Rewarding Learning

ADVANCED SUBSIDIARY (AS)
General Certificate of Education
January 2009

Economics

Assessment Unit AS 3

assessing

Module 2: The National Economy

[ASE31]

ASE31

MONDAY 26 JANUARY, AFTERNOON

TIME

1 hour 30 minutes.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer Question **1** and any **one** of Questions **2**, **3** or **4**.

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.
Quality of written communication will be assessed in all questions **except** Question **1** part **(a)**.
Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time.

You **must** answer this question.

1 The following article was written in January 2008.

Study it carefully and answer the questions which follow.

"Fear of recession stalks the USA"

Gloomy economic news is worrying investors and policy-makers in the USA and sparking calls for government intervention to help prevent a recession. There has been the sharpest fall in home prices for 25 years and a massive increase in the number of homeowners who cannot repay their mortgages. This has led to banks having to write off billions of dollars of bad debts and sparked the worldwide 'credit crunch'. *(Paragraph 1)*

It was against this background that Ben Bernanke, the chairman of the American central bank, made an impassioned plea to Congress for a fiscal stimulus to the economy. He said, "Fiscal action could be helpful as a fiscal and monetary stimulus combined, may provide broader support for the economy than monetary actions alone". *(Paragraph 2)*

He added that the timing of the package was of crucial importance. He said, "Stimulus that comes too late will not support the current level of economic activity and it could be actively destabilising if it comes at a time when growth is already improving". *(Paragraph 3)*

Ben Bernanke's UK counterpart is Mervyn King, the Governor of the Bank of England, and he is all too aware that events in the USA can have a significant impact on the UK economy. Already one UK bank, Northern Rock, has had to be rescued by the government because of its exposure to high risk (sub-prime) American mortgages and other UK banks may be equally at risk. *(Paragraph 4)*

Mervyn King is under considerable pressure to cut UK interest rates in order to prevent a recession but he must also consider the significant inflationary pressures in the economy. These come from rising food and fuel prices as well as a falling value for the pound which is pushing up shop prices. *(Paragraph 5)*

So the UK may find it difficult to follow America's example of slashing interest rates and pursuing an expansionary fiscal policy. The Bank of England is committed to achieving an inflation target of around 2 per cent irrespective of the impact on other economic variables such as growth and unemployment. *(Paragraph 6)*

The narrow nature of the Bank of England's target has angered some on the political left who argue that a recession must be avoided at all costs, no matter what the impact on inflation. *(Paragraph 7)*

One MP said, "Why should the economy be allowed to slide into recession simply because of some meaningless inflation target? The Bank of England should cut interest rates and forget about inflation. Recession imposes real human costs in terms of unemployment and poverty; whereas the inflation figure is just a number and not always a particularly accurate one". *(Paragraph 8)*

(Adapted from The Times January 18th 2008, title "Fed backs fiscal action to boost US growth", author Gary Duncan)

(a) The passage states that many Americans are worried about the possibilit[illegible]ion.

Explain what is meant by the term "recession". [illegible]

(b) In paragraph 2 Ben Bernanke calls for a "fiscal and monetary stimulus" for the econom[illegible]

Analyse how the following actions could help to increase spending in the economy:

(i) A large cut in interest rates. [6]

(ii) An expansionary fiscal policy. [6]

(c) In paragraph 3 Ben Bernanke argues that a badly timed fiscal stimulus could destabilise the economy. Explain how this could happen. [6]

(d) In paragraph 5 Mervyn King states that the fall in the value of the pound is pushing up shop prices in the UK. Explain why a fall in the exchange rate of the pound may be a cause of inflation. [8]

(e) Critically examine the view, expressed in paragraphs 7 and 8, that the Bank of England should cut interest rates, even though this may increase the rate of inflation. [10]

Answer any **one** of Questions 2, 3 **or** 4.

2 **(a)** Explain the difference between nominal and real gross domestic product (GDP). [

(b) Outline **two** of the methods by which GDP may be calculated. [16]

(c) Evaluate the usefulness of using real GDP per person as a guide to a nation's standard of living. [16]

3 **(a)** Describe the main components of aggregate demand in an economy. [8]

(b) Explain why an economy's aggregate demand curve slopes downwards from left to right. [16]

(c) Evaluate the view that a government should always maintain a balanced budget. [16]

4 **(a)** Explain what is meant by the term supply-side policies. [8]

(b) Explain the main factors which may lead to a rightward shift in an economy's long run aggregate supply curve. [16]

(c) Evaluate the view that supply-side policies benefit business at the expense of workers. [16]