



General Certificate of Education  
Advanced Subsidiary Examination  
June 2012

## Economics

## ECON2

### Unit 2 The National Economy

Friday 25 May 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**.

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## Section A: Objective Test

Answer **all** questions in **Section A**.

Each question carries 1 mark. No deductions will be made for wrong answers.

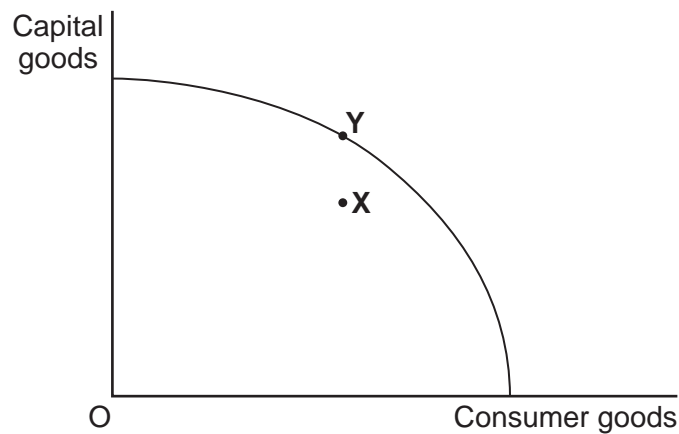
You are advised to spend no more than 25 minutes on **Section A**.

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.

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- 1 Which one of the following is most likely to be an example of a supply-side policy?
- A A reduction in the rate of interest to reduce inflation
  - B An increase in government expenditure on state pensions
  - C A reduction in company taxes to encourage greater investment
  - D A rise in the exchange rate to increase exports
- 2 All other things being equal, which one of the following would be the most likely consequence of an appreciation in the external value of a country's currency?
- An increase in
- A the domestic price level
  - B the volume of exports
  - C employment in the domestic economy
  - D the volume of imports
- 3 Which one of the following is most likely to result in an increase in the long-run trend rate of economic growth?
- A An increase in aggregate demand leading to inflationary pressures
  - B A sustained increase in the value of the pound on the foreign exchange market
  - C A reduction in taxes which increases risk-taking and incentives to work
  - D A sustained reduction in both inflation and labour productivity.

- 4 The diagram below shows an economy operating on its production possibility frontier at point Y.



All other things being equal, which one of the following is most likely to move the economy from point Y to point X within its production possibility frontier?

- A A decrease in inflation
  - B A decrease in investment expenditure
  - C A reduction in productive capacity
  - D A reduction in the trend rate of growth
- 5 Which one of the following best illustrates the accelerator process?
- A A change in one of the components of aggregate demand leading to a much greater increase in national income
  - B An increase in national income resulting in a proportionately larger rise in investment
  - C Government subsidies to firms for research and development helping to increase the rate of innovation
  - D An increase in government spending during a recession helping to stimulate investment

- 6 The table below shows the index of Gross Domestic Product (GDP) measured at current prices and the associated price index for an economy.

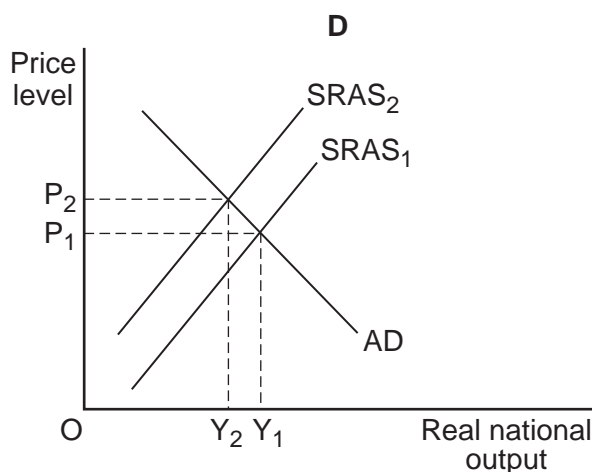
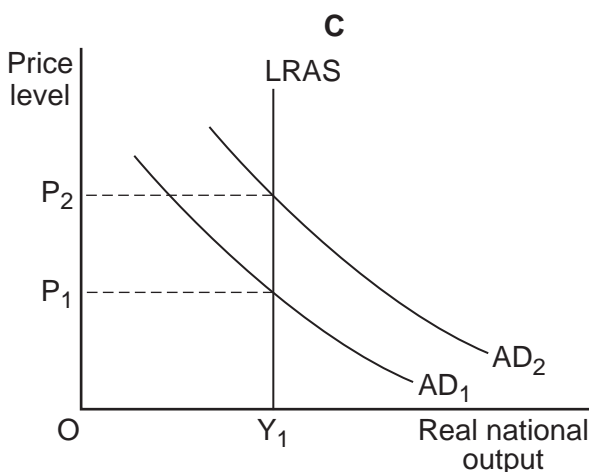
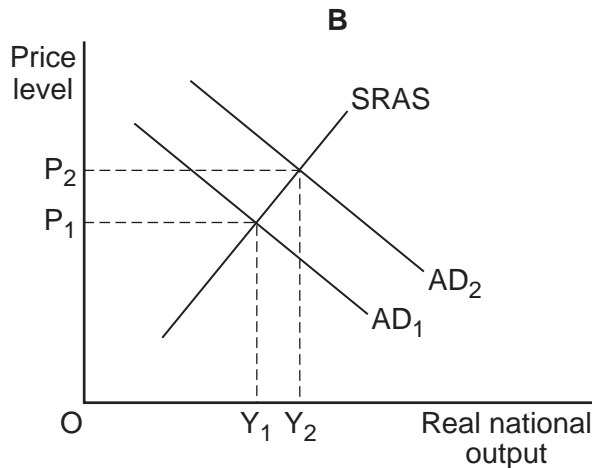
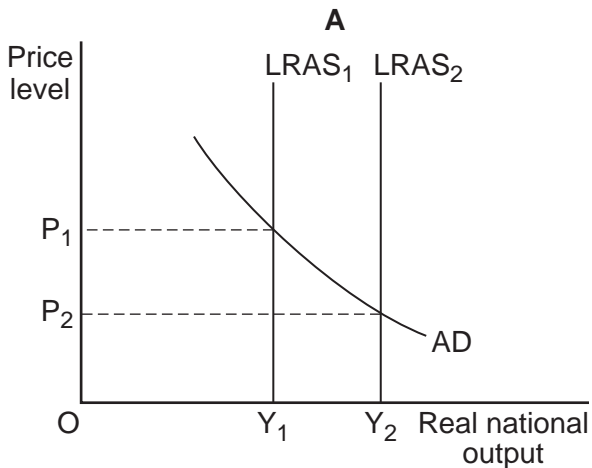
Year	Index of GDP at current prices 2005 = 100	Price index 2005 = 100
2001	80	80
2011	130	110

The table shows that between 2001 and 2011

- A real GDP rose by 50%.
  - B nominal GDP rose by 50%.
  - C real GDP rose by less than 50%.
  - D nominal GDP rose by less than 50%.
- 7 Which one of the following is most likely to result in a rightward shift of the short-run aggregate supply curve?
- A A decrease in wage rates
  - B A decrease in government spending
  - C An increase in taxation
  - D An increase in investment expenditure
- 8 A cut in income tax rates could be considered
- A both a monetary policy and a fiscal policy.
  - B both a monetary policy and a supply-side policy.
  - C both a fiscal policy and a supply-side policy.
  - D neither a monetary policy nor a fiscal policy.

9 The four diagrams below show aggregate demand (AD) and long-run and short-run aggregate supply (LRAS/SRAS) curves for an economy where  $OP_1$  is the initial equilibrium price and  $OY_1$  the initial equilibrium level of real national output.

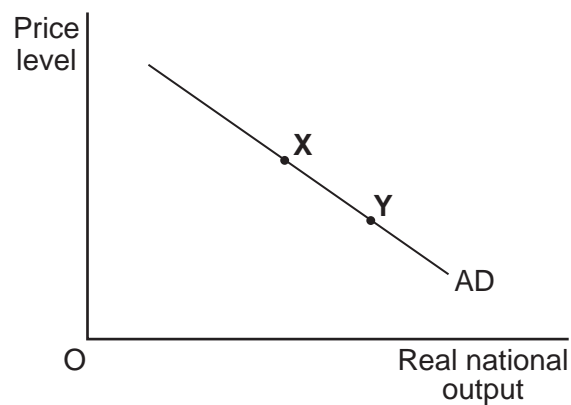
Which diagram, **A**, **B**, **C** or **D**, shows the change resulting from an increase in innovation and productivity improvements?



10 A rise in the level of domestic investment will most likely result from a rise in

- A the current account deficit.
- B interest rates.
- C company profits.
- D the exchange rate.

- 11 Fiscal policy involves changes in both
- A the budget balance and the balance of payments.
  - B interest rates and the supply of credit.
  - C the money supply and the exchange rate.
  - D government spending and tax revenue.
- 12 Deflation is most likely to
- A cause consumers to delay their purchases.
  - B lead to a rise in interest rates.
  - C lead to a rise in imports.
  - D reduce the real value of any money that has been lent.
- 13 The diagram below shows an aggregate demand (AD) curve for an economy.



The movement down the aggregate demand curve from X to Y shows that

- A as real national output rises, firms can lower their costs due to mass production.
- B as real national output falls, the price of imported goods rises.
- C as the price level rises, the nominal value of consumption and investment falls.
- D as the price level falls, consumers and firms purchase more goods.

- 14 An economy is currently operating with a negative output gap. In the short run, if the rate of growth of aggregate demand is positive but less than the rate of growth of productive capacity, then the economy is most likely to experience
- A a decrease in output.
  - B an increase in unemployment.
  - C a decrease in its trend rate of growth.
  - D a decrease in exports.

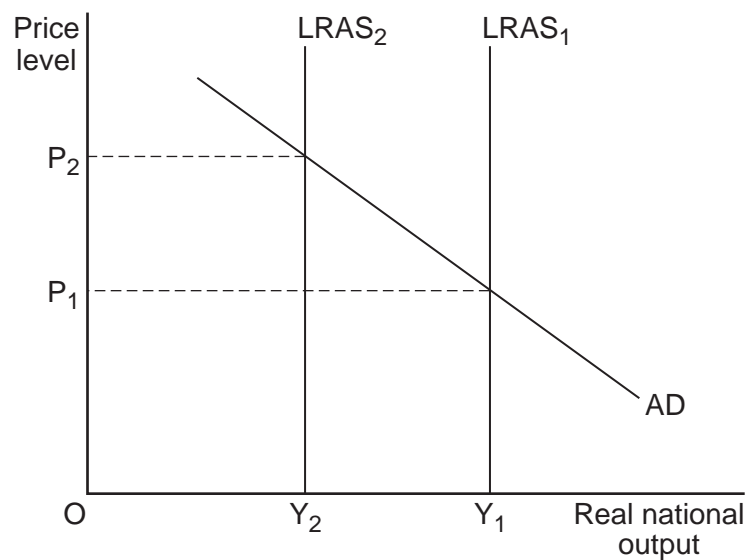
- 15 The table below shows the components of the balance of payments on current account for an economy in 2011.

	£bn
Export of goods	500
Export of services	400
Import of goods	800
Import of services	300
Net investment income	+50
Net transfers	+100

It follows that the balance of payments on current account for 2011 is

- A +£2150 bn
  - B +£200 bn
  - C -£200 bn
  - D -£50 bn
- 16 The UK economy enters a recession but the current account deficit on the balance of payments remains high. Given these problems, which one of the following would be most likely to improve the performance of the UK economy?
- A An increase in taxes on imported goods and a fall in the value of the pound
  - B A fall in interest rates and a rise in the value of the pound
  - C A fall in the money supply and an increase in taxes on imported goods
  - D A fall in government spending and a rise in interest rates

- 17 An increase in interest rates when the exchange rate is rising is most likely to lead to an increase in
- A economic growth.
  - B aggregate supply.
  - C the current account surplus.
  - D unemployment levels.
- 18 The diagram below shows the aggregate demand (AD) curve and two long-run aggregate supply (LRAS) curves for an economy.



The decline in equilibrium real national output from  $Y_1$  to  $Y_2$  implies that the economy

- A is operating within its production possibility frontier.
- B has a falling level of unemployment.
- C has a negative rate of economic growth.
- D is experiencing a low rate of productivity growth.



- 19 Which one of the following is an example of expansionary fiscal policy?
- A A reduction in interest rates
- B An increase in the budget deficit
- C An increase in the money supply
- D An increase in tax rates
- 20 Which one of the following is most likely to lead to a fall in aggregate investment?
- A A reduction in the level of unemployment
- B An increase in spare capacity in the economy
- C A reduction in the average level of interest rates
- D An increase in aggregate demand
- 21 All other things being equal, a large increase in an economy's rate of interest will cause
- A both its aggregate demand curve and its short-run aggregate supply curve to shift to the right.
- B its aggregate demand curve to shift to the right and its short-run aggregate supply curve to shift to the left.
- C both its aggregate demand curve and its short-run aggregate supply curve to shift to the left.
- D its aggregate demand curve to shift to the left and its short-run aggregate supply curve to shift to the right.
- 22 Inflation in an economy is currently at 10%. Which of the following changes in monetary and fiscal policy, **A**, **B**, **C** or **D**, is most likely to reduce the rate of inflation in the economy?

	<b>Interest rates</b>	<b>Government expenditure</b>	<b>Taxation revenue</b>
<b>A</b>	Increase	Increase	Decrease
<b>B</b>	Decrease	Decrease	Increase
<b>C</b>	Increase	Decrease	Increase
<b>D</b>	Decrease	Increase	Increase

Turn over ►

- 
- 23** The government introduces a policy which initially increases the budget deficit but, in the long run, increases the trend rate of economic growth.

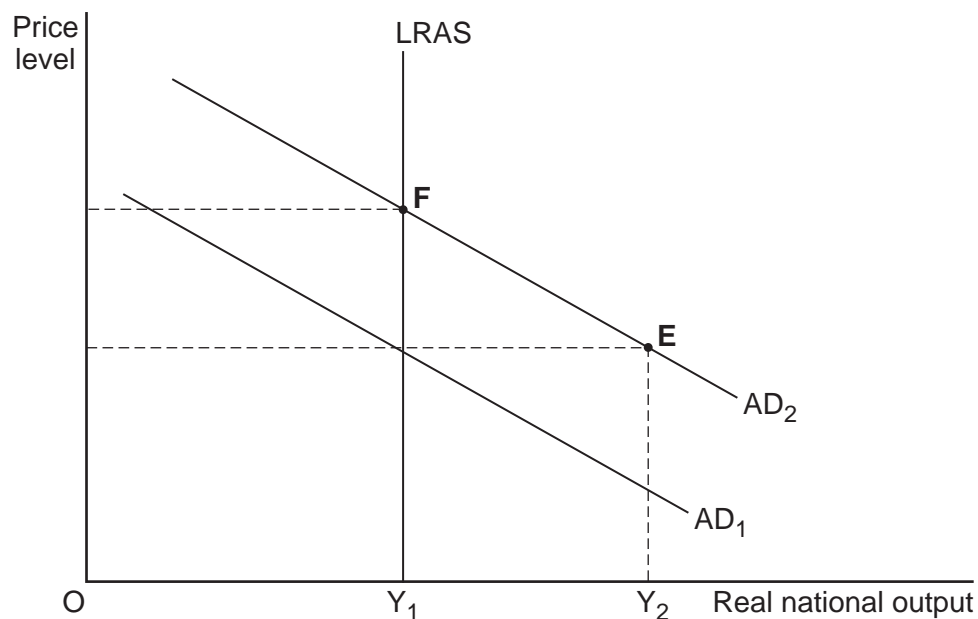
This policy is most likely to have been

- A** placing a tax on imports.
  - B** increasing subsidies for research and development.
  - C** bringing about a fall in the exchange rate.
  - D** increasing the age of retirement.
- 24** The UK steel industry pays for its imported inputs in US dollars and sells its output abroad in euros.

It follows from the above that the UK steel industry will benefit most when the pound is

- A** strong against the US dollar, weak against the euro.
- B** weak against the US dollar, weak against the euro.
- C** weak against the US dollar, strong against the euro.
- D** strong against the US dollar, strong against the euro.

- 25 The diagram below shows the aggregate demand (AD) and long-run aggregate supply (LRAS) curves for the UK economy.



The government predicts that aggregate demand will increase in the long run from  $AD_1$  to  $AD_2$ . All other things being equal, which one of the following policies is most likely to move the economy to a new long-run equilibrium at point  $E$  rather than point  $F$ ?

- A Pursuing an expansionary monetary policy
- B Allowing the exchange rate to rise
- C Increasing taxation
- D Improving the flexibility of the labour market

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

**Total for this Context: 50 marks**

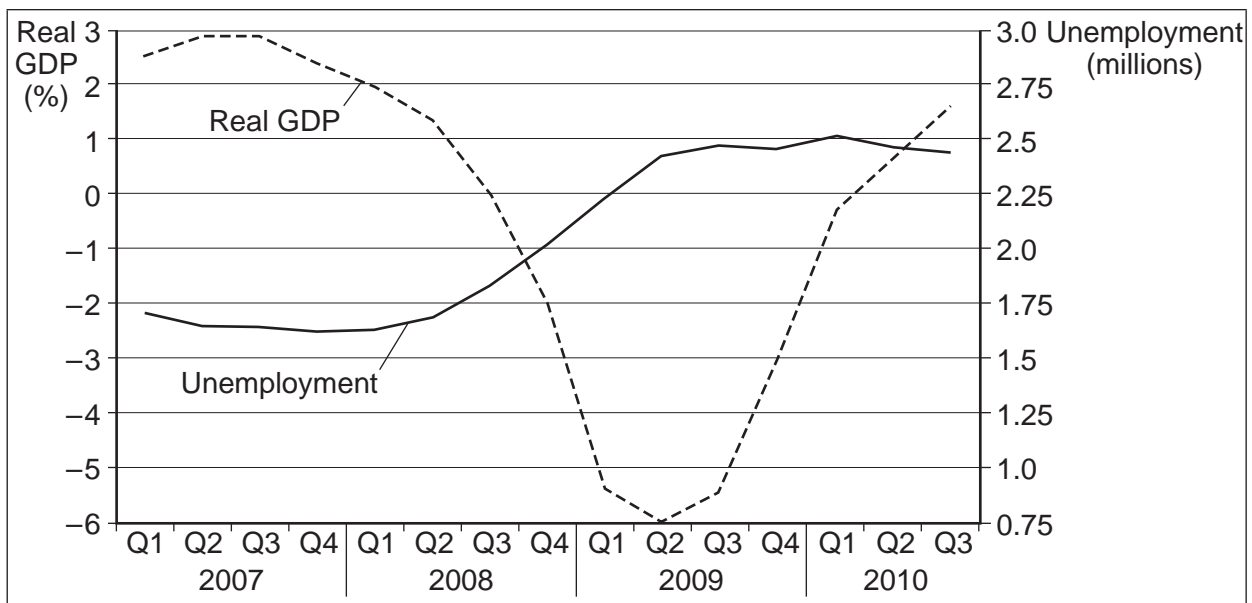
**EITHER**

**Context 1**

**UNEMPLOYMENT IN THE UK**

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

**Extract A: UK real GDP growth (%) and unemployment (millions), 2007 to 2010, quarterly**



Source: official statistics, January 2011

**Extract B: Unemployment rises above 2.5 million**

Figures published by the *Office for National Statistics* show that a sharp fall in employment in the public sector helped to push total unemployment above 2.5 million last month. The largest rise in unemployment was among 16 and 17 year olds, up by 19000 to reach 206000. The number of people employed in the public sector fell by over 33000. However, unlike earlier in 2010 when private firms were creating jobs, employment in the private sector was unchanged. Measures designed to reduce the size of the budget deficit mean that it is inevitable that job losses in the public sector will continue during the years ahead.

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The number of people who were working part-time because they could not find a full-time job increased by 46000 to reach 1.16 million, the highest figure since comparable records began in 1992.

10

Source: news reports, January 2011

**Extract C: 2011 will be tough for the UK economy**

Economists are predicting that the first half of 2011 is going to be tough for the UK economy. The 2.5% rise in VAT and cuts in public spending will drive up unemployment. On a more positive note, the strengthening of private sector investment and the growth in exports of manufactured goods, helped by the 20% reduction in the value of the pound, should help to stimulate the economy.	1 5
Nevertheless, the overall growth in aggregate demand is likely to be less than the economy's underlying trend rate of growth and some economists have predicted that unemployment will rise to around 2.7 million. Another shock to the economy, such as a rise in interest rates triggered by high inflation, could lead to a further increase in spare capacity and even higher unemployment.	10
Since 2009, there has been some rebalancing of the UK economy away from the public sector, with 296 000 new private sector jobs more than compensating for 77 000 jobs lost in the public sector. However, it is predicted that a further 600 000 jobs will go in the public sector over the next 5 years. Regions of the UK, such as the North East, that are very dependent on the public sector, are likely to see a sharp rise in structural unemployment. Many of the jobs created by the private sector are likely to be located in the wrong places and require skills which redundant public sector staff may not be able to provide. People may be unable to move from regions of high unemployment for family reasons or because of the very high house prices in the South East, where most of the jobs are likely to appear.	15 20

Source: news reports, January 2011

- 0 1** Define the term 'structural unemployment' (**Extract C**, lines 15–16). (5 marks)
- 0 2** Using **Extract A**, identify **two** significant points of comparison between the rate of growth in real GDP and unemployment over the period shown. (8 marks)
- 0 3** **Extract C** (lines 6–8) states that 'the overall growth in aggregate demand is likely to be less than the economy's underlying trend rate of growth and some economists have predicted that unemployment will rise to around 2.7 million'.
- Explain why unemployment is likely to rise if aggregate demand grows more slowly than the underlying trend rate of growth of the economy. (12 marks)
- 0 4** **Extract B** (lines 6–8) states: 'Measures designed to reduce the size of the budget deficit mean that it is inevitable that job losses in the public sector will continue during the years ahead.'
- Using the data and your economic knowledge, discuss the view that the measures taken to reduce the size of the budget deficit will inevitably result in a rise in unemployment in the UK. (25 marks)

Turn over ►

Do **not** answer Context 2 if you have answered Context 1.

**Total for this Context: 50 marks**

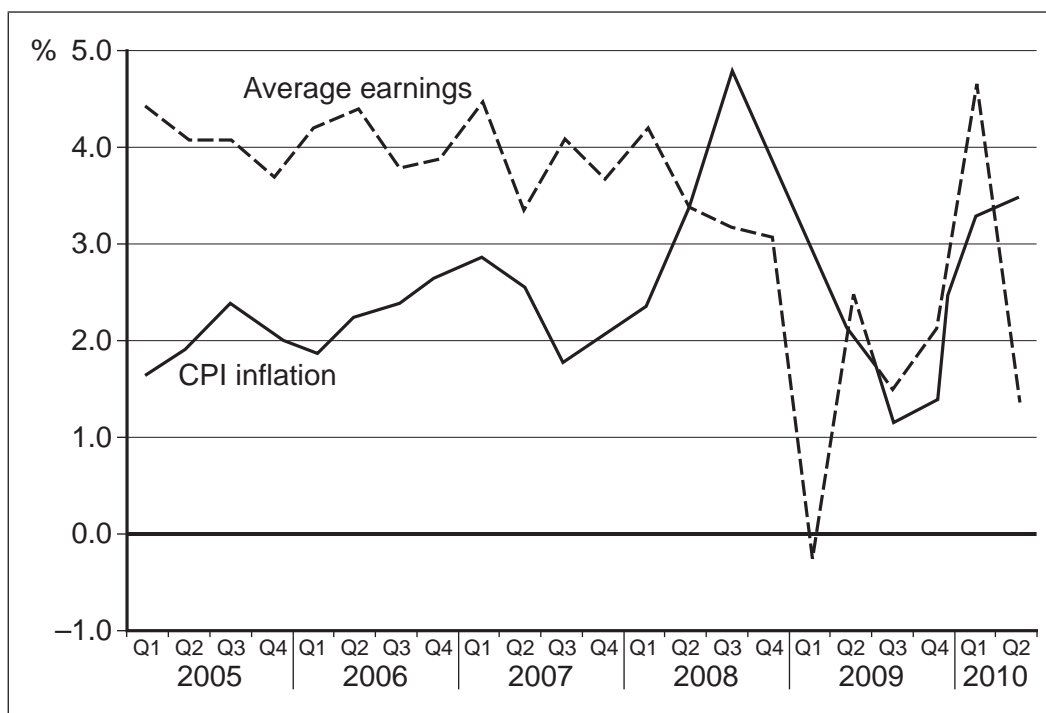
OR

**Context 2**

**INFLATION IN THE UK**

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

**Extract D: CPI inflation and the rate of growth in average earnings in the UK, 2005 to 2010, quarterly**



Source: official statistics, January 2011

**Extract E: Inflation has been above target throughout 2010**

The Bank of England's forecasts for inflation have been over-optimistic for some time now. Inflation has increased partly as a result of the fall in the value of the pound, rapidly rising commodity prices and increases in Value Added Tax (VAT). The pound has fallen by more than 20% against other currencies since the beginning of 2008, pushing up the price of imports. On top of this, the restoration of VAT to 17.5% in January 2010 increased CPI inflation by about 1%. 1  
5

The further increase in VAT to 20% in January 2011 put more upward pressure on inflation. Without the effect of increases in indirect taxes, such as VAT and excise duties on petrol, inflation would have been around 1.5% over the previous 6 months. Instead, inflation has exceeded the Government's 2% target and has been over 3% for most of 2010. Inflation will continue to rise over the next few months but the Bank still believes that it will return to target in 2012. 10

Source: news reports, January 2011

**Extract F: Will rising commodity prices fuel inflationary expectations?**

Food prices, fuel bills, clothing and other costs are rocketing. Figures released yesterday by the United Nations (UN) <i>Food and Agriculture Organisation</i> show that global food prices rose to a record high last month. Many other raw materials and agricultural commodities are close to, or above, their previous peaks. The price of oil, although still well below the \$140 a barrel level it reached in the summer of 2008, is once more approaching \$100 a barrel. This rise in world commodity prices will ensure that inflation in the UK remains high throughout 2011. Many economists believe that this type of cost-push inflation is difficult to control through the use of interest rates.	1 5
The real danger is that inflationary expectations will increase and change people's behaviour. With rising inflation, people will be expecting higher pay. However, pay increases will be hard to obtain in the face of rising unemployment and public sector pay freezes. If wages do start to rise, firms will want to pass on the increase in costs. However, this will not be easy when household disposable income is being constrained by tax rises and benefit cuts.	10
Contractionary fiscal measures should help to reduce inflation, as might supply-side policies. However, if growth in the economy reduces the amount of spare capacity and unemployment falls, earnings may start to rise rapidly. In these circumstances, the Monetary Policy Committee of the Bank of England will raise Bank Rate to try to reduce inflation. Some think that this will be too late.	15

Source: news reports, January 2011

- 0 5** Define the term 'cost-push inflation' (**Extract F**, line 8). (5 marks)
- 0 6** Using **Extract D**, identify **two** significant points of comparison between CPI inflation and the rate of growth in average earnings over the period shown. (8 marks)
- 0 7** **Extract E** (line 2) states: 'Inflation has increased partly as a result of the fall in the value of the pound... .' Using an appropriate diagram, explain why a fall in the exchange rate is likely to increase inflation. (12 marks)
- 0 8** **Extract F** (lines 17–19) states: 'In these circumstances, the Monetary Policy Committee of the Bank of England will raise Bank Rate to try to reduce inflation.' Using the data and your economic knowledge, assess the view that the use of interest rates is the best way to control inflation in the UK. (25 marks)

**END OF QUESTIONS**

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