General Certificate of Education
Advanced Subsidiary Examination
January 2012

Economics   ECON2

Unit 2   The National Economy

Wednesday 18 January 2012   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

Section A (ECON2/1)
● Answer **all** questions on your objective test answer sheet.
● Use a black ball-point pen. Do **not** use pencil.
● Do all rough work in this question paper, **not** on your objective test answer sheet.

Section B (ECON2/2)
● Answer **EITHER** Context 1 **OR** Context 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**. Each question carries one mark. No deductions will be made
  for wrong answers.
● There are 50 marks for **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.

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   All other things being equal, lower inflation in an economy is most likely to be achieved if there is an increase in

   A   productivity.

   B   exports.

   C   consumption.

   D   welfare benefits.

2   Structural unemployment is most likely to be caused by

   A   a recession in the economy.

   B   changes in the demand for labour at different times of the year.

   C   an increase in the number of people changing jobs.

   D   the skills of the unemployed not matching those skills required for the available jobs.

3   The table below shows the index for nominal national income (GDP) and the price level index (CPI) for a country in 2009 and 2010.

	2009	**2010**
GDP	100	130
CPI	120	150

According to these figures, between 2009 and 2010 the country's real national income

   A   increased.

   B   decreased.

   C   stayed the same.

   D   changed by an amount which cannot be determined without further information.

4 Aggregate demand may fall as a result of a decrease in

A   savings relative to investment.

B   the government's budget surplus.

C   the government's budget deficit.

D   imports.

5 All other things being equal, which one of the following sets of changes in an economy, **A**, **B**, **C** or **D**, would be most likely to bring about an improvement in its balance of payments deficit on current account?

A   A decrease in taxes on income, a fall in the exchange rate and a decrease in labour productivity

B   An increase in taxes on income, a fall in the exchange rate and an increase in labour productivity

C   An increase in government spending, a rise in the exchange rate and a decrease in labour productivity

D   A decrease in government spending, a rise in the exchange rate and an increase in labour productivity

6 The diagram below represents an economy that has experienced inflation, with the price level rising from P_1 to P_2.
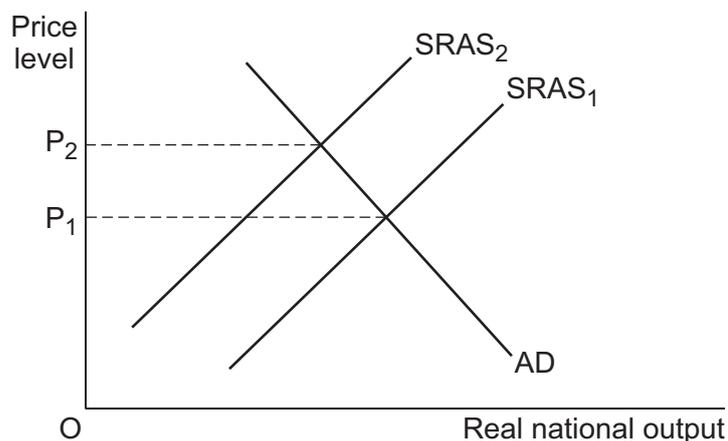
The most likely cause of the inflationary pressures shown in the diagram is

A   a sustained increase in bank lending.

B   a growing budget deficit.

C   money wages increasing faster than productivity.

**D**   a period of time when interest rates are too low.

Turn over ▶

7 In 2010, the euro declined in value against other major currencies. All other things being equal, which one of the following combinations, **A**, **B**, **C** or **D**, indicates the most likely consequences for the economies of the eurozone?

Combination	Exports	Unemployment	Economic Growth
A	Increase	Decrease	Increase
B	Decrease	Increase	Decrease
C	Increase	Decrease	Decrease
D	Decrease	Increase	Increase

8 All other things being equal, more innovation in an economy is most likely to lead to

A a rise in the equilibrium price level.

B an increase in the trend rate of economic growth.

C a reduction in the country's international competitiveness.

**D** a fall in money spent on future research and development.

9 The diagram below shows an economy producing at point X within its production possibility frontier.
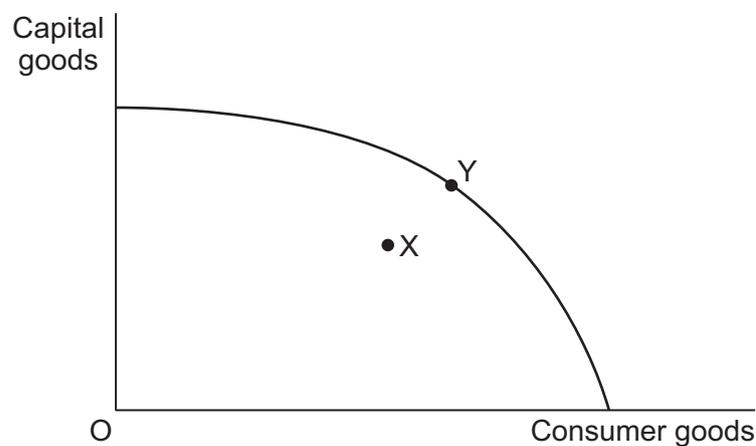
All other things being equal, which one of the following would be most likely to move the economy to point Y?

A An increase in interest rates and a reduction in exports

B An increase in household saving and a reduction in investment

C An increase in imports and a reduction in exports

D An increase in government spending and a reduction in the exchange rate

10 All other things being equal, which one of the following is most likely to cause the long-run aggregate supply curve to shift to the right?

A The provision of funds by the banking system to finance investment in manufacturing

B An increase in consumption which causes a rise in the price level

C A rise in consumption which causes a fall in cyclical unemployment

D An increase in the provision of government unemployment-related benefits

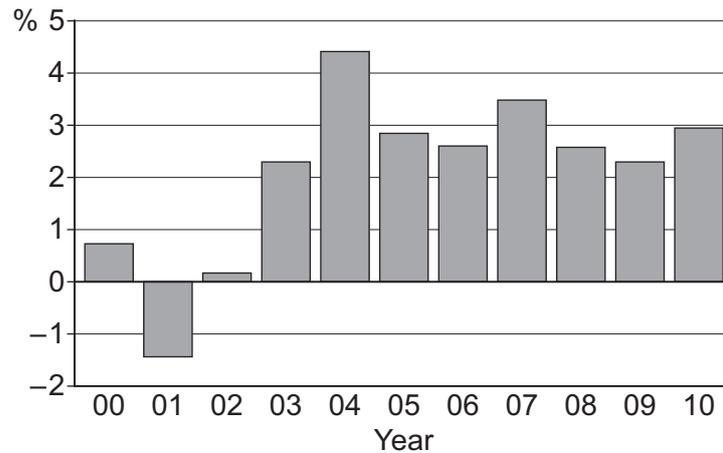**11** The diagram below shows two aggregate demand (AD) curves for an economy.
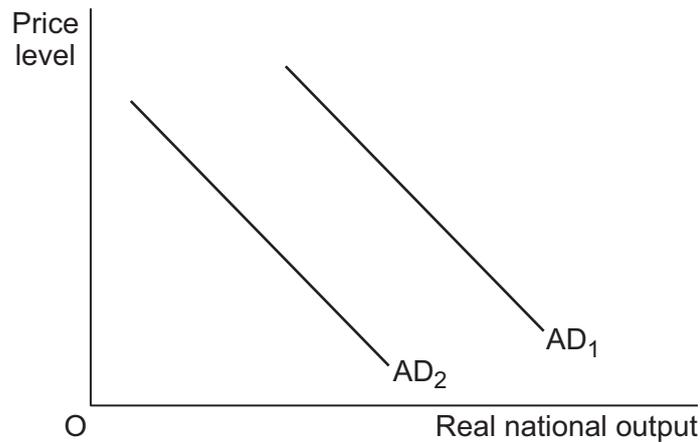
The shift from AD_1 to AD_2 could be explained by an increase in

A imports.

B the price level.

C costs of production.

D investment.

.

Turn over ▶

12 The graph below shows the annual percentage change in an economy's Gross Domestic Product (GDP) between 2000 and 2010, at 2000 prices.

Assuming that inflation was constant at 2% each year, it can be concluded that

A real GDP decreased between 2007 and 2008.

B real national output increased each year from 2002.

C money GDP fell between 2000 and 2002.

D real GDP was highest in 2004.

13 A sustained fall in the exchange rate is most likely to decrease

A inflation.

B international competitiveness.

C economic growth.

D unemployment.

14 Which one of the following is a correct statement relating to the supply side of the economy?

Supply-side improvements in the economy

A may originate in the business sector independently of government.

B usually involve the use of monetary policy.

C are designed to reduce the potential output of the economy.

D are aimed mainly at the control of inflation.

15 The multiplier effect of an increase in investment in an economy is

    A   an increase in productive capacity.

    B   a larger increase in national income than in investment.

    C   an increase in the underlying trend rate of growth.

    D   the movement of the economy from recession to boom.

16 All other things being equal, if inflation in the UK economy falls from 3% to 1%, it can be concluded that

    A   money incomes in the UK have decreased.

    B   on average, the prices of goods and services in the UK have fallen.

    C   UK goods have become more competitive in international markets.

    D   the cost of living for the average person in the UK has continued to rise.

17 A country experiences both unemployment and persistent surpluses in the balance of payments. Which one of the following is most likely **both** to increase employment **and** to reduce a balance of payments surplus?

    A   Increasing interest rates

    B   Increasing government expenditure

    C   Increasing the government's budget surplus

    D   A rise in the exchange rate

18 The table below shows changes in macroeconomic indicators for an economy. During a time of rising unemployment, labour productivity has increased whilst at the same time income per head has fallen.

All other things being equal, which combination, **A**, **B**, **C** or **D**, is most likely to result from these changes?

Combination	The rate of inflation	The balance of payments deficit on current account
A	Increases	Decreases
B	Decreases	Increases
C	Increases	Increases
D	Decreases	Decreases

19 In which one of the following situations is a government most likely to pursue an expansionary fiscal policy in order to increase aggregate demand?

When

A there is a positive output gap

B the long-run trend rate of economic growth is too low

C there is a high level of structural unemployment

D cyclical unemployment is increasing

20 The rapid expansion of large, developing economies such as China and India has led to rising world commodity prices and a larger market for the exports of countries such as the UK.

In the diagrams below, the initial equilibrium price level is P_1 and the initial equilibrium level of real national output is Y_1. Which diagram, **A**, **B**, **C** or **D**, best illustrates the effects of such events on the UK economy?
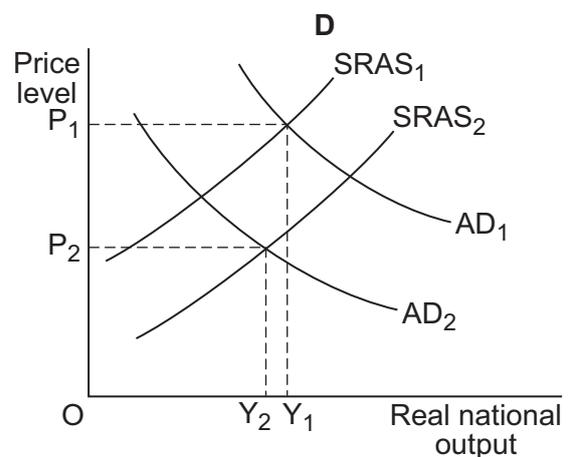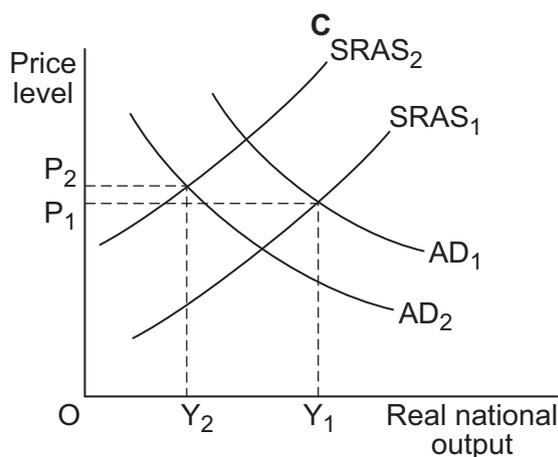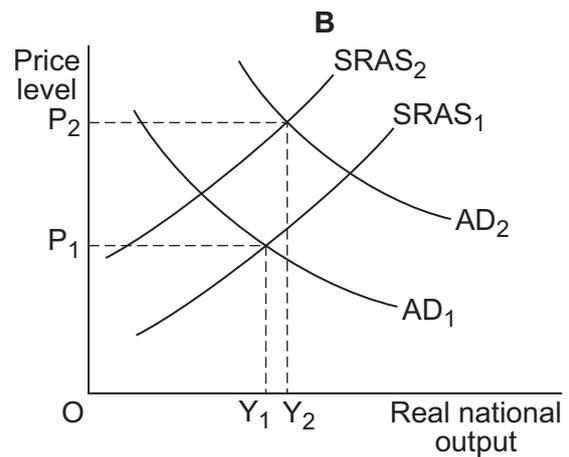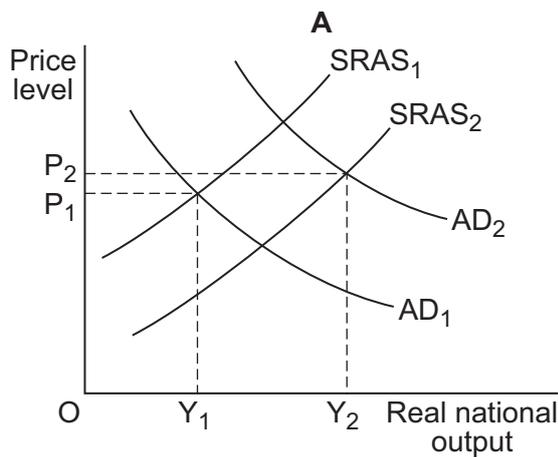
21 Which one of the following is most likely to affect aggregate demand in the short run?

    A An increased rate of innovation

    B An increase in labour productivity

    C An increase in government spending

    D An increase in the mobility of labour

22 In the short term, contractionary fiscal policy is most likely to cause

    A a deterioration in the current account on the balance of payments.

    B a rise in unemployment.

    C a fall in export volumes.

    D an increase in the rate of inflation.

23 A conflict between macroeconomic policy objectives sometimes exists because

    A demand-pull inflation requires action that increases aggregate demand.

    B costs can be reduced only if prices fall.

    C an increase in aggregate demand might reduce unemployment but result in a deterioration in the balance of payments on current account.

    D supply-side policies cannot be used alongside demand-management policies.

24 Which one of the following forms part of the institutional structure of an economy?

    A The productivity of labour

    B Fiscal policy

    C The banking system

    D The underlying trend rate of growth

Turn over ▶

25 The diagram below shows the aggregate demand (AD) and short-run aggregate supply (SRAS) curves for an economy.
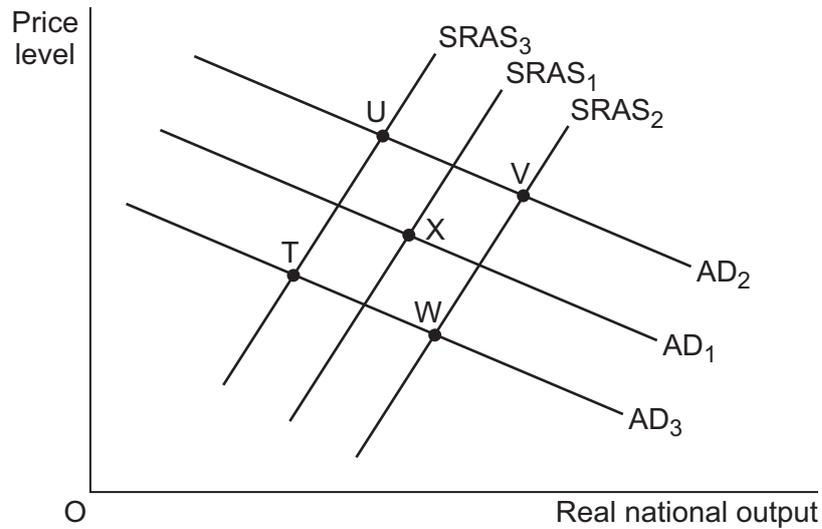
Given that X is the initial equilibrium position, what would be the new equilibrium position following an increase in the price of imported oil and a general restriction on bank lending in the economy?

A   Point T

B   Point U

C   Point V

D   Point W

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

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

Now turn to page 12 for Section B

Turn over for Section B

Section B: Data Response

Answer **EITHER** Context 1 **OR** Context 2.
You are advised to spend at least 50 minutes on **Section B**.

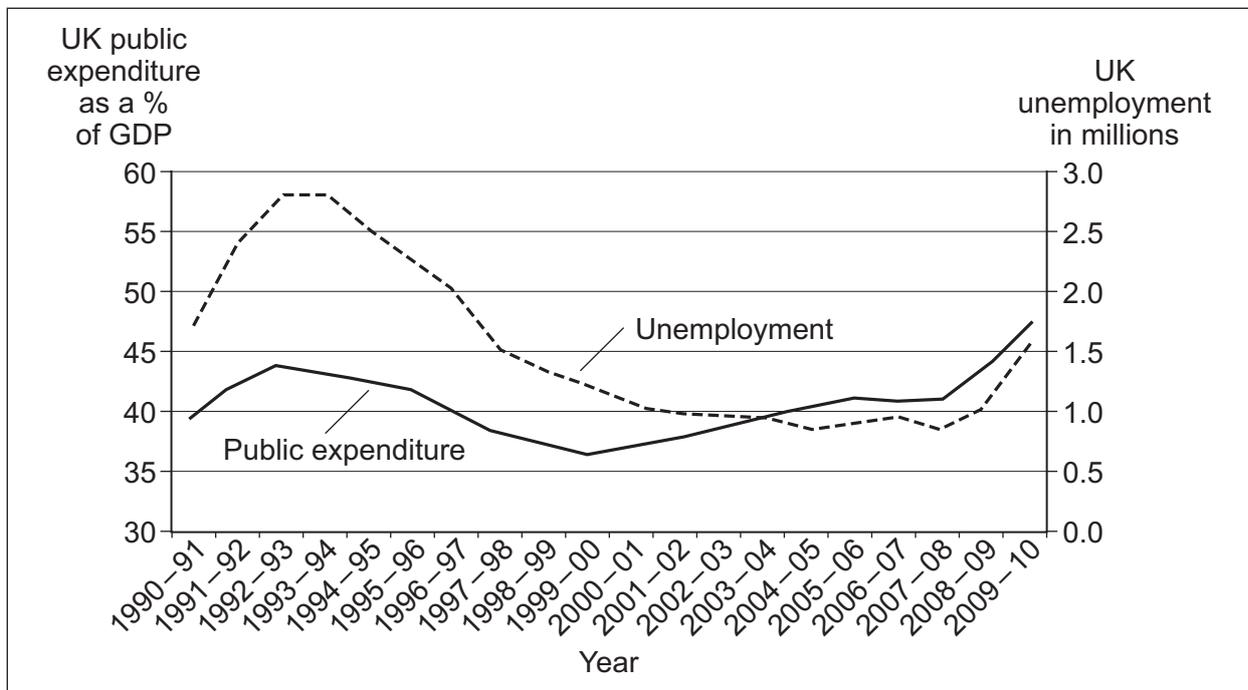**Total for this Context: 50 marks**

EITHER

Context 1

CUTTING PUBLIC EXPENDITURE IN THE UK

Study **Extracts A**, **B and C**, and then answer **all** parts of Context 1 which follow.

Extract A: UK public expenditure as a percentage of GDP and UK unemployment in millions, 1990–91 to 2009–10

Source: *Office for National Statistics*, October 2010

Extract B: The UK economy faces cuts in public spending

The UK economy faces a significant tightening of fiscal policy. This will be achieved primarily through reduced public sector expenditure, which includes spending on goods and services, benefit payments and wages paid to public sector employees. The measures introduced in the October 2010 Public Spending Review plan to cut government expenditure by £81 bn. This plan, laid out by the Coalition Government, implies the longest and deepest sustained period of cuts to public spending since the Second World War. It is inevitable that cuts of this size will reduce the quantity and quality of public services available.   1 ... 5

The cuts in public expenditure are also likely to reduce aggregate demand. The disposable income of many households will fall, or grow more slowly, and some companies will face lower demand from the public sector for their goods and services. However, these effects on demand may be offset, to some extent, if the cuts in public spending improve confidence and reduce the risk of a rise in interest rates.   10

Source: news reports, October 2010

Extract C: Will cuts in public spending damage the economy?

Economists are divided over the impact that the cuts in public spending will have on the UK economy. Some argue that, while unemployment is high and people are not spending enough to provide full employment, the Government has to keep spending high to sustain the recovery and to avoid the risk of falling into another recession. Cuts in public spending will reduce company profits, lead to the cancellation of investment projects and damage the education of young people. In the long run, the quality of the labour force will deteriorate.	1 5
However, if the Government does not reduce the size of the budget deficit, large-scale government borrowing could force up interest rates, destroying both business and consumer confidence. High interest rates are particularly damaging for the UK economy because of the high level of private sector debt. Reductions in public spending could also create opportunities for the private sector to fill the gap, encouraging more private sector investment.	 10

Source: news reports, October 2010

0 1 Define the term 'disposable income' (**Extract B**, line 10). *(5 marks)*

0 2 Using **Extract A**, identify **two** significant points of comparison between public expenditure as a percentage of GDP and unemployment over the period shown.

(8 marks)

0 3 **Extract B** (line 9) states that 'cuts in public expenditure are also likely to reduce aggregate demand'.

Explain why cuts in public expenditure are likely to reduce aggregate demand.

(12 marks)

0 4 **Extract B** (lines 5 – 7) states: 'This plan, laid out by the Coalition Government, implies the longest and deepest sustained period of cuts to public spending since the Second World War'.

Using the data and your economic knowledge, assess the likely impact of substantial cuts in public expenditure on the performance of the UK economy. *(25 marks)*

Turn over ▶

Do **not** answer Context 2 if you have answered Context 1.
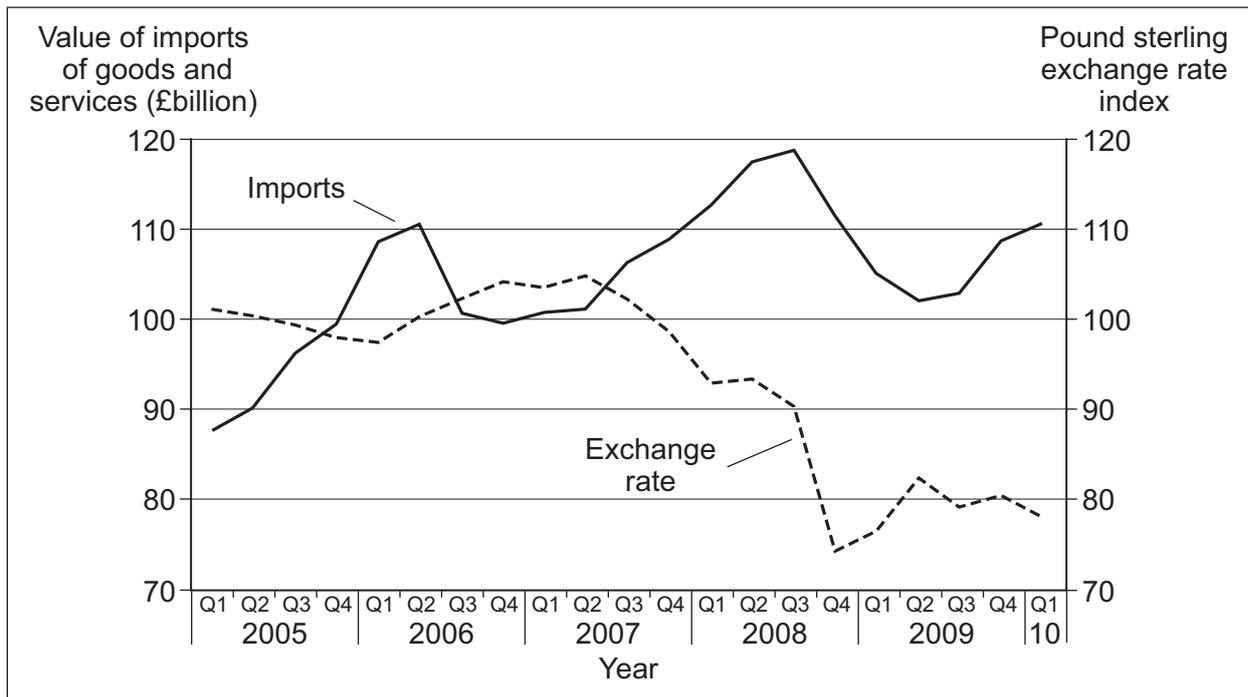
Total for this Context: 50 marks

OR

Context 2

UK IMPORTS AND THE RECOVERY OF THE UK ECONOMY

Study **Extracts D**, **E and F**, and then answer **all** parts of Context 2 which follow.

Extract D: Total value of imports of goods and services (£billion) into the UK and the pound sterling exchange rate index, 2005 to 2010 (Q = quarter)

Source: *Office for National Statistics,* September 2010

Note: The pound sterling exchange rate index measures the value of the pound against a basket of other currencies.

Extract E: Spending on imports grows despite the fall in the value of the pound

The UK's balance of trade in goods and services improved at the start of the 2008–09 recession as the value of imports fell at a faster rate than exports. However, since the UK and global economies have started to recover, UK imports have grown at a faster rate than exports despite the large depreciation of the pound since the second quarter of 2007. The reduction in labour productivity during the recession also affected the competitiveness of home-produced goods.

Since the middle of 2009, imports have increased by 7%. The majority of the rise in imports since mid-2009 relates to increased imports of raw materials, semi-manufactured goods and vehicles. As the economy recovers, the manufacturing and construction sector will buy more inputs from abroad and hence some increase in imports is inevitable. However, the forthcoming rise in taxation, needed to reduce the budget deficit, should help to lessen the growth in household spending on foreign goods.

1

5

10

Source: news reports, September 2010

Extract F: Will a growing trade deficit damage the recovery from recession?

The UK's deficit on trade in goods widened to a record high in July after imports rose sharply and exports fell from the previous month. The goods deficit was £8.7bn, the biggest deficit since figures began in 1998. However, trade in services produced a surplus of £3.8bn. Nevertheless, the deficit on trade in goods and services widened to its highest value in almost five years. Imports increased by 3.1%, which was largely driven by an increase in imports of chemicals, pharmaceuticals, oil and semi-manufactures.	1 5
Although some of the deterioration reflects a sharp rise in imports, which is an indication of the strength of domestic demand, July's dreadful trade figures cast doubt over the ability of external trade to drive the recovery in the UK economy. With cuts in public spending and higher taxes on the horizon, the Government was hoping that the recovery would be secured by an injection of demand resulting from more exports and reduced spending on imports.	10

Source: news reports, September 2010

0 5 Define the term 'recovery' (**Extract F**, line 12). *(5 marks)*

0 6 Using **Extract D**, identify **two** significant points of comparison between the total value of imports of goods and services and the pound sterling exchange rate index over the period shown. *(8 marks)*

0 7 Explain how the value of imports into the UK is likely to be affected by **both** a fall in the value of the pound on the foreign exchange market **and** a reduction in UK labour productivity. *(12 marks)*

0 8 **Extract F** (lines 9 – 10) states that 'July's dreadful trade figures cast doubt over the ability of external trade to drive the recovery in the UK economy'.

Using the data and your economic knowledge, evaluate the extent to which external trade can be relied upon to bring about a recovery in the UK economy. *(25 marks)*

END OF QUESTIONS

There are no questions printed on this page