



OCR – A Level Economics

Component 2 – Macroeconomics

6 Aggregate demand and aggregate supply

Worked Examples

Contents

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- Aggregate demand and aggregate supply

6. Aggregate demand and aggregate supply

Exam Style Question 1

After the Global Financial Crisis of 2008, the US President introduced expansionary fiscal policies of \$800 billion. The International Monetary Fund estimated that the multiplier at the time was approximately 1.5.

(Source adapted from: <https://www.economist.com/the-economist-explains/2016/09/07/what-is-the-keynesian-multiplier>)

(a) Which **one** of the following is a withdrawal from the circular flow of income?

[1]

- ☐ A Exports
- ☐ B Government spending
- ☐ C Investment
- ☐ D Taxation

(b) Calculate the total final increase in US aggregate demand as a result of the President's 'expansionary fiscal policies', assuming no other changes.

[2]



6. Aggregate demand and aggregate supply

Exam Style Question 1

Answer:

(a) ☒ **Correct answer: D – Taxation**

Option A: **Incorrect** because exports is an injection into the circular flow of income.

Option B: **Incorrect** as government spending is an injection into the circular flow of income.

Option C: **Incorrect** as investment is an injection into the circular flow of income.

(b) Calculate the total final increase in US aggregate demand.

Use the multiplier formula:

$$\text{Total increase in GDP} = \text{Initial Injection} \times \text{Multiplier}$$

Given:

- Initial government spending = \$800 billion
- Multiplier = 1.5

$$= 800 \times 1.5 = 1,200 \text{ billion}$$

Final answer: \$1,200 billion increase in AD. [2]

6. Aggregate demand and aggregate supply

Exam Style Question 2

The planned investment in the redevelopment of Dover Port will cost £115 million. The Chief Executive said it will lead to many 'new job opportunities for local people and a transformed waterfront experience' with new cafes, bars, and shops.

(Source adapted from: <https://www.kentonline.co.uk/dover/news/docklands-redevelopment-work-to-start-118581/>)

- (a) If the value of the multiplier is 1.8, which **one** of the following will be the total increase in GDP from the redevelopment, assuming other things are equal?

[1]

- ☐ A £64 million
- ☐ B £115 million
- ☐ C £207 million
- ☐ D £230 million

- (b) Using the example above, explain how the multiplier process leads to an increase in aggregate demand. [4]



6. Aggregate demand and aggregate supply

Exam Style Question 2

Answer:

- (a) Calculate the total increase in GDP.

Use the multiplier formula:

$$\text{Total increase in GDP} = \text{Initial Injection} \times \text{Multiplier}$$

Given:

- Initial government spending = £115 million
- Multiplier = 1.8

$$= 115 \times 1.8 = 207 \text{ million}$$

☒ Correct answer: C – £207 million [1]

- (b) Explain how the multiplier process leads to an increase in AD.

The **multiplier effect** means an initial **£115 million investment** leads to a **greater overall increase in Aggregate Demand (AD)** as money circulates through the economy. [1] Workers and businesses **spend their income**, creating **multiple rounds of spending**.

For example, construction workers **spend on local cafes and hotels**, boosting demand and creating more jobs. [1] As spending continues, the **total increase in AD reaches £207 million** (with a multiplier of **1.8**). [1] Over time, some money is **withdrawn through savings, taxes, or imports**, slowing the effect. [1] However, the **process significantly boosts economic growth**, showing the importance of government investment in stimulating AD.

6. Aggregate demand and aggregate supply

Exam Style Question 3

It is estimated that building a second runway at Gatwick airport will require an investment of £9.3 billion.

The total increase in UK GDP as result of this injection is expected to be around £44.1 billion.

(Source: adapted from www.gov.uk/government/uploads/system/uploads/attachment_data/file/452267/AC01_tagged_amend_25_11.pdf © Crown Copyright)

- (a) Define the term 'injection' in this context. [1]
- (b) Calculate the value of the multiplier based on the data given. You are advised to show your working [2]
- (c) Which **one** of the following is a likely cause of a decrease in the value of the UK's multiplier?

[1]

- ☐ A A decrease in the marginal propensity to save (MPS)
- ☐ B A decrease in the marginal propensity to tax (MPT)
- ☐ C An increase in the marginal propensity to consume (MPC)
- ☐ D An increase in the marginal propensity to import (MPM)

6. Aggregate demand and aggregate supply

Exam Style Question 3

Answer:

- (a) Define the term 'injection' in this context.

An **injection** is **money added into the economy** that increases **aggregate demand (AD)** and **national income**. In this case, the **£9.3 billion investment** in Gatwick Airport's second runway is an **injection** because it **adds new spending** into the economy. [1]

- (b) Calculate the value of the multiplier based on the data given.
Use the multiplier formula:

$$\text{Multiplier} = \frac{\text{Total increase in GDP}}{\text{Initial injection}}$$

Given:

- **Total GDP increase** = £44.1 billion
- **Initial investment (injection)** = £9.3 billion

$$\text{Multiplier} = \frac{44.1}{9.3} = 4.74$$

Final answer: The multiplier is 4.74 [2]

- (c) Which **one** of the following is a likely cause of a decrease in the value of the UK's multiplier?

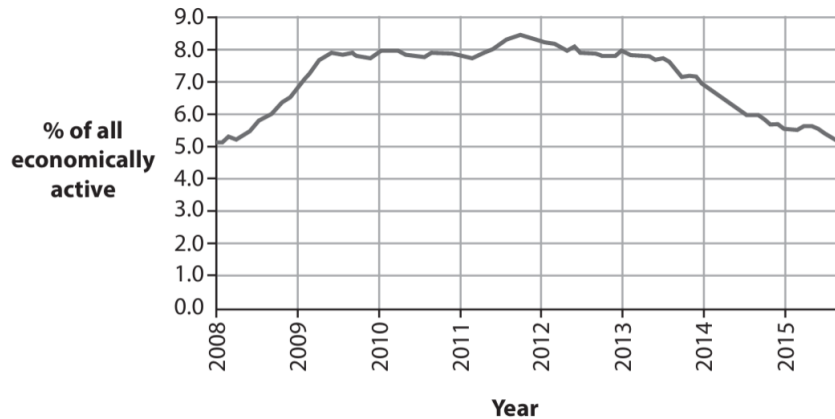
☒ **Correct Answer: D** – An increase in the marginal propensity to import

Option A: **Incorrect** as a decrease in MPS will increase the multiplier.
Option B: **Incorrect** as a decrease in MPT will increase the multiplier.
Option C: **Incorrect** as an increase in the MPC will increase the multiplier.

6. Aggregate demand and aggregate supply

Exam Style Question 4

The chart below shows the UK unemployment rate, seasonally adjusted, from 2008 to 2015.



(Source: <http://www.ons.gov.uk/ons/rel/lms/labour-market-statistics/december-2015/statistical-bulletin.html#tab-8--Unemployment>)

Explain the likely effects on the circular flow of income of the change in unemployment between 2013 and 2015. [4]

6. Aggregate demand and aggregate supply

Exam Style Question 4

Answer:

Explain the likely effects on the circular flow of income of the change in unemployment between 2013 and 2015.

Between **2013 and 2015**, the UK **unemployment rate fell**, meaning **more people were employed** and earning wages. This led to an **increase in the circular flow of income** as households had **higher disposable income**, leading to **greater consumer spending and investment (1)**.

With higher spending, businesses **earned more revenue**, allowing them to **expand and hire more workers**, further strengthening the **flow of money between households and firms (1)**. This represents an **injection** into the economy, boosting **aggregate demand (AD)**. At the same time, **withdrawals such as taxation (T), savings (S), and imports (M) may also increase**, slightly limiting the full effect (1).

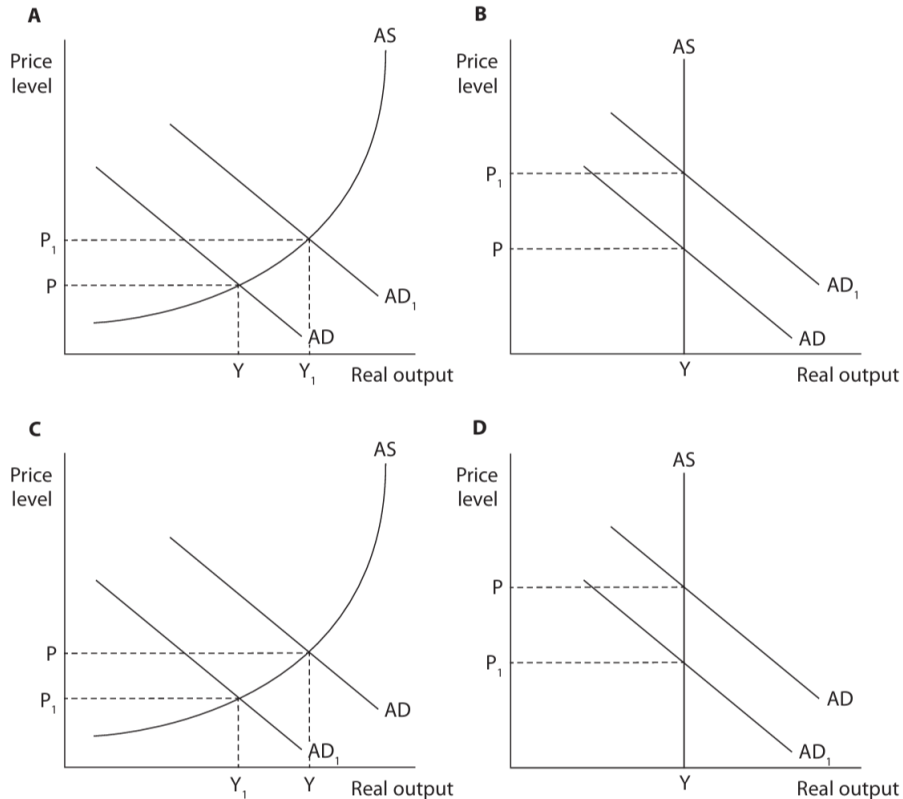
The fall in unemployment, as seen in the **chart**, contributed to **rising consumption and investment**, which created **further rounds of income growth**. However, some of this extra income may have been spent on **imports**, meaning some money leaked out of the economy (1).



6. Aggregate demand and aggregate supply

Exam Style Question 5

- (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]

6. Aggregate demand and aggregate supply

Exam Style Question 5

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.

6. Aggregate demand and aggregate supply

Exam Style Question 6

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]

6. Aggregate demand and aggregate supply

Exam Style Question 6

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.

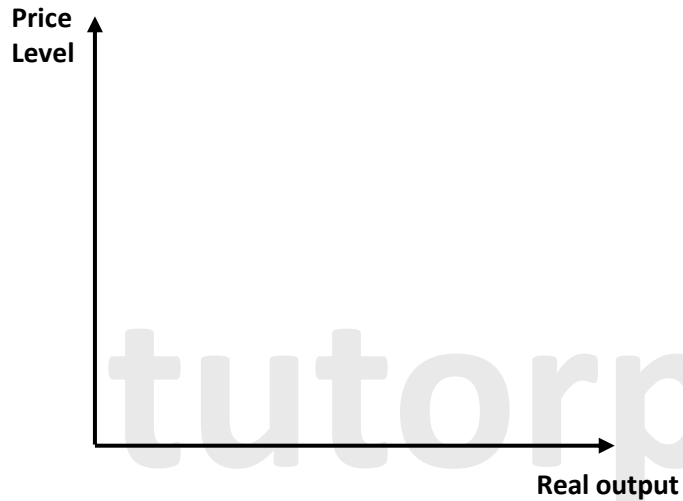
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6. Aggregate demand and aggregate supply

Exam Style Question 7

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



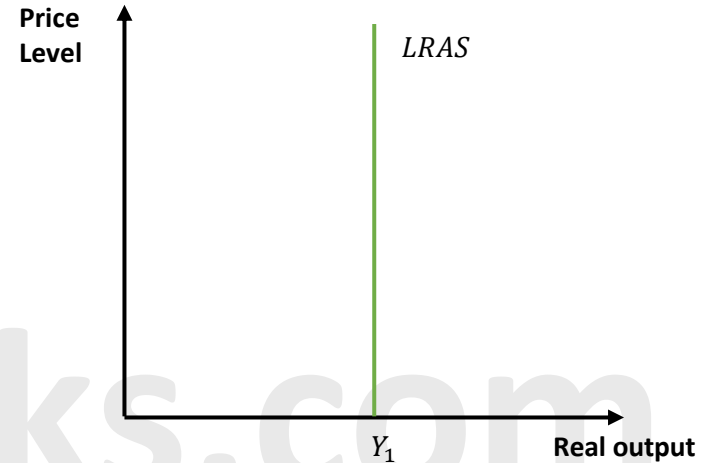
- (b) Explain the reason for the shape of the Classical long-run AS curve. [2]

6. Aggregate demand and aggregate supply

Exam Style Question 7

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]

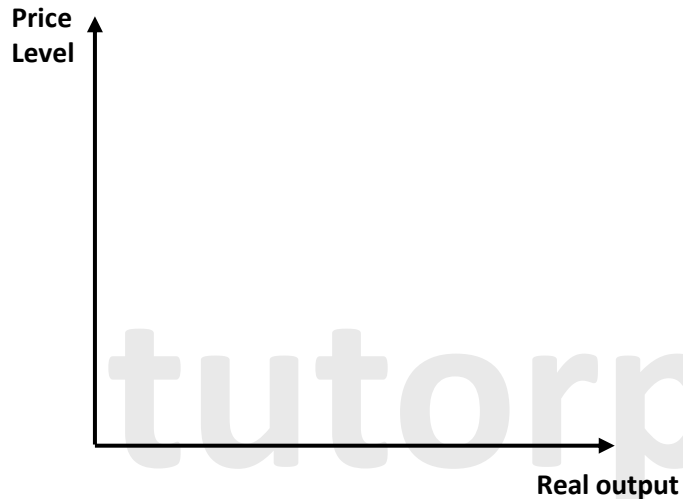
Additionally, **wages and prices are flexible**, allowing the labour market to adjust and maintain **full employment**. In the long run, markets are efficient, and any changes in demand affect **inflation, not output**. **More demand = Higher prices, not more goods**. [1]



6. Aggregate demand and aggregate supply

Exam Style Question 8

- (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

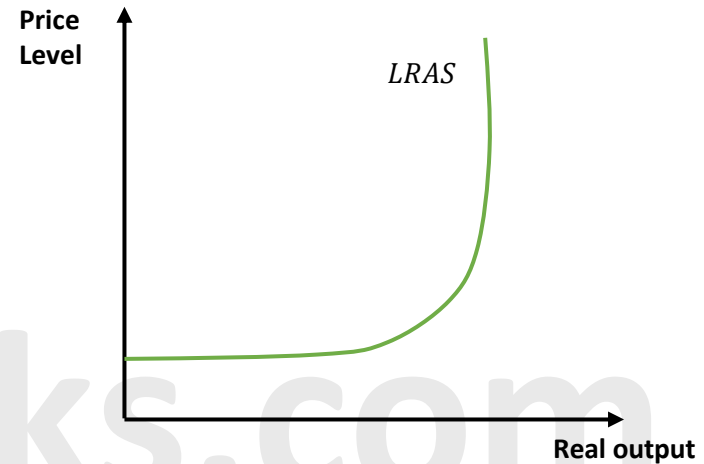
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6. Aggregate demand and aggregate supply

Exam Style Question 8

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.

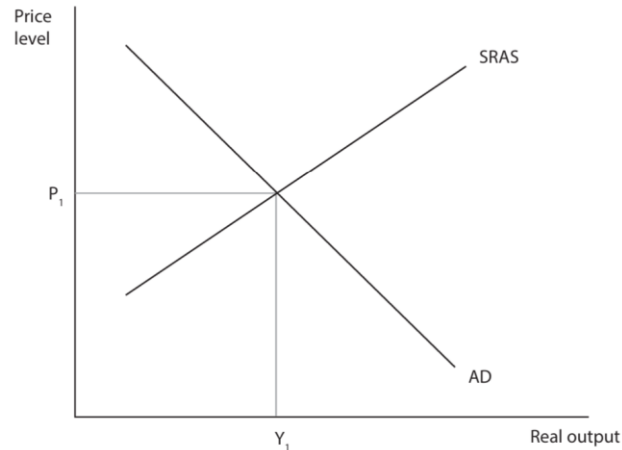
Option C: Incorrect as changes in the cost of raw materials shifts SRAS.

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6. Aggregate demand and aggregate supply

Exam Style Question 9

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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6. Aggregate demand and aggregate supply

Exam Style Question 9

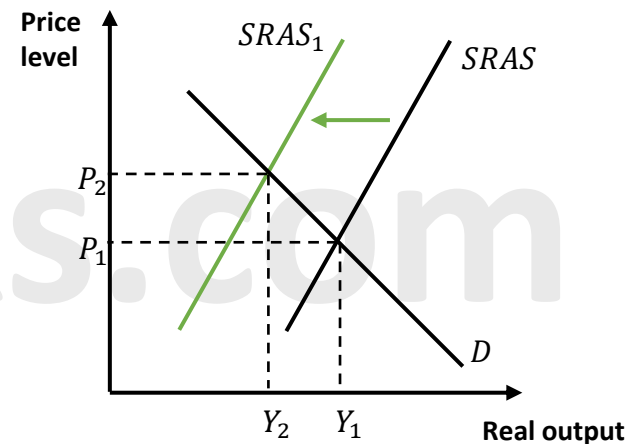
Answer:

(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.

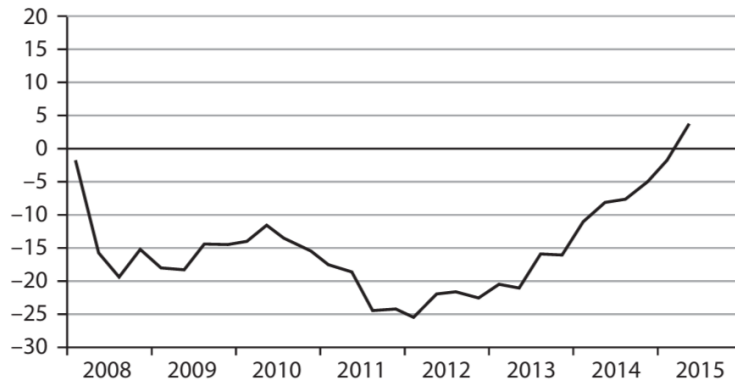
Option D: Wrong as reduced access to credit would decrease investment as banks would be unwilling to lend.

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6. Aggregate demand and aggregate supply

Exam Style Question 10

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]

6. Aggregate demand and aggregate supply

Exam Style Question 10

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]



Please see the '6. Aggregate demand and aggregate supply Revision Notes' pack for detailed notes.

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