Past-paper walk-through

Introduction to the circular flow of income ▪ 4.2

eXercise

Questions in this set

- 9708/12 N25 Q1 ▪ 1 mark
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Question 1

9708/12 N25 ▪ Q1 ▪ 1 mark

1 What is an example of a normative statement?

A Government expenditure is an injection into the circular flow of income.

B Government expenditure in India in 2022 was 29% of gross domestic product.

C The best policy measure to reduce inflation is a reduction in government expenditure.

D The United States of America is the country with the highest military expenditure.

Solution 1

Answer: **C**

Why

- A normative statement contains a value judgement – a claim about what *should* happen.
- Positive statements are factual and testable, even if the fact is hard to measure.
- So the statement using words like "should", "unfair" or "too much" is the normative one.

Question 15

9708/12 N25 ▪ Q15 ▪ 1 mark

15 What is an example of an injection into the circular flow of income in an open economy?

A consumer spending on goods

B expenditure on a government construction project

C spending by households on holidays abroad

D repayment of loans to commercial banks

Solution 15

Answer: **B**

Why

- Injections into the circular flow are investment, government spending and exports.
- Government spending on a construction project is a direct injection.
- Consumer spending is already inside the flow, and saving is a withdrawal.

Question 19

9708/13 N25 ▪ Q19 ▪ 1 mark

19 A government is planning to increase its expenditure on defence. Half of this expenditure will be on equipment such as planes and weapons which it will have to import as it does not produce this equipment domestically.

What is the initial impact on injections and leakages from the circular flow of income?

A The initial rise in injections is greater than the initial rise in leakages.

B The initial rise in injections is greater than the initial fall in leakages.

C The initial rise in injections is smaller than the initial rise in leakages.

D The initial rise in injections is smaller than the initial fall in leakages.

Solution 19

Answer: **A**

Why

- Government spending is an injection, so aggregate demand rises.
- But half of it is spent on *imports*, which is a withdrawal from the circular flow.
- So only the domestically spent half raises national income, and the current account worsens.

Question 15

9708/11 J25 ▪ Q15 ▪ 1 mark

15 What is an example of a transfer payment?

A a household moving savings from one bank account to another

B a monthly repayment on a loan used to buy a new cooker

C the amount paid to transport goods from one city to another

D grants paid to students by the government

Solution 15

Answer: **D**

Why

- A transfer payment is money paid without any good or service being provided in return.
- So it is not payment for output and does not count in GDP.
- A state benefit or pension is a transfer; a loan repayment or a purchase is not.

Question 17

9708/12 J25 ▪ Q17 ▪ 1 mark

17 Based on the circular flow of income, which condition is necessary for an open economy to be in equilibrium?

A Government investment is equal to private investment.

B Planned injections are equal to planned withdrawals.

C Spending by households is equal to taxes collected by government.

D Value of export earnings is equal to expenditure on imports.

Solution 17

Answer: **B**

Why

- In an open economy the injections are investment, government spending and exports.
- The withdrawals are saving, taxation and imports.
- Equilibrium requires planned injections to equal planned withdrawals in total, not item by item.

Question 27

9708/12 J25 ▪ Q27 ▪ 1 mark

27 What is most likely to lead to a persistent surplus in a country's current account of its balance of payments?

A a low domestic savings rate

B an undervalued exchange rate

C highly protectionist policies by other countries

D low investment income from abroad

Solution 27

Answer: **B**

Why

- A persistent current account surplus means exports keep exceeding imports.
- An undervalued exchange rate makes exports cheap and imports dear, year after year.
- A high savings rate has the same effect, since saving rather than spending reduces import demand.