



General Certificate of Education
Advanced Subsidiary Examination
January 2009

Economics

ECON2

Unit 2 The National Economy

Friday 16 January 2009 9.00 am to 10.15 am

For this paper you must have:

- an objective test answer sheet
- a black ball-point pen
- an 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 answer book.
- Do all rough work in your answer book, **not** on your objective test answer sheet.

Section A

- Use a black ball-point pen. Do **not** use pencil.

Section B

- 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.

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**.

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**.

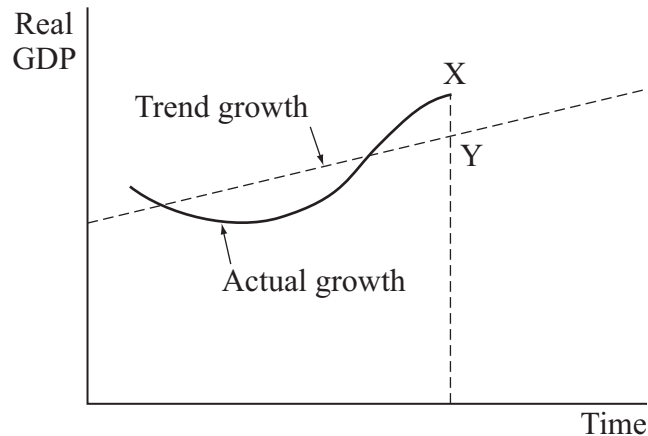
For each question there are four alternative responses, **A**, **B**, **C** and **D**. When you have selected the response which you think is the best answer to a question, mark this response on your objective test answer sheet. If you wish to change your answer to a question, follow the instructions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

- 1 Which one of the following statements about saving is correct?
 - A Saving is a component of aggregate demand.
 - B Saving can finance investment expenditure.
 - C In the short run, less household saving means less consumption.
 - D Increased saving increases demand-pull inflationary pressure.

- 2 An economy is currently operating inside its production possibility frontier. In the short run, if the rate of growth of aggregate demand is less than the rate of growth of productive capacity, then the economy is most likely to experience
 - A an increase in unemployment.
 - B a decrease in output.
 - C a decrease in its trend rate of growth.
 - D a decrease in imports.

- 3 As a component of aggregate demand, consumption is best defined as total expenditure in the economy
 - A on all goods and services including imports.
 - B on all goods and services minus expenditure on exports.
 - C by households on all goods and services.
 - D by households, government and firms plus expenditure on exports less expenditure on imports.

- 4 The diagram below shows the relationship between trend growth and actual growth for an economy.

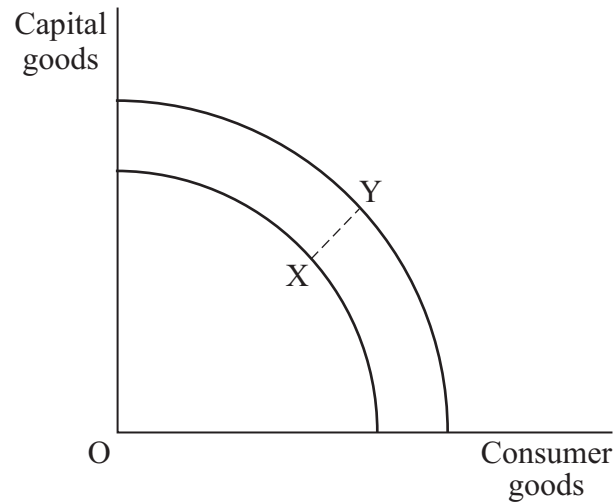


The policy most appropriate to close the output gap XY by influencing aggregate demand would be

- A an increase in the rate of interest.
- B a fall in the exchange rate of the currency.
- C a cut in income tax rates.
- D an increase in government spending.
- 5 Which one of the following is most likely to shift the short run aggregate supply curve to the right?
- A A fall in money wages
- B A reduction in government spending
- C A fall in the exchange rate
- D A decrease in the productivity of labour
- 6 'The multiplier' usually refers to the effect of a change in the level of
- A aggregate demand upon imports.
- B national income upon aggregate demand.
- C saving upon investment.
- D investment upon national income.

Turn over ►

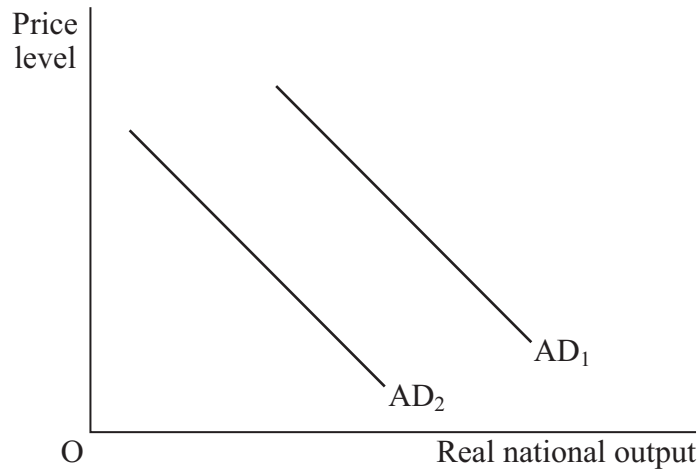
7 The diagram below shows two production possibility frontiers for an economy.



The movement of the economy from position X to position Y must indicate that there has been

- A a reduction in the level of unemployment.
 - B an increase in the economy's output gap.
 - C a rightward shift in the economy's long run aggregate supply curve.
 - D an increase in income per head.
- 8 Expansionary monetary policy is most likely to
- A shift the long run aggregate supply curve to the left.
 - B result from a reduction in taxation.
 - C cause a surplus on the current account of the balance of payments.
 - D shift the aggregate demand curve to the right.

- 9 The diagram below shows two aggregate demand curves for an economy.



The shift from AD₁ to AD₂ could be explained by an increase in

- A imports.
 - B the price level.
 - C costs of production.
 - D investment.
- 10 All other things being equal, an economy is most likely to experience inflation if
- A aggregate supply increases at a faster rate than aggregate demand.
 - B the country runs a balance of trade deficit at full employment.
 - C aggregate demand is increased when the economy is on its production possibility frontier.
 - D the government runs a budget deficit when long run aggregate supply increases.
- 11 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.

Turn over ►

12 A sustained rise in the exchange rate is most likely to increase

- A inflation.
- B unemployment.
- C economic growth.
- D international competitiveness.

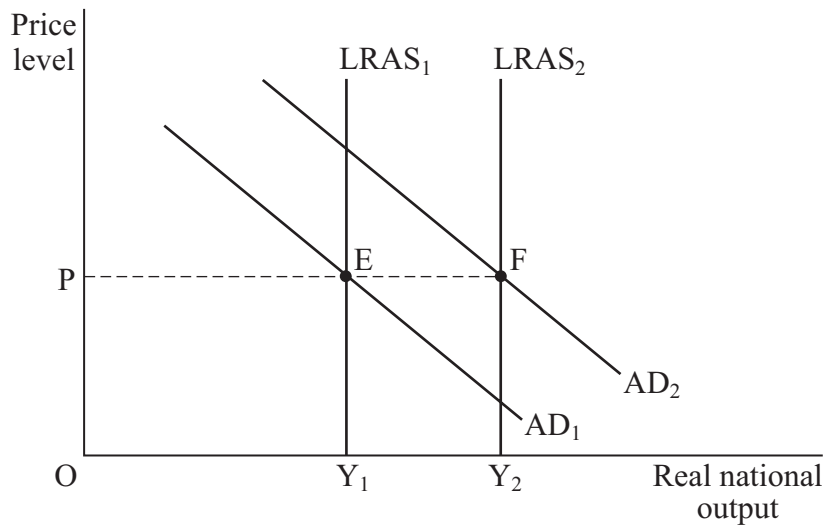
13 The table below shows the change in the Consumer Prices Index for a country between 2007 and 2008.

Year	Consumer Prices Index
2007	200
2008	210

The figures indicate that, approximately, between 2007 and 2008

- A the purchasing power of money fell by 5%.
 - B the rate of inflation was 10%.
 - C the price of consumer goods increased by 10%.
 - D the standard of living increased by 5%.
- 14 Which one of the following is most likely to be an example of a contractionary fiscal policy designed to reduce inflationary pressures?
- A A reduction in the exchange rate
 - B A reduction in the supply of money available to banks for lending purposes
 - C Higher interest rates
 - D An increase in the government budget surplus

- 15 The diagram below shows an aggregate demand/aggregate supply diagram for an economy. The economy is initially in equilibrium at E.



Which one of the following combinations of government policy is most likely to have brought about the change in equilibrium from E to F?

An increase in

- A interest rates and unemployment benefits
 - B government spending on transport infrastructure and vocational retraining programmes
 - C the exchange rate and the money supply
 - D measures to encourage emigration and greater saving
- 16 '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.

Turn over ►

- 17 'Economists predict that the negative output gap in the United Kingdom is likely to grow over the next couple of years.'

In the short run, which one of the following policies is most likely to help to prevent this negative output gap increasing?

- A The Monetary Policy Committee (MPC) raising interest rates
- B The government taking action to increase the exchange rate of the pound
- C An increase in government expenditure accompanied by a growing budget deficit
- D The implementation of supply-side policies that are designed to raise labour productivity

- 18 Which one of the following, **A**, **B**, **C** or **D**, represents the most likely outcome of cuts in interest rates for an economy, all other things being equal?

	Household saving	Household borrowing	The exchange rate of a currency
A	Fall	Fall	Fall
B	Rise	Rise	Rise
C	Rise	Fall	Rise
D	Fall	Rise	Fall

- 19 Structural unemployment is most likely to be caused by

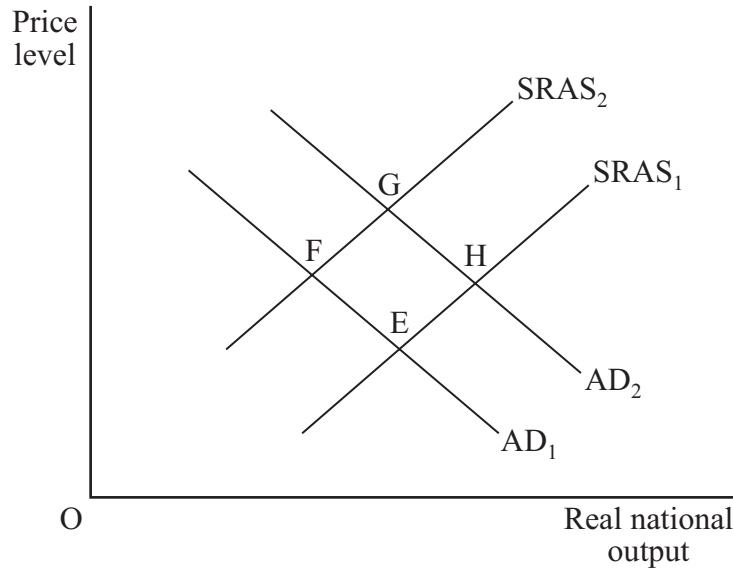
- A a recession in the economy.
- B changes in the demand for labour at different times of the year.
- C an increase in the number of people changing jobs.
- D the skills of the unemployed not matching those required for the available jobs.

- 20 All other things being equal, which one of the following is most likely to increase an economy's underlying trend rate of growth?

A rise in the rate of growth of

- A inflation
- B household income
- C imports of consumer goods
- D labour productivity

- 21 The diagram below shows the aggregate demand (AD) and short run aggregate supply (SRAS) curves for the UK economy, with the initial equilibrium at the intersection of AD_1 and $SRAS_1$ at point E.



The country experiences a 10% increase in oil prices and at the same time exports increase by 10%. As a result of these two events, equilibrium will

- A remain at point E.
 B move to point F.
 C move to point G.
 D move to point H.
- 22 In recent years, the UK has experienced large deficits on the balance of payments on current account. Which one of the following would be **least** likely to reduce such deficits?
- A A rise in aggregate supply
 B A rise in the exchange rate
 C A rise in income tax rates
 D A rise in productivity
- 23 Which one of the following statements relating to monetary policy is correct?
- A A cut in interest rates always increases inflation.
 B While reducing excess demand, an interest rate rise may increase cost-push inflation.
 C Interest rate changes have no effect on aggregate supply.
 D An increase in interest rates will raise the level of investment.

Turn over ►

- 24 The table below shows the value of a country's currency against other currencies, in index number form.

Year	Exchange rate index, 2006 = 100
2005	97
2006	100
2007	104
2008	107

All other things being equal, the most likely consequence of the changes in the exchange rate index shown in the table is that

- A inflationary pressures eased.
 - B the price of imports increased.
 - C the balance of payments on current account improved.
 - D there was a growth in employment in the manufacturing industry.
- 25 When there is full employment, an advantage of supply-side policies is that they
- A immediately benefit the poor.
 - B achieve control over the money supply.
 - C increase the budget deficit.
 - D can bring about an increase in output without adding to inflation.

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

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

TURN TO PAGE 12 FOR SECTION B

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Turn over for the next question

Turn over ▶

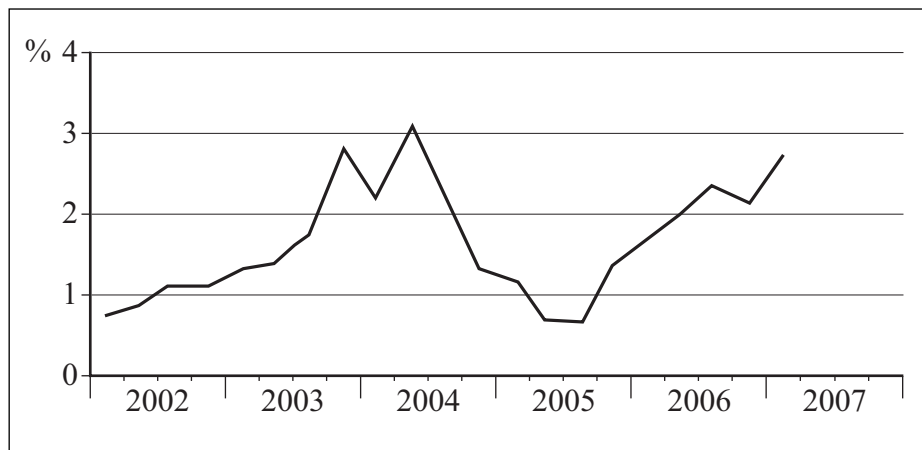
SECTION B: DATA RESPONSE

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****26 PRODUCTIVITY**

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

Extract A: The rate of growth of UK labour productivity, annual % change, 2002–2007



Source: adapted from *www.statistics.gov.uk*, accessed on 29 August 2007

Extract B: Productivity and the performance of the UK economy

Economists, when using the term ‘productivity’, are usually referring to labour productivity. For the UK, the so-called productivity gap continues to cause concern. This is the difference between UK productivity and that of similar economies. In the recent past, UK productivity has been disappointing when compared to some of our major trading partners such as France, Germany and the US. 1
5

International studies provide explanations for differences in labour productivity. Skills and investment levels are regarded as of vital importance. The UK may need higher-quality labour to be applied to more efficient machinery to bring improvements in productivity performance. In the US, it is felt that less job security than in the UK might be a factor. Labour may work harder to impress employers, and so avoid redundancy. The application of new technology is also important. 10

The UK Government views productivity growth as a key policy objective and points to competition, enterprise and innovation as important causes of improved productivity.

Source: news reports, 2008

Extract C: We must have higher productivity in the UK economy

Labour productivity is an important issue when considering UK macroeconomic performance. There is a greater likelihood that any rise in aggregate demand (AD) will be non-inflationary when improvements in productivity are able to generate greater output. This means that economic growth can be sustained over the long term, as can job creation. It must also be borne in mind that the improved competitiveness which higher productivity may bring will, in turn, help to bring the necessary improvements to the balance of payments on current account.	1 5
Of course, benefits are likely to be even greater if higher productivity is accompanied by other supply-side developments such as increased investment, research and development (R&D), and 'welfare-to-work' and tax reforms to encourage the unemployed back into work.	10

Source: news reports, 2008

Question 26

- 26 (a) Define the term 'labour productivity' (**Extract B**, lines 1-2). *(5 marks)*
- (b) Using **Extract A**, identify **two** main features of the annual rate of growth of UK labour productivity for the period 2002 to 2007. *(8 marks)*
- (c) **Extract B** (line 6) suggests that international studies 'provide explanations for differences in labour productivity'.

Explain **two** determinants of labour productivity. *(12 marks)*
- (d) Using the data and your economic knowledge, assess the importance of higher labour productivity in bringing about improvements to UK macroeconomic performance. *(25 marks)*

Turn over for the next question**Turn over ▶**

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

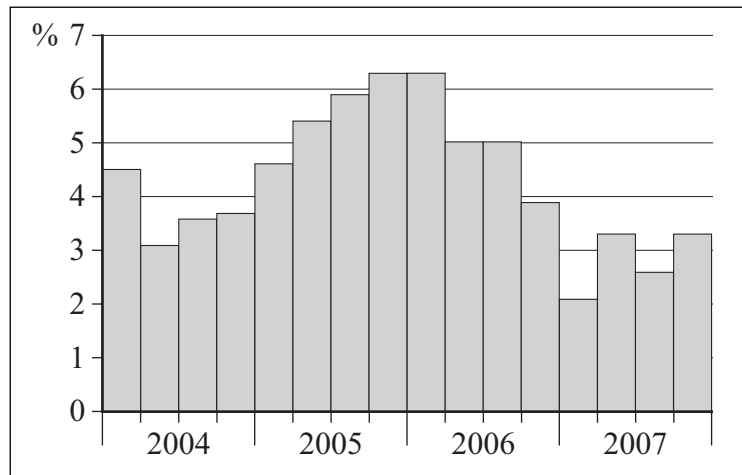
OR

Total for this question: 50 marks

27 HOUSEHOLD SAVINGS

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

Extract D: UK household savings ratio* (%), 2004–2007



* The household savings ratio is household savings expressed as a % of total disposable income (gross income less taxes but including welfare benefits).

Extract E: UK savings ratio tumbles to lowest level for 50 years

The data for 2007 have shown that the rate at which households are saving has plunged to the lowest level in almost half a century. 1

The fall indicates that, as a greater proportion of incomes is accounted for by taxation, higher mortgage payments and credit charges, some households are increasingly having to dig deeper into their savings to maintain a given life-style. However, there will also be those households which may be encouraged to save more as interest rates rise and which have the ability to do so. Providing for old age may be another reason for households to save. 5

Economists warn that consumers are beginning to struggle as the tax burden rises at the fastest rate in nine years and disposable income grows at the slowest rate in a quarter of a century. Households are increasing their borrowing to finance the desired level of current consumption. It may be, however, that borrowing cannot be maintained as interest rates rise further to deal with a worsening inflation problem. 10

Source: adapted from the *Daily Telegraph*, 30 June 2007

Extract F: Does the savings ratio matter to the UK economy?

The issue of household savings has perhaps not always been given the importance it deserves when discussing influences on an economy's macroeconomic performance. First and foremost, it is more likely that economists will discuss factors such as the role of government in inducing growth through, for example, promotion of enterprise and innovation, or the rate of growth of aggregate demand (AD), or the rate of growth of labour productivity.	1 5
However, the potential significance of household savings for UK macroeconomic performance needs to be recognised. Saving by households does, to some extent, provide the funds which financial institutions, such as banks, lend to businesses to finance investment, a prime mover in economic growth. Decisions to save from a given income will also help determine household consumption, a major component of AD. In turn, changes in household consumption may have consequences for the rate of inflation, jobs and the balance of payments on current account.	10

Source: news reports, 2008

Question 27

- 27 (a) Define the term 'savings' (**Extract E**, line 5). *(5 marks)*
- (b) Using **Extract D**, identify **two** main features of the UK household savings ratio for the period 2004 to 2007. *(8 marks)*
- (c) **Extract E** (lines 1-2) states that 'the rate at which households are saving has plunged to the lowest level in almost half a century'.
- Explain **two** determinants of saving by households. *(12 marks)*
- (d) **Extract F** (lines 7-8) argues that 'the potential significance of household savings for UK macroeconomic performance needs to be recognised'.
- Using the data and your economic knowledge, evaluate the significance of household savings for UK macroeconomic performance. *(25 marks)*

END OF QUESTIONS

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