CURRENT ACCOUNT OF BALANCE OF PAYMENTS-SET-1-QP-MS

1. The mining and export of minerals and precious stones is a very important part of the Namibian economy. It was reported that despite a sharp decrease in the quantity of these exports between 1995 and 1999 the export value of the items rose in that period.

(a) Where would the minerals and precious stones be recorded in the Namibian balance of payments? [2]

MARKSCHEME:

(a) 1 mark each for 'visible' and 'export' or 'trade in goods' and 'current account'. [2]

2 Demand for UK exports dropped considerably in November 2002, which pushed the UK further into a visible trade deficit – the largest since records began.

(a) Explain what is meant by a visible trade deficit and identify in which part of the balance of payments the deficit would be recorded. [3]

(b) Discuss whether it matters if a country has a visible trade deficit. [7]

MARKSCHEME:

(a) Up to 2 marks for explaining that imports of goods are greater than exports of goods. Exports / imports (1), goods (1). 1 mark for current account. [3]
(b) Up to 7 marks for discussing whether a current account deficit matters as it usually means decreased earnings potential for the economy. It might not matter if there is a surplus on services or if there are earnings on the capital account or if the deficit is only expected to be a short term one or if the deficit is small. However, this is the largest deficit on record. [7]

3 Changes in the rate of exchange meant that exports of goods from Egypt decreased as they became more expensive in other countries.

(b) If exports from Egypt became more expensive, how might that affect production and employment both in Egypt and in countries importing Egyptian goods? [7]

MARKSCHEME:

In Egypt, production and employment likely to fall as not so many goods sold, resulting in reduced income and further effects on employment. In importing country production might switch to home produced goods resulting in an increase in production and employment and income. If demand switches to imports from another country the effect in the importing country will be reduced (if the other country's goods are cheaper leaving more disposable income) or result in no change. [7]

4 Demand for oil in India

India is the world's seventh-largest consumer of oil. Demand for oil could more than double in the next 15 years because of strong industrial growth and increasing numbers of Indians who will be able to afford to buy cars and motorcycles. As demand grows, so will India's dependence on imports. India imports around 70% of its oil.

(a) Explain using a demand and supply diagram what the article says will be the likely change in the market for oil in India in the next 15 years. [5]

(b) **(i)** Where would the purchase of foreign oil be recorded in India's balance of payments? [3]

(ii) Explain **two** possible disadvantages to the Indian economy of its dependence on imported oil. [4]

MARKSCHEME:

(a) 1 labels, 1 equilibrium (original and new equilibrium), 1 shift in demand, 2 explanation. [5]
(b) (i) current account, goods/visibles/balance of trade, imports. [3]
(ii) Worsen the balance of payments account, possible volatility of prices, possible volatility of supply. 1 for Identification, 1 for explanation. [4]

5 In Ghana local farmers manage small plots of land for subsistence farming. However, some have benefited by selling pineapples at an agreed, fixed price to an exporter. The exporter provides finance, training, fertilizers and machinery and even building materials for the farmers' homes.

In 2005, European supermarkets changed their demand to a new, sweeter pineapple not grown in Ghana. Use demand and supply diagrams to explain what happened in the market for both types of pineapple. [6]

MARKSCHEME:

Two diagrams. Labels (1), shift of demand for new pineapple (1), shift of demand for original pineapple (1), explanation including comment on what happens to equilibrium (3). [6]

1 South Africa imposes a quota on Chinese imports

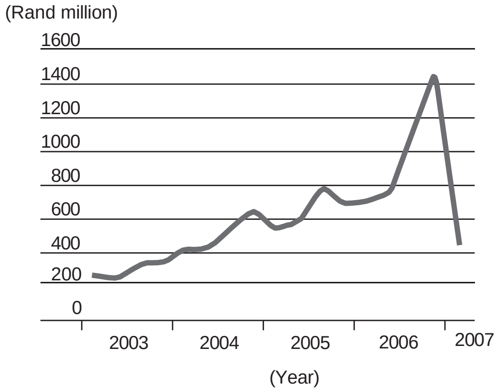
In 2007, the South African Government imposed a quota on the imports of clothing and textiles from China. The aim was to try and reduce these imports and increase home production instead.

In the first quarter of 2007, imports from China fell by 35% but some were replaced by imports from other countries, including unlikely sources such as Malawi and Zimbabwe which doubled their exports to South Africa. It was thought that China was exporting to South Africa via these countries. Overall, imports fell by only 13%.

The hope of increased home production was not achieved as some South African companies could not obtain the imports of the necessary fabrics used as raw materials. Lack of raw materials forced one company to reduce its workforce by 8% despite previously investing heavily for a planned expansion.

Other South African manufacturers did not have the capacity to meet demand so the quotas did not help create employment. The employers said that union power had also not helped. Unions wanted guaranteed employment but employers said, 'we run a business where fashion dictates what we buy and make. We do not know what our fabric requirements are years into the future and cannot promise future employment.'

South Africa imports of clothing
and textiles from China



(a) Where are clothing and textile imports recorded in the balance of payments? [2]

(b) The graph shows imports of clothing and textiles from China. Suggest why imports took the path shown between 2006-2007. [2]

MARKSCHEME:

(a) These are recorded in the visible import (1) section of the current account (1). [2]
(b) The imports of clothing and textiles from China peaked in the last six months of 2006 prior to the introduction of the quota by the South African Government in 2007 as China tried to beat the quota (1), and then declined in 2007 due to the effect of the quota (1). [2]

2 Changes in a country's exchange rate can sometimes have significant effects on its economy and on its balance of payments.

(a) Explain the effects of a fall in a country's exchange rate on its production.[6]
(b) Explain any two of the four sections of the current account. [4]

MARKSCHEME:

(a)Explanation in terms of:
● the fall in the value of the exchange rate will have the effect
● of making exports less expensive
● and imports more expensive
● if the demand for both is price elastic, this should increase the demand for exports
● and decrease the demand for imports
● this should encourage production of exports and increase employment
● it will also encourage production of domestic goods to replace the imports
● the PED, however, may not be elastic.
A maximum of 4 marks if no consideration of PED. [6]
(b) Any two from:
• trade in goods (visible account)
• trade in services (invisible account)
• income
• current transfers. [4]

3 **(a)** Describe the structure of the current account of a country's balance of payments. [4]

(b) Explain the main causes of a current account deficit. [6]

(c) Discuss what would be the most effective policies to increase a country's exports. [10]

MARKSCHEME:

(a) Description of:
• trade in (visible) goods
• trade in (invisible) services
• income flow
• current transfers.
An answer which deals with only the first two elements (comprising the balance on trade in
goods and services) can gain a maximum of 3 marks.
For a list of all 4 – 2 marks.
For a list of 3 – 1 mark.
For a list of 2 – no marks.
If a candidate makes no explicit reference to imports/exports a maximum of 2 marks. [4]
(b) Explanation could include:
• the country is spending more on foreign goods and services than is being spent on that country's goods and services
• a country's goods and services were not very price competitive on world markets/ higher domestic inflation relative to other countries
• this is particularly a problem with a fixed exchange rate system
• a decline in the relative quality of domestically produced goods and services. [6]
(c) Possible policies:
• bring about a fall in the exchange rate by devaluation (if a fixed exchange rate system)
or by allowing a depreciation (if a floating exchange rate system); this would make exports less expensive and so demand for them would be likely to rise
• this will increase total export revenue if PED is elastic
• provide a subsidy which reduces the production costs of domestic firms, enabling them to reduce prices
• supply-side policies to increase the skills/qualifications of the labour force; this would help to improve the quality of exports
• government support for trade fairs/exhibitions in other countries to make people aware of a country's exports.
An answer which fails to consider which would be the most effective policies to increase a country's exports can gain no more than 6 marks.

4 China decides to move towards a more flexible exchange rate

In the past, the Chinese Government kept an exchange rate of 6.8 yuan to US$1. However, a spokesperson for the People's Bank of China, the country's central bank, said that it would begin to allow the market to play a much greater role in determining the exchange rate. It is expected that a more flexible rate will result in an increase in the value of the Chinese currency.

China has had a surplus on the current account of its balance of payments in recent years. Economists believe that an appreciation of its currency should help to reduce the size of the surplus.

The decision by China will please the United States (US) and many other countries which have a large trade deficit with China. The President of the US has said that "market-determined exchange rates are essential to global economic vitality." If the Chinese Government had not decided to allow its exchange rate to be determined by market forces, many American companies would have demanded tough protectionist measures to reduce the number of Chinese imports coming into the US. They had criticised the Chinese Government for keeping its currency artificially weak which gave Chinese exporters an unfair advantage.

(a) Analyse how a rise in the external value of the yuan might affect China's current account balance. [6]

(b) Explain why a large surplus for China over many years in the current account of the balance of payments could be a problem for other countries, such as the US. [4]

(c) Discuss the extent to which trade protection could correct a balance of trade in goods and services deficit. [8]

MARKSCHEME:

(a) Possible reason:

• appreciation of the currency will make exports more expensive

• and imports less expensive

• this is likely to decrease the demand for Chinese exports and increase the demand for imports

• this will decrease China's total export revenue and increase total import expenditure if PED is elastic

• this will reduce China's current account surplus. [6]

(b) Possible problems:

• distinction between short-term and long-term needs to be made clear

• one country's surplus is another country's deficit; the country with the deficit may introduce protectionist measures (as indicated)

• countries with deficits could face exchange rate problem

• countries with deficits could face employment problem. [4]

(c) Up to 4 marks for description of protection, such as:

• tariffs

• quotas

• subsidies

• exchange controls

• embargoes/bans.

There is a maximum of 2 marks for a basic list of protection methods.

Up to 4 marks for discussion of their effectiveness and the other possible ways to reduce the trade deficit, such as:

• increase in exports

• reduction of exchange rate.

There is a maximum of 6 marks if there is no consideration of other possible ways to reduce the deficit OR where the candidate does not consider the relative effectiveness of different possible methods. [8]

5 Many economies are now experiencing a large current account deficit on their balance of payments.

(a) Describe the structure of the current account of the balance of payments. [4]

(b) Explain what is meant by a current account deficit on the balance of payments. [4]

(c) Explain why a large current account deficit on the balance of payments is usually regarded as a serious problem. [4]

(d) Discuss which is the best way to reduce a large current account deficit on the balance of payments. [8]

MARKSCHEME:

(a) • trade in goods (visibles)
• trade in services (invisibles)
• income flows
• current transfers
Identification of four sections (2).
Identification of two/three sections (1).
1 mark for each section described.
Note: maximum of 4 marks. [4]
(b) The combined value of the debit items in the four sections of the current account of the balance of payments is greater than the combined value of the credit items in the four sections of the current account. (4)
Deficit in relation to three sections (3).
Deficit in relation to two sections e.g. trade in goods and services (2).
Deficit in relation to one section e.g. trade in goods (1).
Note: maximum of 4 marks. [4]
(c) • it could mean that a country is consuming more than it is producing, i.e. the country is living beyond its means
• it could mean that if too many goods are being imported from abroad, not enough is being produced in the home country, giving rise to high unemployment
• it usually means that a country's goods are not competitive enough on world markets
• a fall in the value of the currency could potentially lead to imported inflation
• spending/income is leaving the country
• may put downward pressure on the exchange rate and so raise the price of imports.
Note: maximum of 4 marks. [4]
(d) Candidates could focus on reducing imports:
• tariffs
• quotas
• subsidies
• exchange controls
• government encouraging people to buy home produced products
Candidates could focus on encouraging exports:
• devaluation/depreciation of exchange rate
• subsidies
Descriptive answers which do not really focus on which is the 'best' way to reduce a large current account deficit can gain no more than 6 marks.
Note: Full marks may be gained if two ways are explored in depth and 'best' is addressed.
Note: maximum of 8 marks. [8]

CURRENT ACCOUNT OF BALANCE OF PAYMENTS-SET-3-QP-MS

1 Some countries have a fixed exchange rate system, but others allow the external value of their currency (foreign exchange rate) to float.

(a) Describe how a government maintains the external value of its currency in a fixed exchange rate system. [4]

(b) Explain why a government might want the external value of its currency to fall. [4]

MARKSCHEME:

(a) if the value is falling, the government will step in to buy more of the currency
if the value is rising, the government will step in to sell more of the currency
governments buy foreign currencies using reserves
the government could also increase interest rates when the value is falling
and reduce interest rates when the value is rising
reference to the mechanism by which interest rates changes affect the exchange rate
Note: maximum of 4 marks. [4]
(b) to make its exports relatively cheaper in price in foreign markets and therefore more competitive
this could lead to an increase in demand (especially if the price elasticity of demand for the goods is elastic)
to make imports more expensive which should lead to a reduction in the number of (assuming the price elasticity of demand is elastic)
this should lead to an improvement in a country's balance of trade in goods and services the government might not have sufficient reserves to keep intervening in the foreign exchange market (where there is persistent downward pressure on the exchange rate)
Note: maximum of 4 marks. [4]

2 In March 2012, the Indian Government increased the tariff on imports of gold. It did this to reduce the country's growing deficit on the current account of its balance of payments.

(a) Analyse **three** causes of a current account deficit. [6]

(b) Discuss whether a government should always be concerned about a growing current account deficit. [10]

MARKSCHEME:

(a) **Analyse <u>three</u> causes of a current account deficit.**

1 mark for idea of the meaning of the current account/current account deficit.

1 mark each for three causes identified:

- high exchange rate
- inflation
- low productivity
- high costs of production
- low quality of domestically produced products
- low incomes abroad
- high incomes at home
- protectionism abroad
- lack of protectionism at home.|

1 mark each for an analysis of three causes:
• high exchange rate would mean high export prices and low import prices
• inflation makes domestic products less price competitive
• low productivity of labour will raise wage costs/high prices of domestic products
• high costs of production e.g. raw material cost/results in high prices of domestic products
• low quality reduces demand for exports and raises demand for imports
• low incomes abroad may result in low demand for exports
• high incomes at home may lead to high demand for imports
• protectionism abroad e.g. tariffs make it difficult to export
• absence of protectionism at home may result in e.g. dumping.

(b) Discuss whether a government should always be concerned about a growing current account deficit. [10]
Up to 7 marks for why it should:
Up to 5 marks for: may indicate a poor economic performance [1] low demand for country's products [1] may be result of high inflation [1] poor quality products [1] low productivity [1].
Up to 3 marks for: will reduce total demand [1]and so may increase unemployment [1] and lower GDP [1].
Up to 3 marks for: may lead the country into debt [1] interest will have to be paid [1] this will involve an opportunity cost [1].
Up to 7 marks for why it should not:
Up to 5 marks for: may move later to a surplus [1] if imports are of raw materials [1] and capital goods [1] may be used to produce products to replace imports [1] and to be exported [1].
Up to 3 marks for: may be short term [1] especially if caused by falling incomes abroad [1] will be reduces when incomes rise [1].
Up to 2 marks for: may be a relatively small deficit [1] and/or may last for a short time [1] Up to 2 marks for: there may be more serious macroeconomic problems [1] e.g. rising unemployment [1].

Maximum of 5 marks for a list-like response.

3 Between 2011 and 2012 Russia's exchange rate was relatively constant. The country continued to have a surplus on the current account of its balance of payments. The main change in its international trade position arose from it joining the World Trade Organisation. In order to do this, the government agreed to move towards free trade.

(a) Describe what is meant by a current account surplus. [4]

(c) Discuss whether engaging in free trade will always benefit an economy. [10]

MARKSCHEME:

(a) (a) Describe what is meant by a current account surplus. [4]
4 marks for credit items on exports, income and current transfers exceed debit items o imports, income and current transfers.
3 marks for revenue from the export of goods and services exceeds expenditure on the import of goods and services.
2 marks for export revenue exceeds import expenditure.
1 mark for credit items exceed debit items.
1 mark for exports exceed imports.
Note: a maximum of 4 marks overall.
(b)
Discuss whether engaging in free trade will always benefit an economy. [10]
Up to 7 marks for the benefits of free trade:
Up to 5 marks for: allows countries to specialise [1] may result in an efficient allocation of
resources [1] enables firms to take advantage of economies of scale [1] lowers costs of production [1] may lower prices [1].
Up to 4 marks for: greater competition [1] raises quality [1] may lower prices [1] increases choice [1].
Up to 3 marks for: protecting domestic industries may be inefficient [1] infant industries may not have the potential to grow [1] may become dependent on support [1].
Up to 2 marks for: prevents retaliation [1] stops trade wars/keeps exports high [1].
Up to 2 marks for: allows import of resources not available/more expensive domestically [1] allowing firms to produce more efficiently [1].
Up to 2 marks for: offers consumers a variety of goods and services [1] from a wide range of different countries [1].
Up to 7 marks for disadvantages of free trade:
Up to 5 marks for: may prevent development of infant industries [1] may have high start up costs [1] initially unable to take advantage of economies of scale [1] charge high prices [1] may have the potential to become competitive [1].
Up to 4 marks for: there may be unfair competition [1] dumping [1] selling at a price below cost [1] making it impossible for domestic firms to compete [1].
Up to 3 marks for: may result in declining and strategic industries going out of business [1] sudden increase in unemployment [1] increase structural unemployment [1].
Up to 3 marks for: increased dependence on other countries for products [1] so less control over what is imported [1] such as poor quality goods/illegal items [1].
Up to 5 marks for a list-like response.
Note: a maximum of 10 marks overall.

4 What does the future hold for Sweden?

Sweden is a highly developed European country which enjoys one of the highest standards of living in the world. In 2012, its citizens enjoyed an average income of US$49 000. The country's labour force of five million is highly skilled. About 70% of schoolchildren go on to university. Over the years, investment has been high in Sweden and as a result there is a high value of capital goods for each worker to use. In 2012, however, its economic growth rate slowed. The Swedish Government was hoping that its decision to raise the retirement age to 67 would increase the country's economic growth rate.

Sweden exports half of its output. It exports a range of products including cars and capital goods. Among the country's imports are petrol, cars and iron. Table 1 shows the balance of the current account of its balance of payments over the period 2008–2013.

Table 1: Sweden's current account balance, 2008–2013

Year	Current account balance	
	US$ billion	as a % of Gross Domestic Product (GDP)
2008	+38	6.9
2009	+31	7.0
2010	+31	6.8
2011	+32	6.4
2012	+39	7.1
2013	+40	7.2

A country's trade position is influenced by its inflation rate. Indeed, a fall in a country's inflation rate can increase the international competitiveness of its products. The Swedish Government aims to keep the annual inflation rate at 2% or below. If there is a risk that the inflation rate will exceed the 2% target, the Swedish Central Bank will raise the interest rate. Such a change will be likely to influence consumer expenditure, investment and the exchange rate. In recent years, Sweden's inflation rate has remained low, averaging 1.9% between 2008 and 2013.

The low inflation rate provides certainty for Swedish firms. The best known Swedish firm is probably IKEA, which produces furniture and household accessories. In 2012, it reduced its prices which, as on previous occasions, resulted in a rise in its revenue. In 2013, its owners stated that their main goal was to increase the size of the firm by opening new stores throughout the world, including in its expanding markets in China and Russia.

Using information in Table 1, describe what happened to:

(i) Sweden's current account position over the period shown [2]

(ii) Sweden's GDP between 2009 and 2010. [2]

MARKSCHEME:

Using information in Table 1, describe what happened to:
(i) Sweden's current account position over the period shown [2]
• for recognition of surplus e.g. it was in surplus throughout the period / fell at the start and then rose / fluctuated (1)
• for a description of how the figures changed between 2008 and 2013 e.g. increases from US$38 bn to US$40 bn / shows an increase of US$2 bn (1)
(ii) Sweden's GDP between 2009 and 2010. [2]
• it increased (1) although current account balance remained unchanged as a percentage of GDP it fell (1)
• it changed from $442.86 bn ($443 bn) to $455.89bn ($456 bn) (2)

5 In July 2016 the Sveriges Riksbank, Sweden's central bank, cut the rate of interest to 0.25%. The Swedish economy was experiencing deflation, with the weighted price index falling by 0.2% on the previous year. The fall in the rate of interest reduced the value of the krona, Sweden's currency, and was expected to end deflation.

Analyse how a fall in the value of a currency may increase a current account surplus on the balance of payments. [6]

MARKSCHEME:

A fall in the value would mean that more of the currency has to be sold to buy a given unit of another currency (1).
• A fall in the value of the currency would reduce export prices (1) and increase import prices (1).
• Demand for exports may increase/more exports (1) this may increase export revenue (1) if demand for exports is price elastic (1).
• Demand for imports may fall/lower imports (1) this will reduce import expenditure (1) if demand for imports is price elastic (1).
• A rise in export revenue and/or a fall in import expenditure will increase a trade in goods/ and services surplus (1).
• Trade in goods and trade in services appear in the current account (1) credit items in the current account would increase (1) while debit items would fall (1).

1 In 2015, money sent home by Nepalese workers working abroad accounted for 29% of Nepal's total income. These remittances also contributed positively to the country's current account position on its balance of payments. In Kerala, a state in India, remittances accounted for 36% of total income, with people from the state going abroad to undertake a range of jobs including working as dentists and hotel cleaners.

Explain **two** effects of a country having a surplus on the current account of its balance of payments. [4]

MARKSCHEME:

Explain two effects of a country having a surplus on the current account of its balance of payments.

1 mark each for each of two effects identified:

- output/income may be high
- employment may be high
- upward pressure on the exchange rate
- total (aggregate) demand will increase
- demand pull inflation

1 mark each for each of two explanations given:

- a surplus means that there is more export revenue being earned than import expenditure
- a surplus means that international trade is adding to demand for the country's products which may increase employment
- demand for the currency will exceed supply of the currency
- exports add to total demand resulting in inflation

2 In 2014, the government of Kazakhstan devalued its currency, the tenge. A year later the country still had a current account deficit. Therefore, in 2016 it considered adopting a floating exchange rate which might help to remove the deficit. However, it had concerns that this might affect the country's inflation rate which was already high at 17%.

Discuss whether or not a reduction in a current account deficit on the balance of payments will benefit an economy. [8]

MARKSCHEME:

Discuss whether or not a reduction in a current account deficit on the balance of payments will benefit an economy.

Up to 5 marks for why it might:
May mean that demand for imports has fallen (1) and/or demand for exports has risen (1) higher total (aggregate) demand (1) may increase GDP/create economic growth (1) reduce unemployment (1).
Will reduce debt (1) not have to borrow as much to finance it (1).
May cause appreciation of exchange rate (1) leading to lower inflation (1).

Up to 5 marks for why it might not:
If the deficit is reduced by buying fewer imports of raw materials (1) and capital goods (1) may reduce GDP (1) lower exports in the longer run (1).
If fewer imports are being purchased because of a recession (1) GDP will be falling (1).
If fewer imports are being purchased because trade restrictions are introduced (1) there may be retaliation (1) with tariffs/quotas being imposed one exports (1).
Higher total (aggregate) demand might lead to (demand-pull) inflation (1).
Exchange rate may appreciate (1) can reduce total demand/worsen the deficit in the long run (1).
Accept higher total demand on either side. One mark if given on both sides. More marks can only be awarded if a reason why this leads to a benefit/cost is given.

3 Farms in the USA are getting larger. One dairy farm in the state of Indiana has over 38 000 cows. Farms in the USA compete with farms in both developed and developing countries. The value of the farms' exports of milk appears in the trade in goods section of the current account of the USA's balance of payments.

Explain how a country could have a trade in goods surplus, but a deficit on the current account on the balance of payments. [4]

MARKSCHEME:

Explain how a country could have a trade in goods surplus but a deficit on the current account on the balance of payments.

Trade in goods surplus means exports (of goods) exceeds imports (of goods) (1) trade in goods is only one part of the current account (1) *identification of two of the three other components* (1) there could be a larger deficit on the trade in services balance (1) *example of a service item decreasing* (1) there can be a larger deficit on income (primary) balance (1) *example of an income item increasing* (1) there could be a larger deficit on current transfers (secondary) balance (1) *example of a current transfer item decreasing* (1) or a combination of deficits on other items (1).
A current account deficit means more money will be leaving than entering the country (1).

Maximum of 4 marks unless at least one type of economy of scale is related specifically to a farm e.g. buying seed in bulk.

Also credit analysis of external economies of scale.

Maximum of 3 marks for a list-like approach.

4 Iceland's Economic Structure

The people of Iceland once depended on farming and fishing as their main source of income. By 2008, the Icelandic economy was also very heavily dependent on its financial sector. However, the country is now well-known internationally for tourism.

Even though the primary sector now only employs a small proportion of the country's labour force, the influence of this sector in policy-making is very strong. For example, in the fishing industry, there are many government regulations. Regulations that restrict foreign investment in the fishing industry both protect domestic fisherman and the stock of fish in Icelandic waters. Regulation also affects the price elasticity of supply (PES) of fish. The quantity of fish supplied tends to change by a smaller percentage than the change in its price.

From 2002 to 2007, Iceland's annual economic growth rate averaged 5%. In 2006, Iceland's Gross Domestic Product (GDP) was US$17 billion and in 2007 it grew by 9%. This high growth rate was due to the increased availability of bank loans and also the increasing income of its major trading partners, including the European Union (EU) and Norway.

It was during this period of rapid economic growth that the financial sector became an important part of the Icelandic economy. The major commercial banks supported increased consumer spending and major construction projects which improved the standard of living of Icelanders. In addition, commercial banks also expanded into international markets. The international markets were growing rapidly between 2002 and 2007 which brought more money back into the Icelandic financial sector.

However, Iceland faced a major financial crisis in 2008 where all three of its major privately-owned commercial banks failed. This led to falling overall levels of output and increased unemployment. Fig. 1.1 shows the economic growth rate and unemployment rate in Iceland from 2002 to 2014.

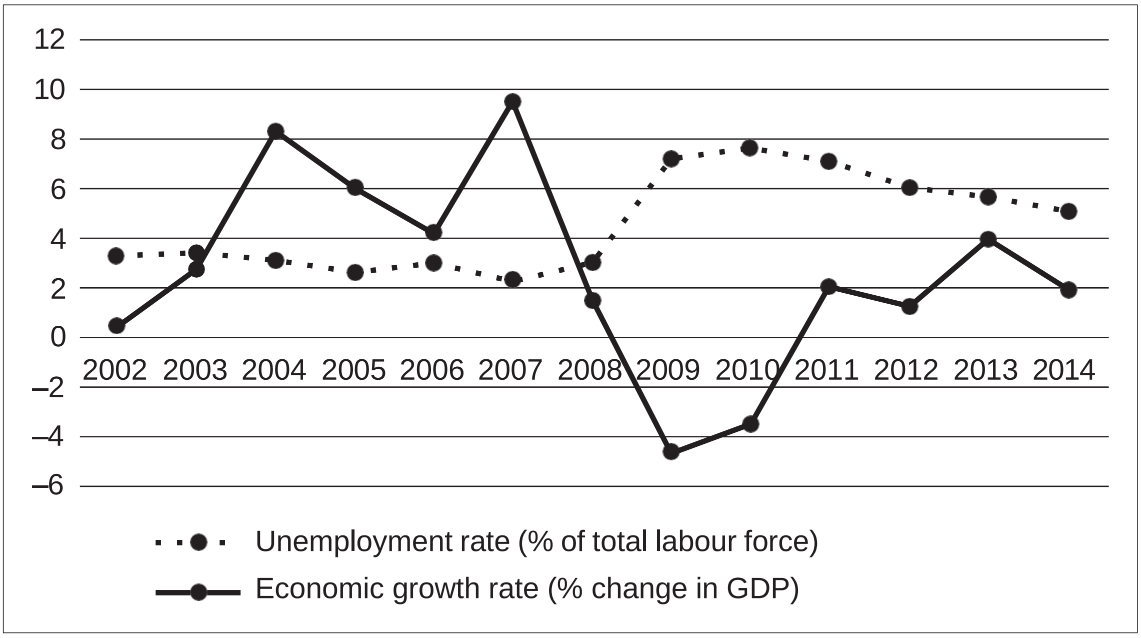


Fig. 1.1 Economic growth rate and unemployment rate in Iceland from 2002 to 2014

The recovery from 2010 to 2017 was initially possible due to loans obtained from international organisations. More recently, it was also due to successful tourism campaigns that have made Iceland a 'must-see' destination for tourists.

Discuss whether or not a growth in tourism is an advantage to a country such as Iceland. [6]

MARKSCHEME:

Discuss whether or not a growth in tourism is an advantage to a country such as Iceland.

Up to 4 marks for why it might be:
Tourism is an export of services (1) bringing in foreign currency (1) improving the current account balance (1).
Tourism may increase government tax revenue (1) this could be spent on e.g. education (1).
Tourism increases the demand for goods and services (1) creating employment/reducing unemployment (1) e.g. in hotels/restaurants/shops (1) increases output / contributes to economic growth (1).
Tourism may attract MNCs/foreign investment (1) e.g. foreign hotel chains may set up in the country (1).
More revenue from tourism may result in a rise in the exchange rate (1) this may reduce the price of imports (1)
Less reliance on primary / secondary sector (1) benefits of diversification (1).

Up to 4 marks for why it might not be:
Tourism may create external costs (1) example e.g. pollution (1).
Tourism may deplete resources (1) e.g. water (1).
Tourism may place a strain on infrastructure, e.g. transport systems (1)
Tourism jobs may be low-paid (1) low skilled (1) seasonal (1).
Foreign firms may send profits home (1) foreign hotels may bring own employees (1).
A high exchange rate may reduce exports / international competitiveness (1). Tourism may increase demand in the economy (1) pushing up the prices the local population have to pay / creating inflation (1).

1 Economists are uncertain about the future United States (US) macroeconomic performance. For instance, in recent years, US unemployment has fallen while the deficit on the current account of the balance of payments has fluctuated. Whether its current account deficit will rise or fall in the future may be affected by proposed tax cuts. Some economists suggest that the US government should not be concerned about the country's current account deficit.

Discuss whether or not a current account deficit on its balance of payments harms an economy. [8]

MARKSCHEME

Level	Descri	Marks
3	A reasoned discussion which accurately examines both sides of the economic argument, making use of economic information and clear and logical analysis to evaluate economic issues and situations. One side of the argument may have more depth than the other but, overall, both sides of the argument are considered and developed. There is thoughtful evaluation of economic concepts, terminology, information and/or data appropriate to the question. The discussion may also point out the possible uncertainties of alternative decisions and outcomes.	6–8
2	A reasoned discussion which makes use of economic information and clear analysis to evaluate economic issues and situations. The answer may lack some depth and development may be one-sided. There is relevant use of economic concepts, terminology, information and data appropriate to the question.	3–5
1	There is a simple attempt at using economic definitions and terminology. Some reference may be made to economic theory, with occasional understanding.	1–2
0	A mark of zero should be awarded for no creditable content.	0

Why it might:
- income/demand is leaving the economy
- employment will be lower than it could be
- it may put downward pressure on the exchange rate
- the country will get into debt
- other countries may not be willing to lend to it / invest in the country.

Why it might not:
- deficit may be low / short term
- enables the country to consume more than it produces
- imports of raw materials and capital goods will increase output in the future.

Why it might:
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Why it might not:
- deficit may be low / short term
- enables the country to consume more than it produces
- imports of raw materials and capital goods will increase output in the future.

2 A US trade agency ruled that US imports of steel bars from China and South Korea might be unfair to US companies because they were sold at below market price. The agency wanted a tariff to be imposed on the imports.

(a) How would the trade in steel bars be classified in the Chinese balance of payments? [2]

(b) Consider how cheap imports might affect US companies. [4]

MARKSCHEME

(a) mark each for visible or goods and export or current account. [2]
(b) Up to 4 marks for considering the effects of cheap imports on US companies, such as cheap raw materials for some companies, but more competition for companies producing similar goods to those imported. [4]

3 (a) What is meant by the balance of payments? [4]

(b) Why do countries trade with each other? [6]

MARKSCHEME

(a) Description of different parts of the current account of the balance of payments. [4]

(b) Discussion about advantages of increased choice, better use of resources, ability to earn income, increase in economic growth. [6]

4 Tourism in Kenya

On average, over one million holiday makers travel to Kenya each year. Many holiday makers like to get away from the colder climates in Europe and North America, and they enjoy visiting the safari parks and beaches.

Tourism is Kenya's largest foreign exchange earner. It brings in between US$1000 million and US$1500 million a year, more than the combined earnings from the next two largest earners, horticulture (flowers and vegetables) and tea. The tourist industry directly employs 500 000 people. It employs another 500 000 people indirectly. For example, the farmers in areas without a tourist industry sell products to restaurants and hotels in the tourist areas.

Economic growth was a success story for the Kenyan Government, and between 2002 and 2007, economic growth increased from 0.5% to 7%. However, in 2008, the demand for holidays in Kenya fell as holiday makers chose to visit other destinations. This had a huge impact on Kenya's economy, and analysts feared a recession was likely. For the Kenyan economy to continue with a 7% growth rate after 2008, tourism would have to increase again.

Explain how tourism affected Kenya's balance of payments before and after 2008.

MARKSCHEME

Definition of balance of payments – 1 mark.
Explanation of what happened before 2008:

- tourism Kenya's largest foreign exchange earner
- it was bringing in between US$1000m and US$1500m a year
- more than the combined earnings from the next two largest earners
- these earnings from this invisible item would be a major contributor to the current account.

5 **(a)** Describe the structure of the current account of a country's balance of payments. [4]

(b) Explain the policies a government could use to reduce a deficit on the current account of the balance of payments. [6]

MARKSCHEME

(a Structure of current account:

- visible trade account – the difference between the export revenue and import spending on physical goods, e.g. cars, washing machines
- invisible trade account – measures the difference between export revenue from and import spending on services, e.g. banking, insurance and tourism
- income – e.g. interest, profit and dividends flowing in and out of the country
- current transfers – e.g. grants for overseas aid.

An answer which just deals with visibles and invisibles can gain up to 3 marks. [4]

(b) Policies:

- expenditure switching policies – attempts to make imports relatively expensive compared to exports, such as through import controls, e.g. tariffs or through a reduction in the exchange rate such as a devaluation/depreciation
- expenditure reducing policies – attempts to reduce spending throughout the economy through deflation, such as through an increase in taxes, a reduction in government spending or an increase in interest rates
- encouraging demand for exports, such as through subsidies.

A maximum of 4 marks if only an increase in exports or a reduction in imports is explained. [6]

CURRENT ACCOUNT OF BALANCE OF PAYMENTS-SET-6-QP-MS

1 Describe the structure of the current account of a country's balance of payments[4].

MARKSCHEME:

There are four elements:

trade in goods/visible balance of exports and imports

- trade in services/invisible balance of services
- income
- current transfers.

An answer which only focuses on the first two elements, i.e. the balance on trade in goods and services, can gain 3 marks. [4]

2 Trade protection and changes in exchange rates are two ways a country can try to reduce a current account deficit of the balance of payments.

(a) Explain what is meant by 'a current account deficit of the balance of payments'. [4]

(b) Analyse why the depreciation of its currency's exchange rate may lead to a reduction in a country's current account deficit. [6]

MARKSCHEME:

(a) Explain what is meant by 'a current account deficit of the balance of payments'. [4]

Candidates could refer to:

- imports greater than exports (1)
- the composition of the current account in terms of trade in goods/visibles, trade in services/invisibles (1), income and/or current transfers (1) is negative
- the idea that when all these four sub-sections are added together, this will produce the current account balance (1)
- if the value of the debit items taken together is greater than the value of the credit items (1), there is a deficit (1)

(b) Analyse why the depreciation of its currency's exchange rate may lead to a reduction in a country's current account deficit. [6]

Up to 4 marks for:

- a fall in a country's exchange rate leading to cheaper prices abroad (1), leading to an increase in demand for exports (1), export revenue will increase as long as the price elasticity of demand is elastic (1), which is likely to reduce the deficit (1)

Up to 4 marks for:

- a fall in a country's exchange rate will make imports more expensive (1), leading to a fall in demand for imports (1), import expenditure will decrease as long as price elasticity of demand is elastic (1)
- this could reduce the deficit (1)

Up to 2 marks for recognising other factors influence the current account, e.g. changes in trade restrictions, changes in incomes abroad, changes in PED, changes in PES (1+1).

3 Discuss whether an economy will always benefit from an increase in international trade. [10]

MARKSCHEME:

Discuss whether an economy will always benefit from an increase in international trade. [10]

Up to 7 marks on the benefits of international trade:
Up to 2 marks: the concentration on the most effective use of resources (1) can lead to greater output (1), supporting table (1).
Up to 2 marks: it can lead to a greater choice for consumers (1), improving standards of living (1).
Up to 2 marks: the opportunity to participate in international trade will force domestic firms to be efficient (1), they will need to be as competitive as possible and this will lead to a reduction in unemployment (1).
Up to 2 marks: it might be possible for such firms to benefit from economies of scale (1), reducing the costs of production (1).
Up to 2 marks: if the value of the exports exceeds the value of the imports, this could lead to a favourable balance of trade (1), bringing more money into the economy than goes out (1).

Up to 7 marks on the disadvantages of international trade:
Up to 3 marks: the domestic firms may be less efficient than foreign ones (1) and this could lead to some of them going out of business (1), leading to an increase in unemployment (1). Up to 2 marks: the value of imports could be greater than the value of the exports (1), leading to a trade deficit (1).
Up to 3 marks: foreign firms may use certain tactics (1) to establish themselves in a market, such as dumping (1), which could lead to domestic firms being undercut (1).

4 Many countries have a deficit in the current account of their balance of payments but some countries, such as China, Germany and Japan, regularly have a surplus in their current account.

(a) Explain **two** consequences of a current account deficit. [4]

(b) Analyse what can cause a surplus in the current account of the balance of payments. [8]

(c) Discuss whether a current account surplus is always to be regarded as desirable. [8]

MARKSCHEME:

Many countries have a deficit in the current account of their balance of payments, but some countries, such as China, Germany and Japan, regularly have a surplus in their current account.

(a) Explain two consequences of a current account deficit. [4]

Up to 2 marks for the following:

- if a country is spending more on imports than on exports, this will result in money leaving a country (1) making the country less well-off (1)
- output and employment are lower than they would otherwise be (1), because too few exports are being demanded and too many imported goods are entering the country (1)
- the deficit will put downward pressure on a country's exchange rate (1), leading to a depreciation of its value/fall in internal inflation (1)
- if one country has a deficit (1), it means that another country will have a surplus (1)

(b) Analyse what can cause a surplus in the current account of the balance of payments. [8]

Up to 6 marks for a surplus in:

- visible balance (1): depreciation/devaluation of exchange rate would make exports cheaper and imports dearer; this would contribute to a surplus if PED was elastic (1). A country's exported goods have a reputation for quality/reliability (1), other countries rate of economic growth is higher (1) inflation rate is lower – making goods relatively cheaper (1), higher productivity (1) reducing prices and/or raising quality of goods(1)

Up to 4 marks for a surplus in:

- invisible balance (1): country is very good in particular services, e.g. banking or insurance (1); shipping services can bring in a lot of money (1); tourist expenditure by people visiting a country (1)

Up to 2 marks each for a surplus in

- income, a net positive investment income (1), e.g. money from dividends, would contribute to a surplus (1)
- current transfers (1), e.g. net surplus from gifts, charitable donations and payments from one government to another (1), workers' remittances (1)

Maximum of 4 marks for a list or list-like answer

5 Discuss whether a current account surplus is always to be regarded as desirable. [8] Up

to 6 marks on the argument that it is always to be regarded as desirable:

Up to 2 marks each for the following:

- the surplus can be used to increase foreign exchange reserves (1), strengthening the economic position of a country (1)
- if there is a surplus, a government will not need to borrow money to finance a current account deficit (1), meaning that the money can be spent on other, more productive, uses (1)
- the purchasing of a country's exports, and/or the lower rate of purchase of imports, means that there is higher output (1), resulting in a higher level of employment (1)

Up to 6 marks on the argument that it is not always to be regarded as desirable:

Up to 3 marks for:

- a surplus can lead to an appreciation/revaluation of a country's exchange rate (1), making its exports more expensive (1) and this could damage the competitiveness of the exports (1)

Up to 2 marks for:

- one country's surplus is another country's deficit; the country with the deficit may introduce protectionist measures (1) which would ultimately be bad for world trade, affecting all countries (1)
- less goods available in domestic market (1) lowers standard of living for consumers (1)
- high exports of raw materials may result in depletion of resources (1) having an adverse impact on economy in the long-run (1)
- if exports become less competitive, this will affect output (1), leading to a lowering of living standards (1)

Answers that state that the current account surplus can be used to spend on government projects/use when in recession etc. are incorrect.

Maximum of 4 marks for a list or list-like answer.

1 Capital goods make up over half of Japanese exports. In 2013, although Japan's imports rose more rapidly than its exports, there was still a surplus on the current account of its balance of payments. Across the world, increasing trade was leading to new airports being opened to meet the demand for transporting goods.

(a) Explain **two** reasons why a country's export revenue might increase when export prices ri[s4e].

(b) Analyse how a government could increase the surplus on the country's current account of the balance of payments. [6]

MARKSCHEME:

(a_)One mark each for each of two reasons identified:

inelastic demand for exports
fall in exchange rate
increase in demand
rise in investment
removal of trade restrictions abroad
inflation in other countries

(b) One mark each for each of two reasons given:

- inelastic demand for exports would mean demand falling by less than the rise in price
- fall in exchange rate would make exports relatively cheaper
- demand may increase as a result of e.g. a rise in incomes abroad
- rise in investment may make exports more quality competitive
- removal of trade restrictions abroad may make exports cheaper in foreign markets
- prices may rise by more in other countries

2 The changing oil market

In 2013 China overtook the United States of America (US) as the largest importer of oil. The rise in Chinese demand has driven up the price of oil. The higher price of oil has made production techniques used in the US, such as hydraulic fracking, possible and has provided more oil for US domestic consumption. US oil companies have purchased larger, more expensive capital equipment and are employing more specialist engineers. The expansion in the US oil industry contributed to the fall in the country's unemployment rate to 6.1% in 2014.

Despite being the largest importer of oil, China is not yet the world's largest consumer. In 2013 the US oil industry supplied 10.5 million barrels a day, exported 3.4 million barrels a day and imported 10.9 million barrels a day. These figures are likely to change in the future. For example, in 2013 the US had 250 million vehicles and China had only 100 million. It is forecast that by 2030 China will have 350 million vehicles. If this change does occur, China will become more vulnerable to oil price changes and disruptions in the supply of oil.

While US oil production is increasing, its consumption is falling. More oil is being discovered in the country and more sophisticated techniques are being used to extract it. At the same time, fewer young people in the country are learning to drive, vehicle ownership per household is falling and average mileage is declining. In addition, US cars are becoming more fuel efficient as a result of tighter fuel economy standards and consumers switching to more economical vehicles.

US consumers are becoming more sensitive to changes in the price of oil but a rise in price still leads to a rise in oil producers' revenue. Changes in the price of oil, oil production and oil consumption also still have a significant effect on the US economy. For example, the discovery of more oil in the country usually affects the value of the US dollar.

Changes in the consumption and production affect China's and the US's current account positions on their balance of payments. Currently China has the world's largest current account surplus whilst the US has the world's largest current account deficit. It is interesting to note that both countries have been trying to increase their economic growth rate. The US central bank, the Federal Reserve, has tried to raise the growth of the country's output by cutting the rate of interest.

Discuss whether a government should try to reduce a surplus on the current account of its country's balance of payments. [6]

MARKSCHEME:

Up to 4 marks for why it might:
Living standards would be higher (1) as more imports could be purchased (1).
Exports satisfy foreign demand not domestic demand (1).
May reduce inflationary pressure (1) a surplus results in higher demand (1).
A surplus would put upward pressure on the exchange rate (1) making exports more expensive (1) and making it more difficult for a government to maintain a fixed exchange rate (1).
Importing more machinery (1) will increase economic growth in the long-run (1).
Up to 4 marks for why it might not:
Exports exceeding imports will increase total demand (1) this may increase economic growth (1).
Higher demand for exports and import substitutes will encourage firms to expand output (1) this will create more jobs / reduce unemployment (1).
More exports / fewer imports may increase the demand for the currency (1) causing the currency to appreciate (1) keeping imported inflation down (1) reduce the surplus without government action (1) by raising export prices and lowering import prices (1).

3 In Saudi Arabia, output of cement has risen as a result of an increase in demand from the construction industry for building houses, schools, hospitals and roads. The market for cement is also being affected by price changes, export bans and mergers between companies making cement.

Explain **two** reasons why a country might want to restrict exports.[4]

MARKSCHEME:

1 mark each for each of two reasons identified:

- keep prices low on home market
- prevent stocks running out
- maintain monopoly of raw materials
- reduce balance of payments surplus / reduce demand-pull inflation
- raise price of exports.

1 mark each for each of two explanations given:

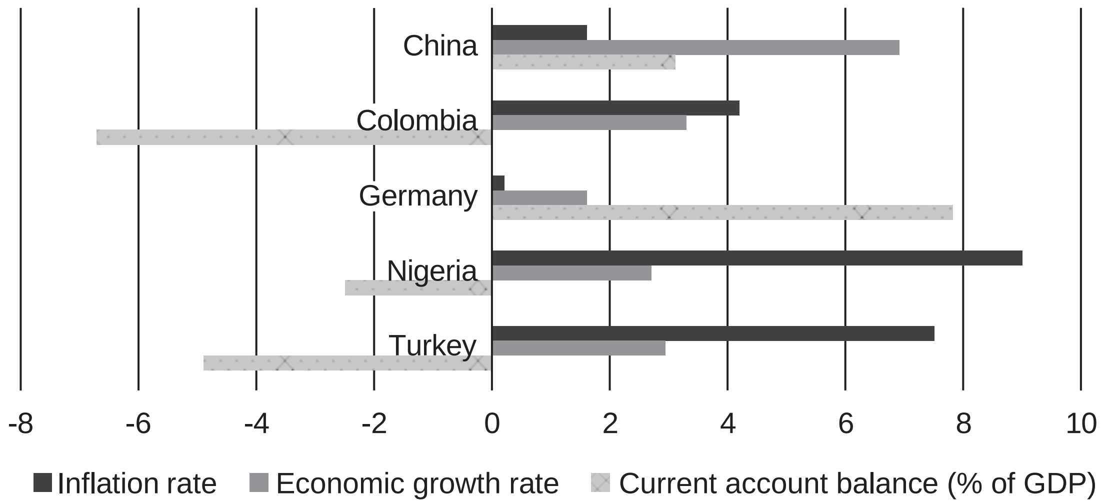
- reducing exports may increase supply on the home market
- a government may want to conserve e.g. oil for future generations to enjoy
- reducing exports of raw materials that are found mainly in the country may mean that other countries/firms will not be able to produce the product
- may increase export revenue if demand is inelastic.

4 **Nigeria adopts a floating exchange rate**

In June 2016, Nigeria adopted a floating exchange rate after the country's central bank had spent months trying to maintain its fixed exchange rate. It had used foreign currency reserves to buy its currency, imposed tariffs and limited the amount of foreign currency that Nigerians could purchase.

Most economists thought that the value of Nigeria's currency would depreciate. A lower value of the Nigerian naira might help increase output and reduce the deficit on the current account of the country's balance of payments. In 2015, Nigeria experienced a deficit on its current account for the first time in 20 years. Countries with a current account deficit often have a higher inflation rate and a lower economic growth rate than those with a current account surplus. Fig. 1 shows the inflation rate, economic growth rate and the current account balance of selected countries in 2015.

Fig. 1 The inflation rate, economic growth rate and current account balance of selected countries in 2015



A current account deficit can lower the exchange rate and so may increase import prices. A higher price of imports, including imported food, can accelerate inflation.

In 2015, as well as experiencing a current account deficit, tax revenue fell in Nigeria and was lower than government expenditure. Some economists predicted that the government would cut spending on education and healthcare in 2016 to reduce the gap between tax revenue and government spending.

The Nigerian government has been trying to reduce poverty in the country. In 2015, more than 60% of the population were living in poverty. Among the causes of the high level of absolute poverty was an unemployment rate of 9.5%. One policy measure proposed to reduce poverty in Nigeria is for the government to raise the wages of low-paid workers.

The government also wants to diversify the economy because the oil industry accounts for almost 90% of the country's export earnings. The oil industry pays high wages to some of its workers and relatively high interest rate payments to local banks. It also creates water pollution and air pollution.

Analyse to what extent the information in Fig. 1 suggests that countries with current account deficits have higher inflation rates and lower economic growth rates than those with current account surpluses. [4]

MARKSCHEME:

Analyse to what extent the information in Table 1 suggests that countries with current account deficits have higher inflation rates and lower economic growth rates than those with current account surpluses.

The three countries with current account deficits do have higher inflation rates (1). Correct identification of Columbia/Nigeria/Turkey as the three countries with a deficit (1).
China and Germany have lower inflation (1).
The picture is less certain in terms of economic growth (1).
Evidence (up to 2) e.g. Columbia has a deficit but relatively high economic growth (1).
Germany had a surplus but low economic growth (1).

5 In 2016, France had a trade in services deficit. France is a rich, developed country with a high standard of living. The country is, however, facing several challenges including population problems. Also, after elections in 2017, politicians and economists debated whether the country should try to move towards freer international trade.

(a) Define *a trade in services deficit*. [2]

MARKSCHEME:

Imports of services being greater than exports of services (2).
• A deficit on a section of the balance of payments (1).

6 Each question is introduced by stimulus material. In your answer you may refer to this material and/ or to other examples that you have studied.

Mexico has a history of trade deficits. The government is moving the economy closer to free trade,

to try to improve its macroeconomic performance. It was predicted in 2017 that Mexico's economy would experience a small rise in its unemployment rate. In 2017 the economy's inflation rate was 6.6%, the highest rate since 2001. A number of policy measures may be used to reduce inflation, including increasing the rate of income tax.

(Define *trade in goods balance. [4]*

MARKSCHEME:

Define *trade in goods balance.*

Value of exports of goods / revenue earned from exports minus value of imports of goods / expenditure on imports of goods (2).
Exports minus imports (1) of goods / visible items (1).

Accept exports (of goods) = imports of (goods) for 1 mark