2.8 Aggregate Supply: Short Run, Long Run and Supply-Side Shocks: 30-minute Pack

AQA 7136 · Calculators not allowed · about 30 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Use full sentences for questions worth 4 marks or more. Time guidance 30 minutes. No calculator is allowed.

1 State and briefly explain one reason why an exchange rate appreciation could shift short-run aggregate supply (SRAS) to the right in a small open economy.

(Total for Question 1 is 3 marks)

2 Explain two reasons why short-run aggregate supply (SRAS) might be relatively flat at low levels of output but become steeper as the economy approaches potential output (LRAS).

(Total for Question 2 is 3 marks)

3 Explain briefly how a temporary negative supply shock and a permanent reduction in productive capacity would differ in their effects on SRAS and LRAS and on policy responses.

(Total for Question 3 is 4 marks)

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4 Explain how a sustained improvement in total factor productivity (TFP) would affect both SRAS and LRAS, and indicate the likely time profile of these effects.

(Total for Question 4 is 3 marks)

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5 Diagram question: A government implements a long-term programme of public investment in transport and digital infrastructure expected to raise productive capacity. On an AD/AS diagram, show the effect this policy would have on LRAS and SRAS over time, and explain the likely effect on the price level and real output in the medium to long run. (Describe what you would draw.)



(Total for Question 5 is 4 marks)

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Mark scheme · 2.8 Aggregate Supply: Short Run, Long Run and Supply-Side Shocks: 30-minute Pack

Question 1

identifies that an appreciation makes imported inputs and intermediate goods cheaper in domestic currency terms	**M1**
explains that cheaper imported inputs reduce firms' production costs, increasing supply at each price level and shifting SRAS to the right	**A1**
alternative development: cheaper imported capital goods can raise productivity, reinforcing the rightward shift	**B1**

Answer: An appreciation reduces the domestic cost of imported inputs and capital goods, lowering firms' unit costs and so shifting SRAS right as firms supply more at each price level.

Question 2

identifies spare capacity: when output is well below potential, there are unemployed resources and idle capital	**M1**
explains that firms can increase output without bidding up wages or other input prices, so SRAS is relatively flat and output rises more for a given rise in AD	**A1**
identifies that as capacity is used up, inputs become scarcer and marginal costs rise, so SRAS becomes steeper as further increases in AD produce more inflation than extra output	**A1**

Answer: With spare capacity SRAS is flat because firms can use idle labour/capital without raising input prices; as capacity is used up inputs become scarce, marginal costs rise and SRAS steepens so AD increases cause more price rises than extra output.

Question 3

states that a temporary negative supply shock shifts SRAS left but leaves LRAS unchanged	**M1**
explains that the temporary SRAS shift raises prices and lowers output in the short run but can reverse when the shock passes	**A1**
states that a permanent reduction in productive capacity shifts LRAS left (and may also shift SRAS left)	**M1**
explains that a leftward LRAS shift reduces potential output permanently, implying policy must focus on supply-side measures rather than demand management to restore growth	**A1**

Answer: A temporary shock shifts SRAS left raising prices and lowering output temporarily while LRAS remains unchanged; a permanent capacity reduction shifts LRAS left reducing potential output and requiring supply-side policies to rebuild capacity rather than demand stimulus.

Question 4

a rise in TFP increases output per unit of input, lowering unit costs and raising productive capacity	**M1**
in the short run SRAS shifts right because firms can supply more at each price level due to lower costs	**A1**
in the long run LRAS shifts right as the economy's potential output increases; the LRAS effect is persistent while the SRAS shift may be an initial response followed by further supply-side gains	**A1**

Answer: Higher TFP reduces unit costs and raises output per input, shifting SRAS right in the short run and shifting LRAS right in the long run as potential output increases, with LRAS effects building over time.

Question 5

correctly labels axes and initial curves AD, SRAS and LRAS and marks initial equilibrium E1	**B1**
shows LRAS shifting right to LRAS2 to represent higher potential output due to infrastructure investment	**B1**
shows SRAS may also shift right (or remain) as productivity and lower unit costs spread, and explains this timing difference	**B1**
identifies medium/long-run outcome: higher real output (potential) and, ceteris paribus, a lower or unchanged price level relative to where it would otherwise be, with explanation that increased capacity reduces inflationary pressure	**B1**

Answer: Draw LRAS shifting right (and possibly SRAS right); result: higher real output and lower or stable price level in medium-long run, reducing inflationary pressure.

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