Economics
ECON2

Unit 2 The National Economy

Wednesday 19 January 2011   9.00 am to 10.15 am

For this paper you must have:
- an objective test answer sheet
- a black ball-point pen
- an AQA 8-page answer book.

You may use a calculator.

Time allowed
- 1 hour 15 minutes

Instructions
- In **Section A**, answer **all** questions on your objective test answer sheet.
- In **Section B**, answer **EITHER** Question 26 **OR** Question 27 in your AQA answer book.
- For **Section A**, do all rough work in this question paper, **not** on your objective test answer sheet.

Section A (ECON2/1)
- Use a black ball-point pen. Do **not** use pencil.

Section B (ECON2/2)
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON2/2.

Information
- The maximum mark for this paper is 75.
- There are 25 marks for **Section A** and 50 marks for **Section B**.
- In **Section A**, each question carries 1 mark. No deductions will be made for wrong answers.
- In **Section B**, the marks for questions are shown in brackets.
- You will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Advice
- You are advised to spend no more than 25 minutes on **Section A** and at least 50 minutes on **Section B**.

**ECON2**

Section A: Objective Test

Answer **all** questions in **Section A**.
Each question carries 1 mark. No deductions will be made for wrong answers.
You are advised to spend no more than 25 minutes on **Section A**.

For each question there are four alternative responses, **A**, **B**, **C** and **D**. When you have selected the response which you think is the best answer to a question, mark this response on your objective test answer sheet. If you wish to change your answer to a question, follow the instructions on your objective test answer sheet.

1   Which one of the following would be an example of a loosening of fiscal policy?

    A   A fall in the money supply

    B   A rise in the rate of inflation

    C   A fall in interest rates

    D   A rise in the government budget deficit

2   The diagram below shows two aggregate demand (AD) curves and the short-run aggregate supply (SRAS) curve for an economy.
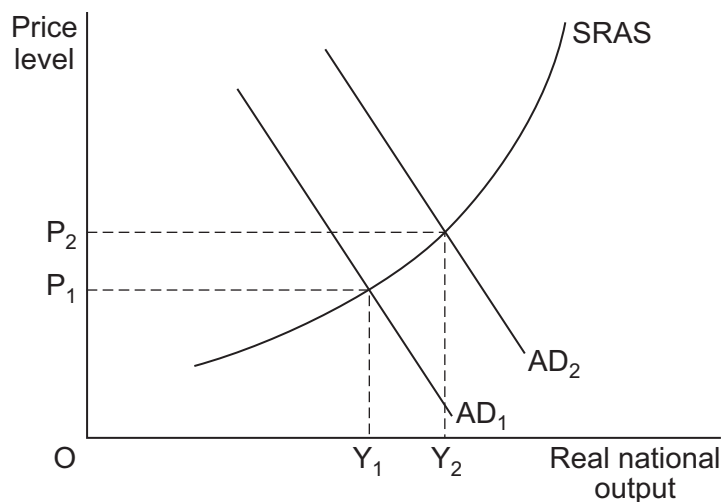
Which one of the following could explain the shift of the aggregate demand curve from AD_1 to AD_2?

An increase in

    A   exports

    B   savings

    C   the exchange rate

    D   rates of taxation

3 Economic growth is usually measured by the annual change in

A the retail price index.

B real national income.

C the output of the manufacturing industry.

D consumer expenditure.

4 Which one of the following is most likely to result in a demand-side shock to the UK economy?

A large rise in

A world commodity prices

B UK wages due to a wave of strikes

C UK interest rates

D the price of imported semi-manufactured goods

5 The relationship between the growth of national income and the resulting increase in investment is termed the

A accelerator.

B output gap.

C economic cycle.

D multiplier.

6 All other things being equal, which one of the following combinations, **A**, **B**, **C** or **D**, is most likely to lead to a deterioration in the UK balance of payments on current account?

|	UK inflation rate	Exchange rate of the £	UK unemployment
A	Increase	Decrease	Decrease
B	Decrease	Increase	Increase
C	Increase	Increase	Decrease
D	Decrease	Decrease	Increase

Turn over ▶

7 The Monetary Policy Committee (MPC) of the Bank of England meets each month to decide on the rate of interest that is most likely to help it achieve the government's inflation target.

The MPC is most likely to decrease interest rates if

A inflation is above target and the exchange rate is high and rising.

B the rate of growth of money wages is above the rate of growth of labour productivity.

C employment is rising.

D there is a negative output gap.

8 All other things being equal, which one of the following is most likely to lead to a decrease in aggregate demand?

An increase in

A imports

B long-run aggregate supply

C the government budget deficit

D the surplus on the balance of payments on current account

9 The annual rate of inflation in the UK falls from 5 per cent to 2 per cent but the annual rate of inflation in the UK's main trading partners remains at 5 per cent. As a result, all other things being equal, it is likely that in the long term

A UK exports will increase.

B UK imports will increase.

C the UK current account balance will deteriorate.

D withdrawals from the UK circular flow of income will increase.

**10** The diagram below illustrates an improvement in the supply-side performance of an economy.
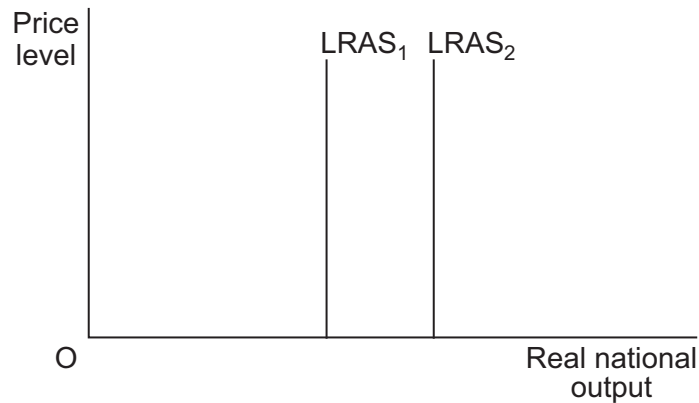
Which one of the following developments is most likely to directly cause the shift in the long-run aggregate supply curve from $LRAS_1$ to $LRAS_2$?

A Growth in export markets

B Improvements in the banking system that increase the funds available for investment

C An improvement in consumer confidence

D A sustained increase in government spending on welfare benefits

11 Which one of the following is most likely to be an example of cyclical unemployment?

A Gill lost her job as a television engineer two months ago and is waiting to start a new job next month.

B Brian has not worked for 15 years since losing his job as a coal miner.

C Hitesh lost his job as a construction worker six months ago when a recession led to a downturn in the construction industry.

D Faith works in the hotel trade as a casual chef and spends November to April out of work.

Turn over ▶

12 The diagram below shows the production possibility frontier for an economy, where the economy is initially at point X.
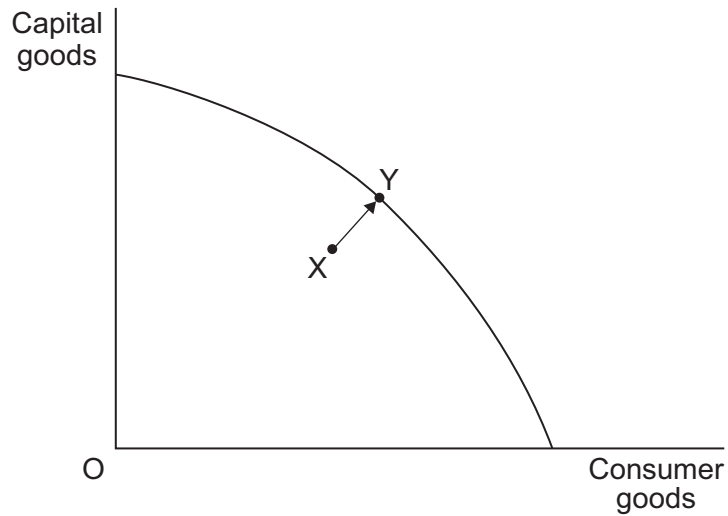

Assuming there is no change in the production possibility frontier, a movement from point X to point Y illustrates that there has been

A underlying economic growth.

B an increase in spare capacity.

C a rise in real national income.

D an improvement in technology.

13 In October 2008, the Chancellor of the Exchequer announced plans to increase government spending on construction projects, such as schools, medical buildings, housing and leisure centres, in order to help prevent the UK economy from entering recession.

Such a policy could best be considered an example of

A expansionary fiscal policy.

B contractionary budgetary policy.

C contractionary supply-side policy.

D expansionary monetary policy.

14 All other things being equal, demand-pull inflation is most likely to result from an increase in

A the level of interest rates.

B government spending.

C the rate of income tax.

D the cost of imported raw materials.

15 All other things being equal, in the long run a fall in the exchange rate is likely to

    A   increase unemployment because it makes domestic products less competitive abroad.

    B   increase unemployment because it makes foreign products more competitive in the home market.

    C   reduce aggregate demand because it increases the domestic currency price of imports.

    D   increase aggregate demand because it can reduce the foreign currency price of exports.

16 The diagrams below show aggregate demand (AD) curves and short-run aggregate supply (SRAS) curves for an economy. The economy is initially at output OY.

Which diagram, **A**, **B**, **C** or **D**, shows the most likely impact of a rise in wage rates together with a fall in interest rates charged on consumer credit?
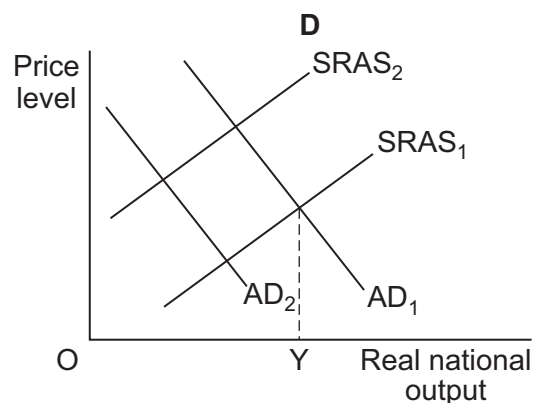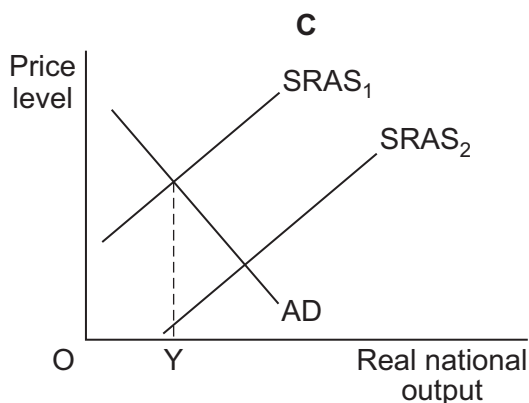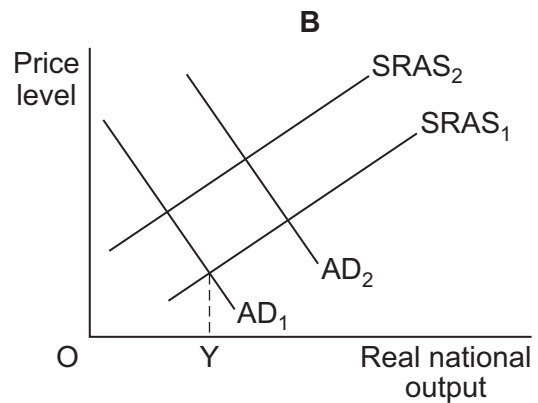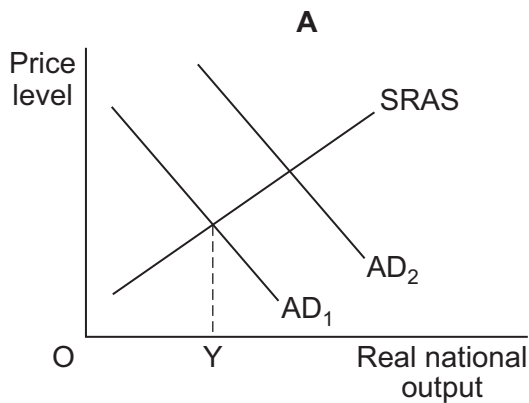
Turn over ▶

17 All other things being equal, a large increase in interest rates in the UK is most likely to

A decrease the size of the government budget deficit.

B increase aggregate investment.

C lead to an increase in bank lending.

D decrease house prices.

18 In Country X, the underlying trend rate of growth is 2.75%. The table below shows the actual rate of growth in real national income over four successive years.

Year	Percentage growth in real national income
1	2.1%
2	1.2%
3	0.5%
4	1.3%

Between Year 1 and Year 4, it is most likely that

A unemployment increased.

B aggregate demand fell.

C productive capacity decreased.

D the current account on the balance of payments deteriorated.

19 A country is experiencing a balance of payments surplus but growing inflationary pressures. Which measure is most likely to reduce both a balance of payments surplus and the inflation rate?

A A cut in interest rates

B An appreciation of the exchange rate

C A rise in the budget deficit

D A decrease in government expenditure

20 Which one of the following is most likely to be classified as an instrument of monetary policy?

  A   Taxation

  B   The inflation rate

  C   The exchange rate

  D   Government spending

21 The diagram below shows two aggregate demand (AD) curves and the short-run aggregate supply (SRAS) curve for an economy.
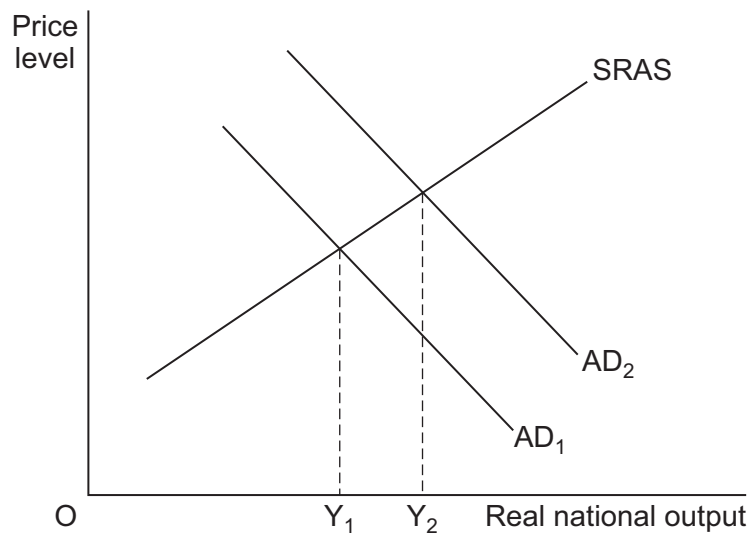

The change in real national output from Y_1 to Y_2 could be due to

  A   the introduction of new supply-side policies.

  B   an increase in the government's budget surplus.

  C   an expansionary monetary policy.

  D   an increase in the current account deficit on the balance of payments.

22 Which one of the following is an example of fiscal policy having a direct supply-side effect?

  A   An increase in the money supply leading to greater output

  B   A reduction in income tax boosting consumption and the supply of consumer credit from banks

  C   A reduction in interest rates boosting investment and the productive potential of the economy

  D   Government expenditure on retraining schemes increasing factor mobility

Turn over ▶

23 In the diagram below, a decline in consumer confidence in an economy is represented by a leftward shift in its aggregate demand curve from AD_1 to AD_2.
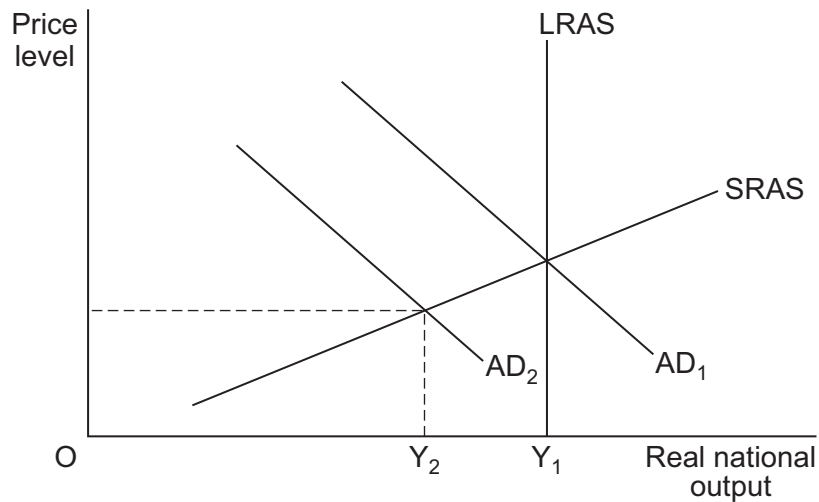
As a result of the fall in aggregate demand, output falls from Y_1 to Y_2 and unemployment rises. The type of unemployment that results from this fall in demand is best described as

A structural unemployment.

B cyclical unemployment.

C seasonal unemployment.

D frictional unemployment.

24 Which one of the following is most likely to reduce the level of investment in a particular economy?

A fall in

A the value of a country's currency on the foreign exchange market

B aggregate demand in the economy

C the level of unemployment

D the spare capacity of the economy

25 Foreign companies build new factories in a country to take advantage of cheap labour and cheap land. All other things being equal, the result of this investment for that country's economy would be

A a movement along both its aggregate demand curve and long-run aggregate supply curve.

B a movement along its aggregate demand curve and a shift in its long-run aggregate supply curve.

C a shift in its aggregate demand curve and a movement along its long-run aggregate supply curve.

D a shift in both its aggregate demand curve and long-run aggregate supply curve.

**QUESTION 25 IS THE LAST
QUESTION IN SECTION A**

**On your answer sheet
ignore rows 26 to 50**

Turn over for Section B

Turn over ▶

Section B: Data Response

Answer **EITHER** Question 26 **OR** Question 27.
You are advised to spend at least 50 minutes on **Section B**.

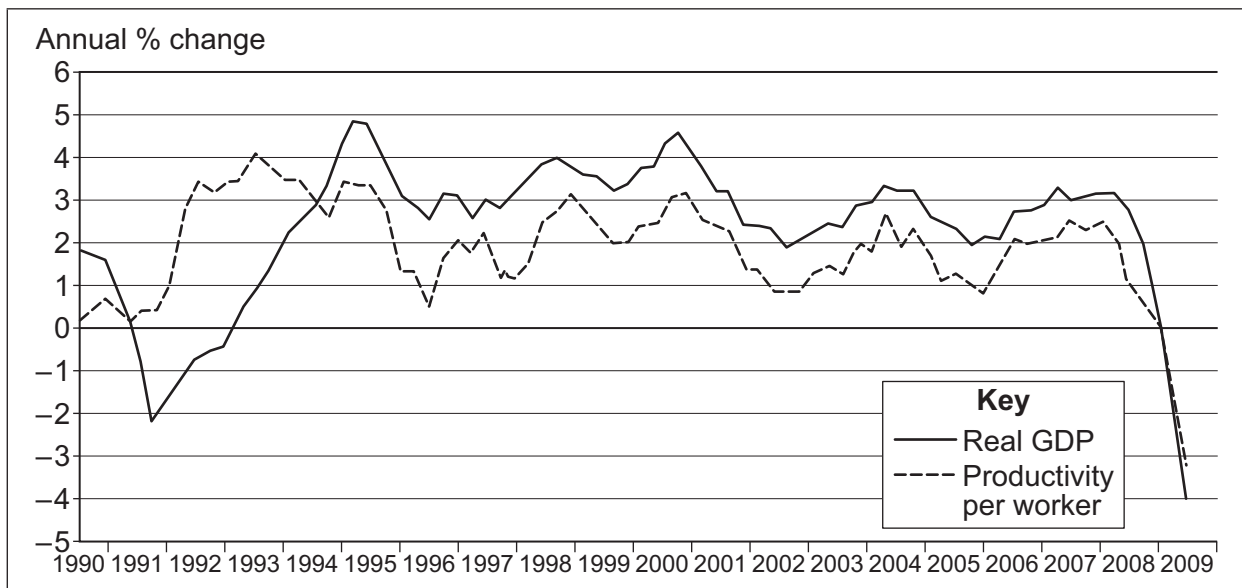**EITHER**   **Total for this question: 50 marks**

Question 26

ECONOMIC GROWTH AND RECOVERY

Study **Extracts A**, **B and C**, and then answer **all** parts of Question 26 which follow.

Extract A: Growth in real GDP and productivity, UK, 1990–2009

Source: adapted from *www.statistics.gov.uk*, accessed September 2009

Extract B: Achieving economic growth

With the economy in recession and unemployment rising, politicians and economists   1
are trying to find ways of stimulating economic growth. From one year to the next,
the crucial factor affecting growth is spending. If people spend more, firms will
sell more and this will encourage firms to produce more. Lower bank lending,
rising unemployment and a lack of confidence have contributed to lower aggregate   5
demand and led to a negative actual rate of economic growth in the UK.

However, the answer to increasing the long-run trend rate of economic growth is not
simply one of increasing spending. If aggregate demand persistently exceeds the
capacity of the economy to produce goods and services, we will end up with high
inflation and a growing balance of payments deficit. In the short run, the economy   10
will experience a boom but this is likely to be followed by a prolonged recession.

If growth is to be sustained, improvements in the supply-side performance of the
economy are essential. Investment and other developments that lead to higher
productivity help to increase the productive capacity of the economy. In the long run,
economic growth is stimulated by improvements in technology and an environment   15
in which economic incentives provide encouragement to entrepreneurs and workers.

Source: news reports, September 2009

Extract C: Will the recession reduce economic growth in the future?

Britain's economy shrank by a further 0.7 % in the second quarter of 2009 but it is widely expected that it should start to recover by the end of the year. The large degree of spare capacity should keep inflation low. It means that firms will find it more difficult to raise prices and may even decide to cut prices. They will also resist increases in costs. This is significant because monetary policy will need to remain loose for a long time in order to support recovery.

Nevertheless, the recession and financial crisis will probably reduce the growth of productive capacity because some firms will go out of business, the number of new firms being formed will fall and investment in physical capital will decline.

A period of recession is often accompanied by firms reducing their spending on training and cutting back on research and development. In addition, individuals who are unemployed for significant periods may view their chances of finding work as being low and therefore drop out of the labour market. This also reduces the potential output of the economy.

Lines: 1, 5, 10

Source: news reports, September 2009

0 1 Define the term 'productive capacity' (**Extract B**, line 14). *(5 marks)*

0 2 Using **Extract A**, identify **two** significant points of comparison between the percentage change in real GDP and the percentage change in productivity per worker over the period shown. *(8 marks)*

0 3 **Extract C** (lines 2 – 3) suggests that the 'large degree of spare capacity should keep inflation low'.

Explain **two** reasons why the existence of spare capacity in an economy is likely to help keep inflation low. *(12 marks)*

0 4 **Extract B** (lines 7 – 8) states that 'the answer to increasing the long-run trend rate of economic growth is not simply one of increasing spending'.

Using the data and your economic knowledge, assess the importance of **both** demand-side **and** supply-side policies in helping the UK economy to achieve a prolonged period of economic growth. *(25 marks)*

Turn over ▶

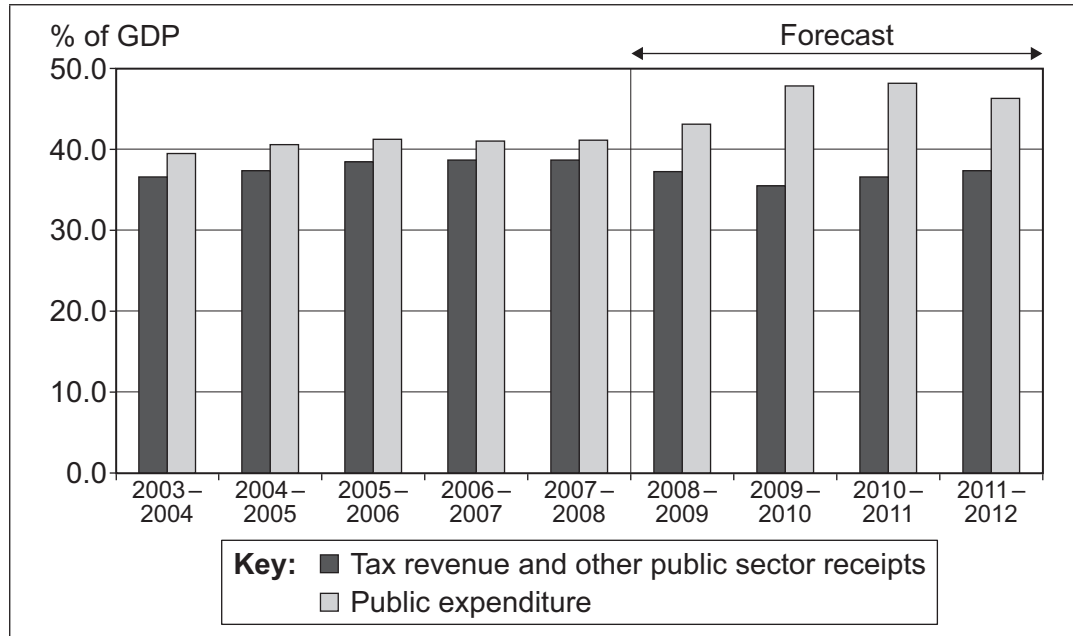Do **not** answer Question 27 if you have answered Question 26.

OR **Total for this question: 50 marks**

Question 27

FISCAL AND MONETARY POLICY IN THE UK

Study **Extracts D**, **E and F**, and then answer **all** parts of Question 27 which follow.

Extract D: Actual and forecast public sector revenue and public expenditure as a % of GDP, UK, 2003–04 to 2011–12

Source: HM Treasury, April 2009

Extract E: Fiscal policy

The overriding objective of economic policy is to maintain a stable economy. This requires low inflation, low unemployment and a steady rate of economic growth. Fiscal policy is used by governments to influence the level of aggregate demand in the economy in order to achieve their economic objectives. Fiscal measures also affect both aggregate supply and the pattern of economic activity. The tax and benefits system can influence aggregate supply by affecting incentives to work. Indirect taxes, which affect relative prices, and the way in which the government spends its money affect how the nation's scarce resources are used. [1] [5]

In response to the current global recession, many nations around the world have stimulated their economies by using fiscal measures and most are running a large budget deficit. The UK has been one of the major economies leading calls for fiscal action to stimulate aggregate demand. In November 2008, a number of fiscal measures were announced, including a £145 tax cut for basic-rate tax payers, a temporary 2.5% cut in VAT, £3 billion worth of investment spending brought forward from 2010 and a variety of other measures. The total cost of these measures was roughly £20 billion. The recession and expansionary fiscal policies have contributed to a significant rise in the forecast budget deficit to an estimated £175 billion (12.4% of GDP) in 2009–10. [10] [15]

In a recent meeting in London, there was agreement amongst world leaders that budget deficits should not be cut back for at least a year, despite the growing concern about rising government debt. There was also agreement that expansionary policies should be withdrawn only when recovery in the world economy has been secured. [20]

Source: news reports, September 2009

Extract F: Monetary policy

The Bank of England's monetary policy objective is to deliver price stability and, subject to that, to support the Government's economic objectives, including those for growth and employment. Between 1992, when inflation targeting was first introduced, and 2007, GDP growth averaged 2.8% while inflation averaged around 2.5%. This period of steady growth and low inflation was also accompanied by a reduction in the volatility of the economy.	1 5
Monetary policy is used to stimulate or slow the economy in the short run so that the economy is kept as close as possible to its long-run potential rate of growth and inflation is kept close to its target. In the long run, output and employment depend mainly on the supply side of the economy.	10
Monetary policy cannot completely eliminate cyclical fluctuations in the economy, nor will the economy be able to avoid the effects of unexpected economic shocks such as a substantial increase in oil prices.	

Source: news reports, September 2009

0 5   Define the term 'budget deficit' (**Extract E**, line 11).   *(5 marks)*

0 6   Using **Extract D**, identify **two** significant points of comparison between public sector revenue and public expenditure over the period shown.   *(8 marks)*

0 7   **Extract E** (lines 4–5) states that fiscal measures 'affect … the pattern of economic activity'.

Explain **two** ways in which fiscal measures can influence the pattern of economic activity.   *(12 marks)*

0 8   **Extract E** (lines 1–2) states: 'The overriding objective of economic policy is to maintain a stable economy. This requires low inflation, low unemployment and a steady rate of economic growth.'

Using the data and your knowledge of recent economic events, assess the contribution that fiscal and monetary policies can make in maintaining a stable economy.   *(25 marks)*

END OF QUESTIONS

There are no questions printed on this page