



General Certificate of Education
Advanced Subsidiary Examination
June 2011

Economics

ECON2

Unit 2 The National Economy

Friday 27 May 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

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.
- 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**.

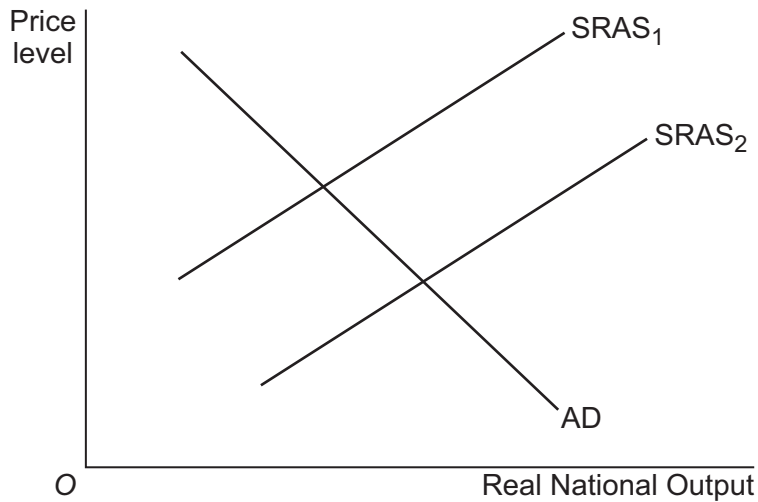
For each question there are four alternative responses, **A**, **B**, **C** and **D**. When you have selected the response which you think is the best answer to a question, mark this response on your objective test answer sheet. If you wish to change your answer to a question, follow the instructions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

- 1 Which one of the following would be classified as fiscal policy? A UK government decision to
 - A increase the budget deficit
 - B decrease the exchange rate against the euro
 - C reduce the growth of the money supply
 - D raise interest rates

- 2 All other things being equal, a substantial cut in the rate of income tax in the short run is most likely to reduce
 - A inflation.
 - B unemployment.
 - C spending on imports.
 - D the government budget deficit.

- 3 According to the UK government's definition, the economy is said to be in recession when
 - A employment in manufacturing declines.
 - B the balance of payments on current account moves into deficit.
 - C economic growth falls below the underlying trend rate.
 - D real national output falls for two successive quarters or more.

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



The shift of the short-run aggregate supply curve from SRAS₁ to SRAS₂ can be explained by a fall in

- A the price level.
 - B the world price of oil.
 - C the trend rate of growth.
 - D productivity.
- 5 In an economy with a positive output gap
- A there is spare capacity.
 - B actual output is less than potential output.
 - C there is cyclical unemployment.
 - D demand-pull inflationary pressures exist.
- 6 According to the accelerator theory, investment is most likely to increase when
- A the level of national income is high.
 - B the rate of growth of national income is increasing.
 - C interest rates are falling.
 - D there is spare capacity in the economy.

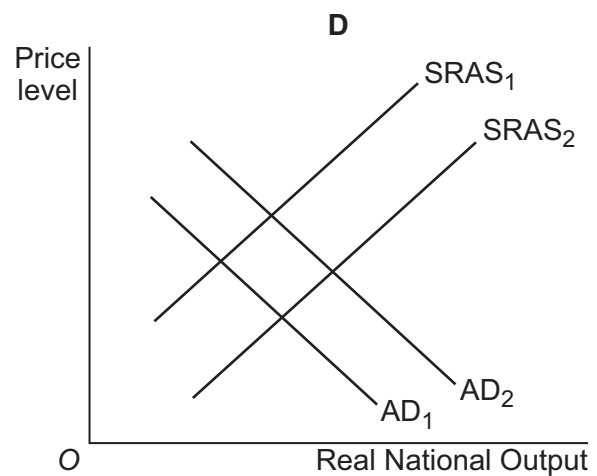
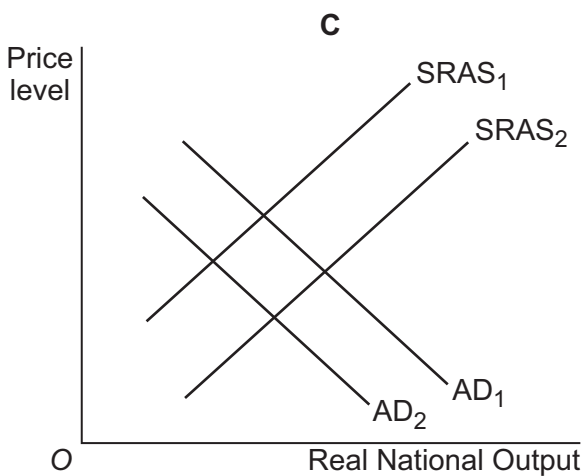
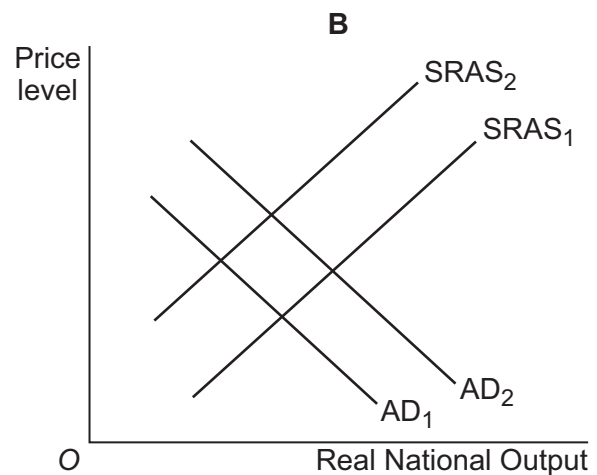
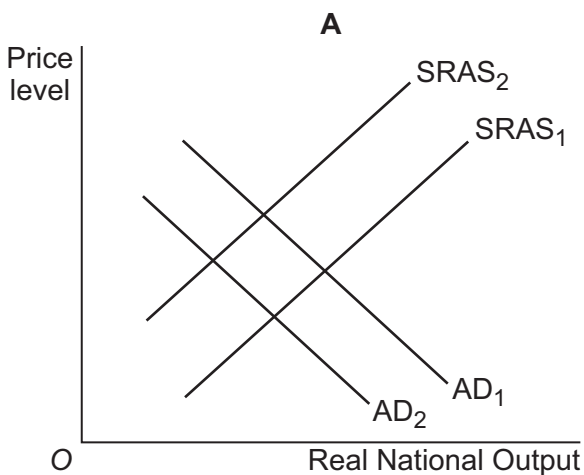
Turn over ►

- 7 Which one of the following is most likely to be an example of a supply-side improvement in the economy?

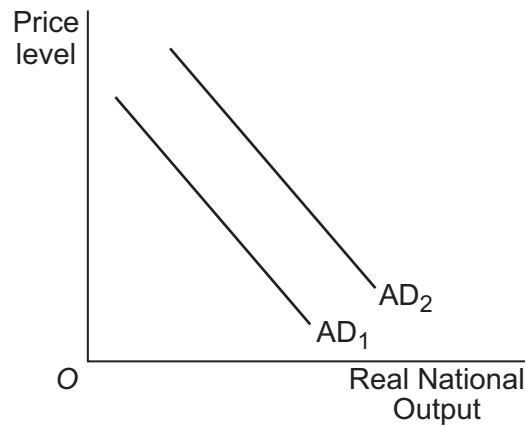
An increase in

- A** business innovation
B consumer expenditure
C exports
D factor immobility
- 8 A country imports many of its raw materials and exports a large proportion of its finished goods. The diagrams below show the initial aggregate demand (AD_1) and short-run aggregate supply ($SRAS_1$) curves together with possible shifts of these curves.

All other things being equal, which diagram, **A**, **B**, **C** or **D**, best illustrates the likely impact of a rise in the country's exchange rate?



- 9 The diagram below shows a shift of the aggregate demand (AD) curve for an economy.



Which one of the following combinations, **A**, **B**, **C** or **D**, would be most likely to cause the shift from AD_1 to AD_2 ?

	Household savings	Business investment
A	Rise	Rises
B	Rise	Falls
C	Fall	Falls
D	Fall	Rises

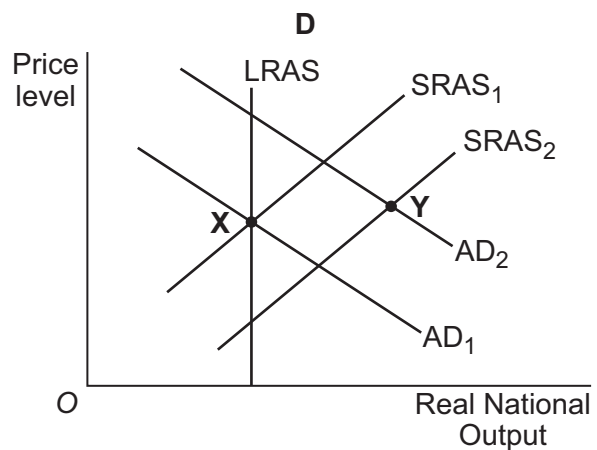
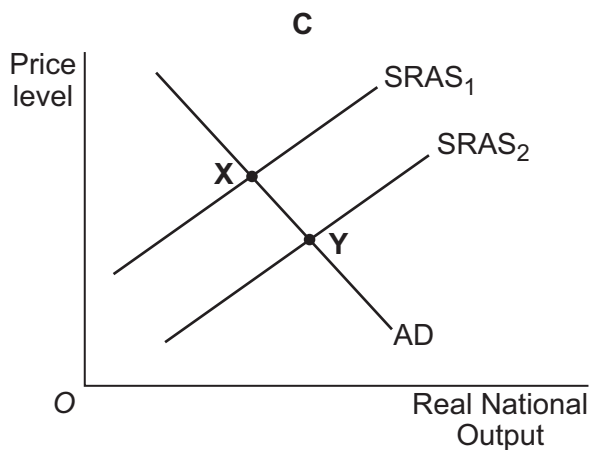
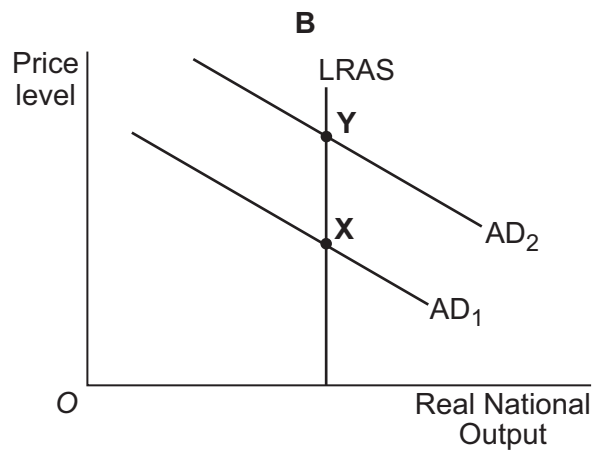
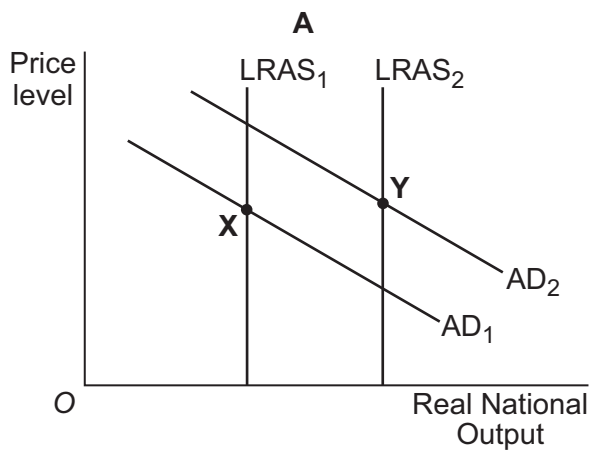
- 10 All other things being equal, a fall in the exchange rate will stimulate aggregate demand through a fall in the
- A foreign currency price of exports.
 - B rate of inflation.
 - C domestic price of imports.
 - D current account surplus.
- 11 Which one of the following statements about the UK financial system is true?
- A The Bank of England implements fiscal policy.
 - B Banks lend money to people most in need.
 - C Banks provide a link between the supply of savings and the demand for investment funds.
 - D The Bank of England sets the inflation target that the banking system has to meet.

Turn over ►

- 12 All other things being equal, which one of the following situations is most likely to lead to a deterioration in the UK's balance of payments on current account?

A fall in

- A UK inflation relative to the rest of the world
 B UK labour productivity relative to the rest of the world
 C the exchange rate of the pound
 D incomes in the UK
- 13 The effects on the economy of increased investment expenditure by firms are illustrated by a movement from X to Y. Which one of the following diagrams, A, B, C or D, best illustrates this movement?



- 14 Which one of the following statements relating to the use of fiscal policy is correct?
- A Fiscal policy involves the use of the money supply and interest rates to achieve economic objectives.
 - B Expansionary fiscal policy is the only method of reducing a positive output gap.
 - C Fiscal policy can be used to influence both the total output in the economy and the distribution of output between particular industries.
 - D An increase in the budget deficit is likely to reduce aggregate demand.
- 15 An economy had nominal GDP growth of 8% last year, inflation of 5.5% and population growth of 2.5%. The approximate percentage change in real GDP per capita was
- A -2.5
 - B 0
 - C +2.5
 - D +5.0
- 16 Since the 1970s, many of the UK's primary and secondary sector firms have closed or shrunk in size. The real value of manufacturing output today is little different from forty years ago. The result has been enormous job losses in these sectors. Some regions badly affected by closures still have above national average unemployment rates despite large injections of taxpayers' money. In contrast, the service sector has seen very fast growth over this period.
- Which one of the following can be inferred from the data? Over the past 40 years,
- A the pattern of economic activity in the UK has changed.
 - B the level of unemployment has increased.
 - C the government has used monetary policy to reduce employment.
 - D growth of the manufacturing sector was above that of the whole economy.
- 17 Which one of the following will be most effective in reducing inflation in the short run when the economy is operating at full employment?
- A Reducing imports
 - B Increasing savings
 - C Increasing investment
 - D Reducing taxes on income

- 18 The table below contains data on the components of aggregate demand in an economy in 2009.

	Components of aggregate demand, 2009	
	£bn at 2005 prices	% change on 2008
Household consumption	524.0	4.0
Government consumption	146.0	3.4
Gross fixed investment	153.0	5.2
Exports of goods and services	248.0	2.6
Imports of goods and services	285.0	7.1

Which one of the following is supported by the data?

- A Gross fixed investment was the greatest component of aggregate demand in 2009.
- B The increase in the value of the components of aggregate demand between 2008 and 2009 was solely due to inflation.
- C The economy had a balance of payments surplus on current account in 2009.
- D Household consumption amounted to approximately two-thirds of aggregate demand in 2009.
- 19 The table below contains selected indicators for an economy experiencing inflation.

	2000	2005	2010
Taxation (% of GDP)	35.25	36.50	37.75
Public spending (% of GDP)	41.25	39.50	39.00
Real GDP (2000 = 100)	100.00	130.00	150.00

The information above shows that between 2000 and 2010 there was

- A a fall in public sector spending in £ millions.
- B a rise in total tax revenue.
- C a 150 per cent increase in real GDP.
- D a rise in public sector borrowing.

- 20** The type of unemployment caused by insufficient aggregate demand is
- A** frictional.
 - B** cyclical.
 - C** seasonal.
 - D** structural.
- 21** All other things being equal, which one of the following is the most likely effect on the UK economy of a change in the exchange rate from \$1 = 60p to \$1 = 80p?
- A** A fall in aggregate demand and a rise in inflationary pressure
 - B** A rise in aggregate demand and a fall in inflationary pressure
 - C** A rise in aggregate demand and a rise in inflationary pressure
 - D** A fall in aggregate demand and a fall in inflationary pressure
- 22** Which one of the following is a monetary policy measure that may be used to reduce inflation?
- A** An increase in the budget deficit
 - B** An increase in the budget surplus
 - C** An appreciation of the exchange rate
 - D** A depreciation of the exchange rate
- 23** An economy has introduced a series of successful supply-side policies. All other things being equal, which combination of macroeconomic indicators, **A**, **B**, **C** or **D**, is the most likely outcome?

	Employment	Inflation	Deficit on the current account
A	Increasing	Decreasing	Decreasing
B	Decreasing	Increasing	Increasing
C	Increasing	Increasing	Decreasing
D	Decreasing	Decreasing	Increasing

Turn over ►

- 24** The consequence of increasing the interest rate when the exchange rate is rising is likely to be an increase in
- A** aggregate demand.
 - B** aggregate supply.
 - C** the current account surplus.
 - D** the level of unemployment.
- 25** Which one of the following statements concerning UK investment is correct?
- A** Increased investment leads to a reduction in saving.
 - B** Investment is the largest component of aggregate demand.
 - C** Investment is a withdrawal from the circular flow of income.
 - D** Investment can increase the capital stock of the economy.

**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

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

UK TRADE IN GOODS AND SERVICES

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

Extract A: Value of UK trade in goods and services (£ billion, quarterly)

	Exports	Imports	Balance
2008 Q1	101.3	112.6	-11.3
Q2	107.2	117.3	-10.1
Q3	107.9	118.8	-10.9
Q4	105.6	111.5	-5.9
2009 Q1	97.8	105.6	-7.8
Q2	93.9	102.3	-8.4
Q3	95.1	103.2	-8.1
Q4	100.1	109.6	-9.5

Source: Office for National Statistics, *Statistical Bulletin*, 9 February 2010

Extract B: Will the UK's share of world exports increase in 2010?

The global recession was accompanied by a decline in world trade in goods and services. However, the growth in world exports appears to have increased again in the third quarter of 2009 but remains well below the pre-crisis peak.	1
Weaker demand worldwide reduces the demand for UK exports but this is likely to be offset, to some extent, by the fall in the value of the pound that began in the middle of 2007. Since that time, UK export prices have fallen by around 10% compared to the price of exports from other major economies. This should help to increase the UK's share of world exports which has been declining for many years.	5
According to the CBI (Confederation of British Industry), optimism about the prospects for the export of UK manufactured goods rose to its highest level since 1995. However, price is not the only determinant of the demand for UK exports; amongst other things, it will also depend on the extent of the recovery in the world economy and the ability of UK companies to compete with overseas producers in terms of the latest technology.	10

Source: news reports, January 2010

Extract C: A growth in exports is required to rebalance the UK economy

In the years before the recession, the growth in household consumption helped to fuel an upsurge in spending on imports which increased the deficit on the current account of the balance of payments.	1
Because of the recession, the government increased its spending and allowed the budget deficit to grow significantly to boost aggregate demand. It is inevitable that, as the UK economy recovers from recession, the government will cut its spending and raise taxes to try to reduce the budget deficit to a manageable level. However, a sustained improvement in the UK economy requires not only that there is an uninterrupted increase in aggregate demand but also that spending switches away from household consumption and government spending towards exports.	5 10
Rising exports and lower spending on imports should have a multiplier effect. This will contribute to the increase in aggregate demand that is needed to reduce unemployment and to absorb the high degree of spare capacity that currently exists. However, the fall in the value of the pound and the resumption in the growth of the economy may be accompanied by an unwelcome increase in inflation.	15

Source: news reports, January 2010

- 0 1** Define the term 'aggregate demand' (**Extract C**, line 5). (5 marks)
- 0 2** Using **Extract A**, identify **two** significant features of the changes in the value of UK trade in goods and services over the period shown. (8 marks)
- 0 3** **Extract B** (lines 9–10) states that 'optimism about the prospects for the export of UK manufactured goods rose to its highest level since 1995'.
Explain **two** factors that might lead to an increase in the demand for UK exports. (12 marks)
- 0 4** **Extract C** (lines 8–10) states that a 'sustained improvement in the UK economy requires . . . that spending switches away from household consumption and government spending towards exports'.
Using the data and your economic knowledge, assess the importance of an increase in exports for achieving an improvement in 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

INFLATION

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

Extract D: UK Consumer Prices Index (CPI) and Retail Prices Index (RPI), annual % change (quarterly)

	CPI	RPI
2008 Q1	2.4%	4.0%
Q2	3.4%	4.4%
Q3	4.8%	5.0%
Q4	3.9%	2.7%
2009 Q1	3.0%	-0.1%
Q2	2.1%	-1.3%
Q3	1.5%	-1.4%
Q4	2.1%	0.6%

Source: *www.statistics.gov.uk*, accessed on 3 March 2010

Extract E: Prospects for inflation

The Bank of England expects that inflation in the UK is likely to rise sharply in the next few months and it will probably exceed the Government's target of 2%, as measured by the Consumer Prices Index. This temporary rise is likely to result from the increase in the rate of Value Added Tax (VAT), back to 17.5%, and the rise in the price of petrol compared to a year ago.

1

5

The average price of imports has risen by around 15% in the past 18 months and this puts upward pressure on business costs. Companies may temporarily absorb some of this increase by accepting lower profits but are eventually likely to increase prices to restore their profitability. Alternatively, they might try to counteract the increase in import prices by reducing the real wages of their employees or through measures to increase labour productivity.

10

In the medium term, the Bank of England expects inflation to return to target as aggregate demand is expected to remain below the economy's full capacity level of output.

Source: news reports, January 2010

Extract F: Supply-side improvements are the key to a sustained recovery

The key to a sustained recovery in the UK economy is a combination of low interest rates, tight control over public spending and supply-side policies to improve the competitiveness of the economy. Supply-side policies will help to stimulate growth and this growth will help to generate the tax revenues needed to reduce the budget deficit.	1
If successful, supply-side policies will make the UK more competitive and stimulate aggregate demand by boosting exports and by encouraging UK residents to buy home-produced goods rather than imports. Supply-side policies will also contribute to lower inflation by increasing productivity and the productive capacity of the economy. Such policies have an essential role to play in enabling the Bank of England to control inflation without compromising the recovery of the economy.	5 10

Source: news reports, January 2010

- 0 5** Define the term 'supply-side policies' (**Extract F**, line 2). *(5 marks)*
- 0 6** Using **Extract D**, identify **two** significant points of comparison between the CPI and RPI measures of inflation over the period shown. *(8 marks)*
- 0 7** **Extract E** (line 6) states that the 'average price of imports has risen by around 15% in the past 18 months'.
- Using an AD/AS diagram to help you, explain the effect that a rise in the price of imports is likely to have on the rate of inflation in the UK. *(12 marks)*
- 0 8** **Extract F** (lines 7–8) states: 'Supply-side policies will also contribute to lower inflation'.
- Using the data and your economic knowledge, evaluate the importance of supply-side policies in helping to control inflation in the UK. *(25 marks)*

END OF QUESTIONS

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