2.6 The Balance of Payments: Causes and Correction of Disequilibrium: Test Pack

Total Marks

AQA 7136 · Calculators not allowed · about 20 minutes

Name: _____ Date: ____ / ____ / _____

Answer all questions. Write full sentences for questions worth 4 marks or more. Time guidance: 20 minutes total.

1 Define 'current account deficit' in the context of a national economy such as the UK, and state one immediate implication for foreign exchange flows.

(Total for Question 1 is 2 marks)

2 State two ways in which an appreciation of the pound sterling could lead to a larger current account deficit for the UK.

(Total for Question 2 is 2 marks)

3 Explain why supply-side policies to improve UK competitiveness often take longer to reduce a persistent current account deficit than expenditure-switching measures, and state one implication of this time lag for policy choice.

(Total for Question 3 is 3 marks)

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4 Explain how expenditure-reducing policies, for example a deflationary fiscal consolidation in the UK, can reduce a current account deficit. Give one likely short-term cost of such a policy.

(Total for Question 4 is 3 marks)

5 Assess briefly which approach is likely to be more desirable for the UK in correcting a persistent current account deficit: expenditure-switching policies such as depreciation and selective tariffs, or expenditure-reducing policies such as fiscal consolidation. Give two evaluative points.

(Total for Question 5 is 4 marks)

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Mark scheme · 2.6 The Balance of Payments: Causes and Correction of Disequilibrium: Test Pack

Question 1

a current account deficit is when a country's total receipts from exports of goods and services plus primary and secondary income are less than its payments for imports and income/transfers, i.e. the current account balance is negative **B1**

implies a net outflow of foreign currency or the need for financing from capital inflows or reserves to pay for the excess of imports over exports **B1**

Answer: A current account deficit occurs when a country's receipts on goods, services and income are less than its payments, implying net outflows of foreign exchange or a need to finance the gap with capital inflows or reserves.

Question 2

appreciation makes UK exports more expensive for foreign buyers, reducing export volumes **B1**

it makes imports cheaper for UK consumers and firms, increasing import volumes and worsening net exports **B1**

Answer: An appreciated pound raises export prices overseas, reducing exports, and lowers prices of imports for UK buyers, increasing imports; both worsen the current account.

Question 3

supply-side policies work by changing the productive capacity, skills, technology or regulatory environment, which takes time to deliver higher productivity or improved products **M1**

therefore their effect on export competitiveness and the trade balance is gradual and long-term rather than immediate **A1**

implication: policymakers may need to combine short-term switching measures with long-term supply-side reforms, balancing immediate needs against long-run sustainability **A1**

Answer: Supply-side reforms take time because they alter capacity, skills and technology, so their effects on exports are gradual; thus short-term switching measures are often used alongside them.

Question 4

expenditure-reducing policies aim to lower aggregate demand so that imports, which are demand-sensitive, fall and net exports improve **M1**

a fiscal consolidation that reduces government spending or raises taxes lowers domestic income and spending, causing import demand to fall and narrowing the current account deficit **A1**

likely short-term cost: higher unemployment or a deeper recession as aggregate demand and output fall **A1**

Answer: Cutting government spending or raising taxes reduces domestic demand and imports, improving the current account, but this can cause higher unemployment or a recession in the short term.

Question 5

point: expenditure-switching can improve competitiveness quickly and protect jobs in tradable sectors, but may be inflationary and invite retaliation **M1**

developed: depreciation helps exporters but, if import-dependent inputs are used, costs rise and inflation may offset competitiveness gains **A1**

point: expenditure-reducing directly lowers import demand and can reduce the deficit without changing relative prices, but at the cost of lower output and higher unemployment **M1**

developed: fiscal consolidation may restore confidence and reduce deficits sustainably, but political and social costs may make it undesirable **A1**

Answer: Switching policies act faster and support tradable sectors but risk inflation and retaliation; reducing policies cut import demand but at the cost of lower output and jobs. The preferable mix depends on the state of the economy and policy trade offs.

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