Edexcel AS/A-level Year 1 Economics A exam practice answers

8 National income

**1 (a)** The marginal propensity to import is the change to the value of imports brought about by a change in income.[1]

 **(b)** It was (rearranging the formula) 1/1.25, so the marginal propensity to withdraw (mpw) is 0.8. The new mpw is 0.9, so the multiplier is 1.11. [2]

**(c)** Correct answer D: a rise in the exchange rate. [1]

**2** Your essay should contain the following elements:

**(i)** A definition of an increase in the value of the currency, or *appreciation*. Use a numerical example to explain that when a currency gets stronger, it means you can buy more of a foreign currency for a certain amount of your own currency. For example, the pound has appreciated against the euro since 2010 when £100 bought 110 euros. Now £100 buys 125 euros.

**(ii)** Identification of two or three impacts that this rise in the currency has on the components of aggregate demand. For this part of the essay there are 14 marks available for KAA (knowledge, application and analysis), so you should make three reasonable points with application and explanation of the processes involved, or two points with extended analysis. These points might include:

* Exports are likely to fall because UK exports will be more expensive on foreign markets.
* Imports are likely to rise because imports into the UK will be relatively cheap compared to goods and services produced in the UK.
* Investment falls. UK firms might be less likely to invest in their own country because they are concerned there will be a fall in sales in the future. They might invest in production units in other countries, as the investment in foreign firms will be cheaper.

**(iii)** Now the 14 KAA marks have been allocated it is time for the evaluation. For this part of the essay there are 6 marks available, so you should make three reasonable points, or two points with extended analysis. These points might include:

* Low price elasticity of demand for imports and exports, meaning that a rise in the value of the currency might actually increase the value of net exports in the short run. This evaluation point is usually awarded 4 marks.
* It depends on what is happening in other countries that we trade with. If there is a period of growth, e.g. in Germany, then our exports to Germany might not fall when the pound increases in value relative to the euro.
* Price of imports and exports is only one factor affecting demand. We should also consider non-price factors, such as the quality of the after-sales service.
* It depends on how long the appreciation lasts, how large, and how likely it is to be sustained. If the situation is a short-run clip it is likely to have very little impact on trade patterns. This argument is especially significant because there are contracts in place guaranteeing trade at fixed rates, and currency exchange rates are often protected by ‘hedging’, a money market tool for allowing people to protect themselves from adverse currency movements. [20]