



Edexcel A - AS Level Economics

Theme 2 – The UK economy – performance and policies

2.2 & 2.3 Aggregate demand and Aggregate supply

Worked Examples

Contents

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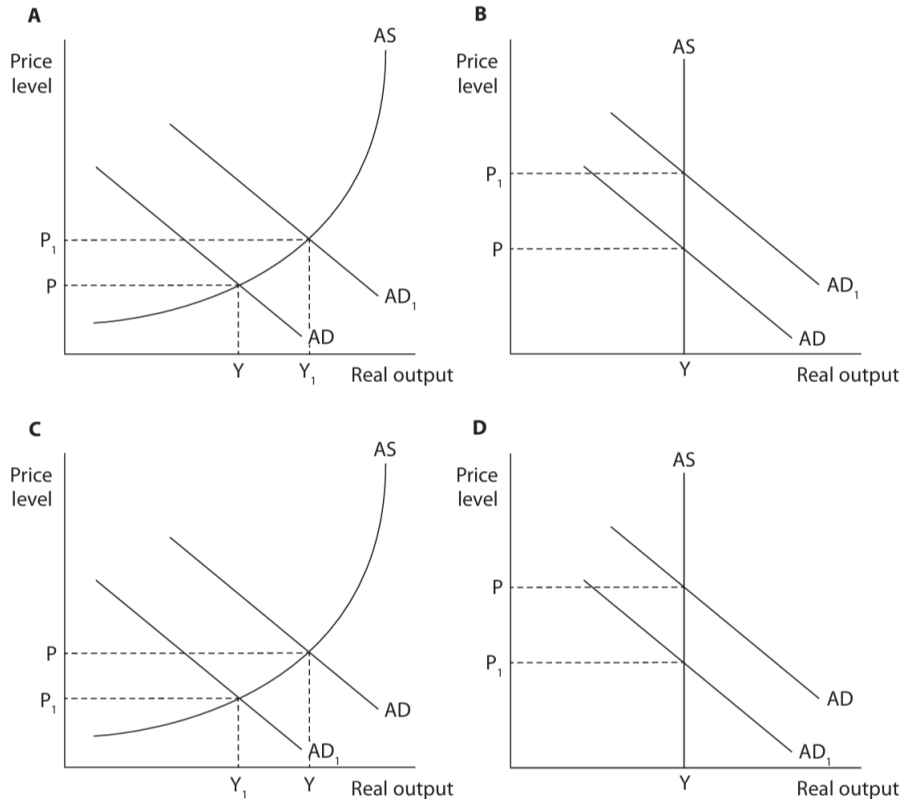
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- Aggregate Demand (AD)
- Aggregate Supply (AS)

2.2 & 2.3 Aggregate demand and Aggregate Supply

Exam Style Question 1

- (a) Which one of the following diagrams illustrates the impact of an increase in net exports along a Keynesian long-run aggregate supply (LRAS) curve? [1]



- (b) Using the classical LRAS curve, explain what will happen in the long run to real output if aggregate demand (AD) increases. [2]

- (c) Explain the likely impact on AD of a fall in average house price. [2]



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Exam Style Question 1

Answer:

- (a) Correct answer: A

Option B: **Incorrect** because this is a Classical LRAS curve.

Option C: **Incorrect** as this shows AD decreasing.

Option D: **Incorrect** as this is a Classical LRAS curve.

- (b) What happens in the long run if aggregate demand increases (Classical LRAS model)?

In the classical model, the long-run aggregate supply (LRAS) is perfectly inelastic (a vertical line). This means that, in the long run, real output stays the same [1] at the full employment level (Y), no matter what happens to AD. [1]

- (c) What happens to aggregate demand if house prices fall?

A fall in house prices makes homeowners feel poorer, leading to less spending and lower consumer confidence. [1] This **negative wealth effect** reduces aggregate demand (AD) since consumption is a major component of AD. [1] As a result, economic growth may slow down.

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Exam Style Question 2

A number of business groups have signed an open letter to the UK Government asking it to commit to delivering the full High Speed 2 rail link. This will connect London to the northern cities of Manchester and Leeds at a cost of £56 billion and reduce journey times by as much as 50%.

(Source adapted from: <https://www.theguardian.com/uk-news/2019/jun/22/business-heads-urge-next-pm-to-commit-to-finishing-hs2>)

Explain **one** likely impact of this project on aggregate supply in the UK. [4]

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Exam Style Question 2

Answer:

Explain one likely impact of this project on aggregate supply in the UK.

A big infrastructure project like High Speed 2 (HS2) can **boost aggregate supply (AS)** by making transport **faster and more efficient**. [1] **Lower journey times by as much as 50%** means businesses can move goods and workers more quickly, **reducing costs and increasing productivity**. [2] This shifts the **long-run aggregate supply (LRAS) curve to the right**, leading to **more output and economic growth**. [1] Plus, better connections between cities encourage **business investment and innovation**, making the economy more competitive.

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Exam Style Question 3

The Hong Kong-Zhuhai-Macau Bridge is the world's longest sea bridge. It reduces the journey time from Hong Kong to Zhuhai from 4 hours to just 30 minutes. It cost the equivalent of \$18.8 billion and was government funded.

(Source adapted from: www.theguardian.com)

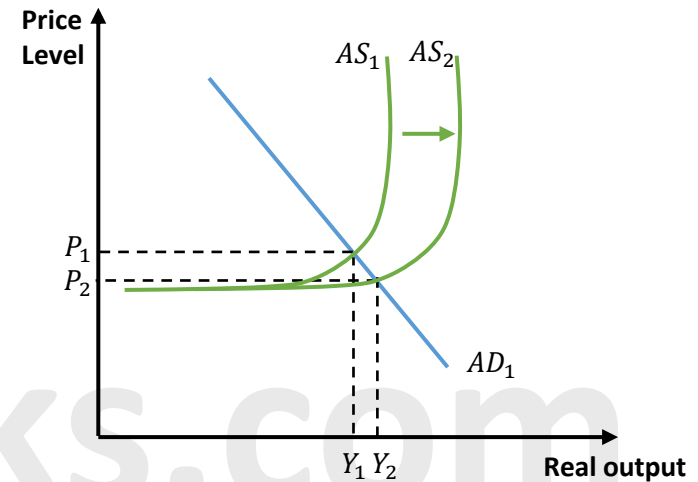
Draw an AD and AS diagram to show the likely impact of this new bridge on the price level and real output in the region. [4]



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Exam Style Question 3

Answer:



Knowledge/understanding:

Correct labels on axes (1) and lines (1)

Application:

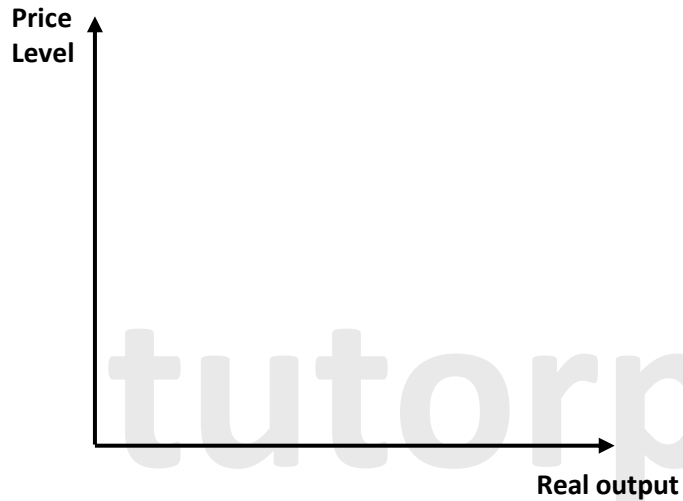
Correct shift of line(s) (1) showing change in price level and/or real output (1)



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Exam Style Question 4

- (a) Illustrate the shape of the **Classical** long-run aggregate supply (AS) curve on the diagram below. [1]



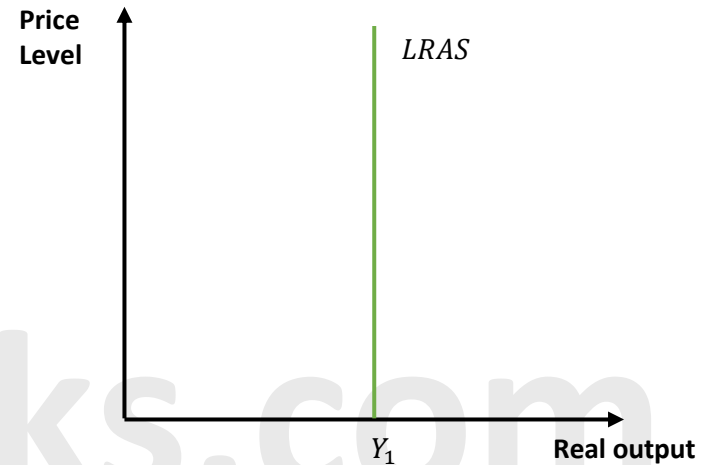
- (b) Explain the reason for the shape of the Classical long-run AS curve. [2]

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Exam Style Question 4

Answer:

- (a) Drawing the Classical Long-Run Aggregate Supply (LRAS) Curve [1]



- (b) Explain the reason for the shape of the Classical long-run AS curve. [2]

The **classical long-run aggregate supply (LRAS) curve is vertical** because the economy operates at **full capacity**, meaning **all resources are fully used** and there is **no spare capacity**. This means that increasing aggregate demand **won't increase real output**, only prices. [1]

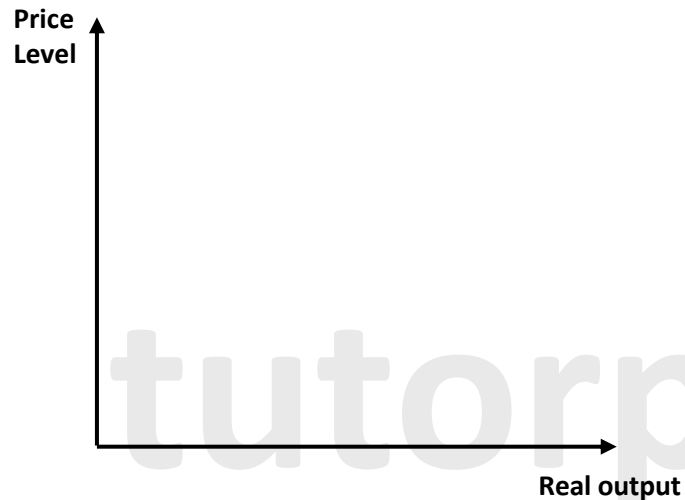
Additionally, **wages and prices are flexible**, allowing the labour market to adjust and maintain **full employment**. In the long run, markets are efficient, and any changes in demand affect **inflation, not output**. **More demand = Higher prices, not more goods**. [1]



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Exam Style Question 5

- (a) Illustrate the shape of the Keynesian long-run AS curve on the diagram below. [1]



- (b) Explain what is meant by spare capacity in an economy. [2]
- (c) Which **one** of the following is most likely to cause a movement along the AS curve? [1]

Changes in:

- A Competition policy
- B Relative productivity
- C The cost of raw material
- D The level of aggregate demand

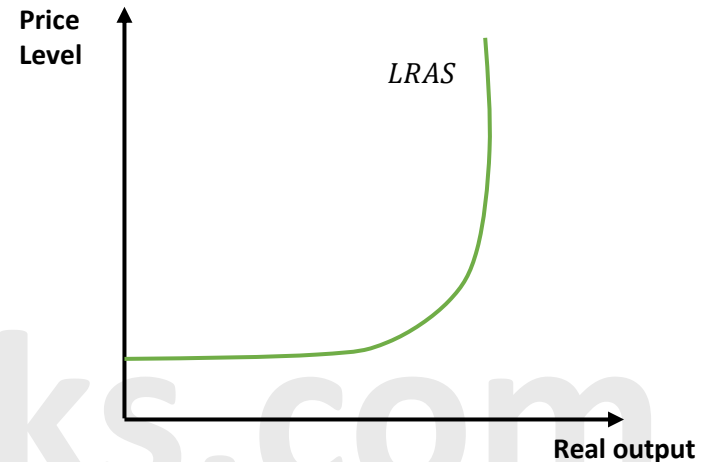
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Exam Style Question 5

Answer:

- (a) Drawing the Keynesian Long-Run Aggregate Supply (LRAS) Curve [1]



- (b) What is spare capacity in an economy?

Spare capacity means that an economy isn't using all its resources **efficiently and not operating at full capacity**. [1] This includes **unused factories, unemployed workers, and idle machines**. In this situation, businesses can **increase output without raising costs**, because there are plenty of resources available. [1]

- (c) What causes a movement along the AS curve?

The correct answer is **D – the level of aggregate demand**.

Option A: Incorrect as changes in competition policy shifts the LRAS.

Option B: Wrong as changes in relative productivity shifts the LRAS.

Option C: Incorrect as changes in the cost of raw materials shifts SRAS.

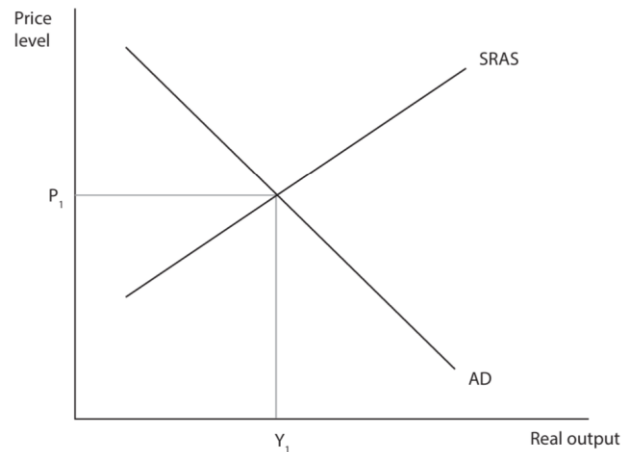
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Exam Style Question 6

The diagram below shows the aggregate demand (AD) and short-run aggregate supply (SRAS) for the UK.



- (a) Define the term 'aggregate demand'. [1]
- (b) Annotate the diagram above to show the likely impact of a rise in the cost of raw materials on the UK's equilibrium level of real output and price level. [2]
- (c) Which **one** of the following factors is most likely to cause an increase in the long-run aggregate supply? [1]

- A Decrease in investment
- B Increase in relative productivity
- C Increase in the level of unemployment benefits
- D Reduced access to credit for consumers and businesses

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Exam Style Question 6

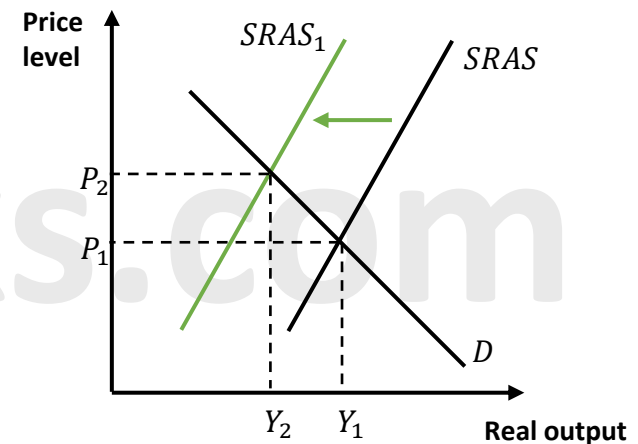
Answer:

(a) Definition of Aggregate Demand (AD)

Aggregate demand (AD) is the **total** spending on goods and services in an economy at a given price level over a period of time. [1]

Formula: $AD = C + I + G + (X - M)$ [1]

(b) Impact of a Rise in Raw Material Costs (Annotating the Diagram)



(c) What Increases Long-Run Aggregate Supply (LRAS)?

Correct answer: B – Increase in relative productivity

Option A: Wrong as a decrease in investment will reduce capital stock of the economy, reducing LRAS.

Option C: Wrong as increase in level of unemployment benefits will reduce the incentive to work, reducing LRAS.

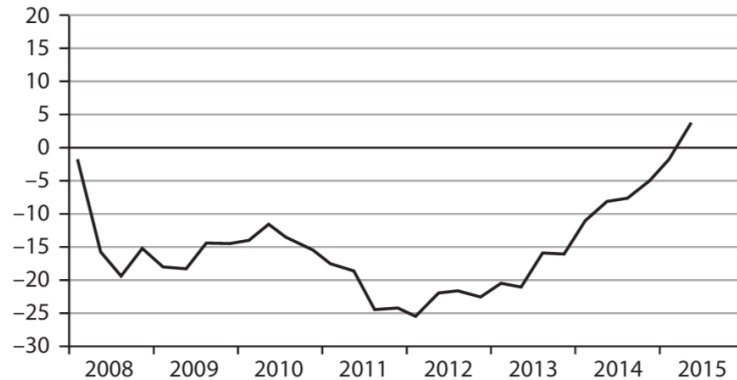
Option D: Wrong as reduced access to credit would decrease investment as banks would be unwilling to lend.

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Exam Style Question 7

The chart below shows the results from a survey of UK consumers' confidence in their financial situation. A negative balance means that, on average, consumers reported their financial situation got worse, a positive balance means they reported it improved, and a zero balance indicates no change. This is recorded on a scale from -100 to +100.



(Source: http://www.ons.gov.uk/ons/dcp171778_418064.pdf)

- (a) Explain **one** likely reason for the change in consumer confidence between 2012 and 2015. [3]
- (b) Which **one** of the following is most likely to result from an improvement in UK consumer confidence? A decrease in the marginal propensity to: [1]
- A Consume
 - B Tax
 - C Import
 - D Save



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Exam Style Question 7

Answer:

(a) Why did consumer confidence rise between 2012 and 2015?

One likely reason is **economic recovery** after the 2008 financial crisis. By 2012, the UK economy had started to **grow again**, leading to **higher employment, rising wages, and lower inflation**. [1] This **improved consumer confidence** from its lows of -25 in 2012. [1] As people felt more financially secure, their **confidence increased**, encouraging **more spending**. [1]

(b) What happens when consumer confidence improves?

Correct answer: D– Save

Please see the '2.2 Aggregate Demand or 2.3 Aggregate Supply Revision Notes' pack for detailed notes.

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