level of imports (1).
- Evaluation of the likely success of the chosen policy **in switching expenditure from imports/reducing the imports of consumer goods (1).**
- For example, if the PED for imports is inelastic, a tariff may make little difference in reducing imports (1).

Guidance:

Examples of policies may include any example of protectionism, other policies to boost the price competitiveness and /or availability of domestic consumer goods e.g., supply side policies.

18. AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

Successful supply-side policies will cause a rightward shift in the long-run AS curve, reflecting more efficient production. This would make a country's products more competitive in international markets and so there is likely to be an increase in net exports, correcting a deficit in the current account. Supply-side policies could include improvements in training and education, making labour markets more flexible, reductions in the powers of trade unions, an increase in competition and a reduction in rules and regulations.

Potential disadvantages of supply-side policies are that they are essentially a long-run solution and so may take a relatively long period of time to have an impact, such as improvements in training and education. Some of the policies could be quite expensive and so would involve the government in considerable expenditure, money which could have spent elsewhere (giving rise to the issue of opportunity cost).

Guidance: There are a number of alternative approaches to answering this question. At the simplest level, analysis and evaluation may focus on an assessment of the effectiveness of supply side policies only. Furthermore, this may be expanded to include a direct comparison with the effectiveness of alternative policies such as fiscal, monetary or protectionist policies. In addition, such an assessment may simply be part of evaluation. However, if supply side policies are ignored or receive scant attention then only a Level 2 mark may be awarded.

A one-sided response can only gain a maximum of Level 2.

AO3 Evaluation

Points to consider may include:

the cause of the deficit, the cost and ease of introducing various policies, the possible unintended consequences of introducing policies etc. leading to a justified conclusion as to whether supply-side policies would be the most effective way to correct a deficit in the current account of the balance of payments of an economy.

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

19. (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)

• What is meant by an import tariff (1)

• What is measured by the current account of the balance of payments (1)

• What is meant by an imbalance in the current account of the balance of payments in terms of a surplus or deficit. (1)

AO2 Analysis (max 3 marks)

For an analysis of how import tariffs will affect the prices of imports (1) and how this may affect domestic consumption on imports (1) and how this may correct the imbalance (1)

Note: a diagram may be useful but cannot be expected.

AO3 Evaluation (max 2 marks)

Final effect is uncertain e.g., as a result of the PED for imports (1); other policies can be used (1); whether trading competitors retaliate (1). Reserve (1) for a justified conclusion.

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

• Explanation of what is meant by a persistent deficit on the current account of the balance of payments.

• Analysis of the consequences of a persistent deficit on the domestic economy e.g., in terms of employment levels, economic growth, inflation, living standards, government budget, business confidence, possible need to restructure the economy etc.

• Analysis of the consequences of a persistent deficit on the external economy e.g., exchange rates, ability to trade, need for imports, debt interest, etc.

Note: accept answers that refer to the impact on other economies when another economy has a persistent current account deficit.

Max L 2 if only the consequences on the domestic or the external economy are considered.

AO3 Evaluation

That clearly considers the likely consequences on both parts of the economy and comes to a conclusion as to the most likely consequences.

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4