GCE
AS and A Level

Economics

AS exams 2009 onwards
A2 exams 2010 onwards

Unit 2:
Specimen question paper

Version 1.1

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General Certificate of Education
Specimen Paper for examinations in 2009 onwards
Advanced Subsidiary Examination

ECONOMICS **ECON2**
Unit 2 The National Economy

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.
- For each question in **Section A** there are four alternative responses. 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.

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 marks.
- 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, to organise information clearly and to 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.

Each question is followed by four responses, **A, B, C** and **D**.
For each question select the best response and mark its letter on the objective test answer sheet provided.

1 A recession is said to occur in the UK economy when

A the current account of the balance of payments is in deficit for more than two years.

B real national output falls for two successive quarters.

C nominal national income falls but real national income continues to grow.

D the growth of output of manufacturing industries slows down.

2 If an economy's output gap moves from being negative to positive, the economy is likely to experience

A deflationary pressure.

B rising unemployment.

C excess aggregate supply.

D inflationary pressure.

3 A government's spending review forecast a budget deficit in 2008/2009 compared to a budget balance in 2005/2006. Which one of the following would bring about this change?

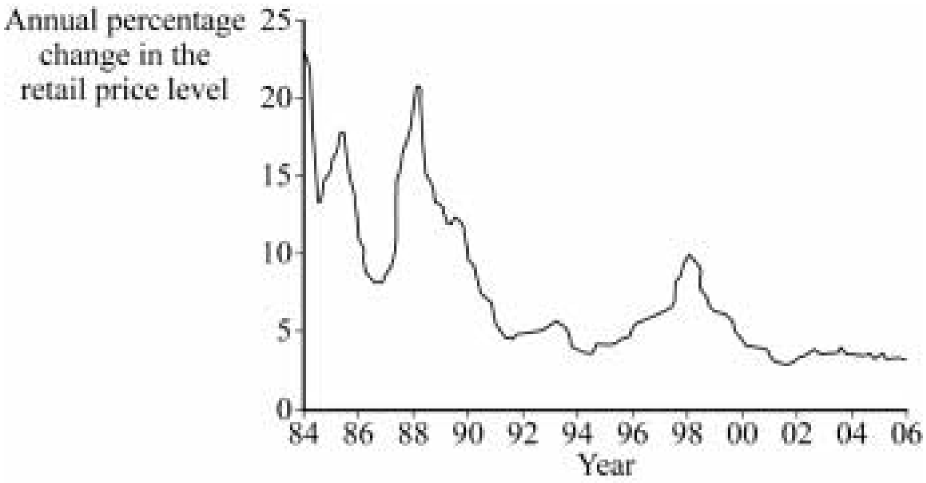
A A decrease in public spending and an increase in tax revenue

B A decrease in public spending and no change in tax revenue

C An increase in public spending and a decrease in tax revenue

D No change in public spending and an increase in tax revenue

4 The graph below shows the annual percentage change in the average level of retail prices in an economy between 1984 and 2006.



From the graph above it may be concluded that

A average prices fell in some years and rose in others.

B prices were at their highest level in 1984.

C prices remained constant from 2002 onwards.

D the price level increased at different rates in different years.

5 Which one of the following is most likely to increase the level of consumption in the UK economy?

A A rise in house prices

B A rise in interest rates

C A rise in taxes on expenditure

D A rise in taxes on income

6 Other things remaining constant, which one of the following would cause aggregate demand to increase? An increase in

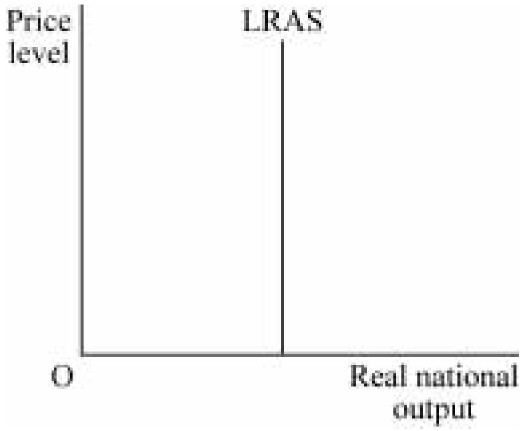
A taxation on income

B interest rates

C savings

D government expenditure

7 The diagram below shows a long run aggregate supply curve (LRAS) for an economy.



The LRAS curve shows the economy's

A equilibrium price level.

B potential output.

C level of inflation.

D actual economic growth.

8 All other things being equal, an increase in the productivity of labour in an economy will lead to

A an increase in the price level.

B a rightward shift of the aggregate supply curve.

C an increase in the rate of growth of the labour force.

D a decline in the level of aggregate demand.

9 The accelerator relationship explains how

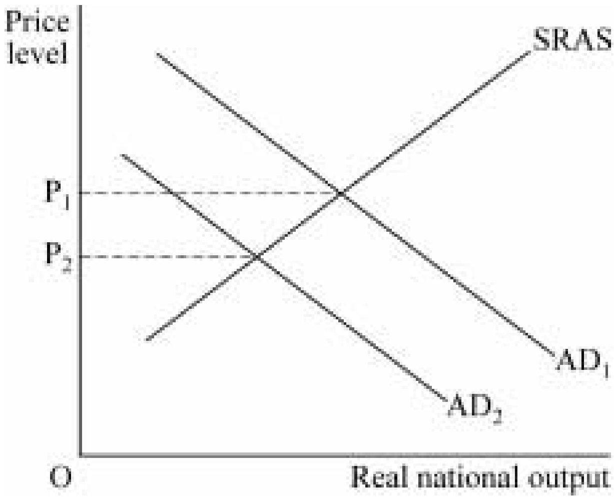
A an increase in aggregate investment expenditure leads to an increase in national income.

B a decrease in the rate of interest leads to an increase in the level of investment expenditure.

C an increase in company profits leads to an increase in the level of investment expenditure.

D an increase in the level of national income leads to an increase in the level of aggregate investment expenditure.

10 The diagram below shows two aggregate demand curves and the short run aggregate supply curve for an economy.



The fall in the price level from OP_1 to OP_2 could be explained by an increase in

A real incomes.

B interest rates.

C labour productivity.

D investment.

11 Which one of the following is most likely to be a reason for the Bank of England to reduce its interest rate by 0.25 per cent?

A Unemployment is falling and the economy is in boom.

B Inflation is constant and the current account balance on the balance of payments is improving.

C Growth in GDP is below its trend rate and High-Street sales have stagnated.

D There is strong growth in GDP and exports are booming.

12 Economic growth occurs when there is an increase in

A aggregate demand.

B the inflation rate.

C wage rates.

D productive capacity.

13 Supply-side policies are most likely to be concerned with influencing

A the long run trend rate of economic growth.

B the long run trend in the exchange rate of the currency.

C short run fluctuations in the general price level.

D short run fluctuations in the flow of exports.

14 All other things being equal, in a country with full employment, which one of the following is most likely to lead to an increase in inflationary pressure? An increase in

A savings

B imports

C exports

D the exchange rate

15 A fall in the exchange rate is most likely to lead to

A a rise in the price of exports.

B a fall in the price of imports.

C higher demand for exports.

D higher demand for imports.

16 The government is concerned that, without any change to its current economic policy, the rate of growth of the economy will fall below its trend rate. Which one of the following policy changes is most likely to prevent this from happening?

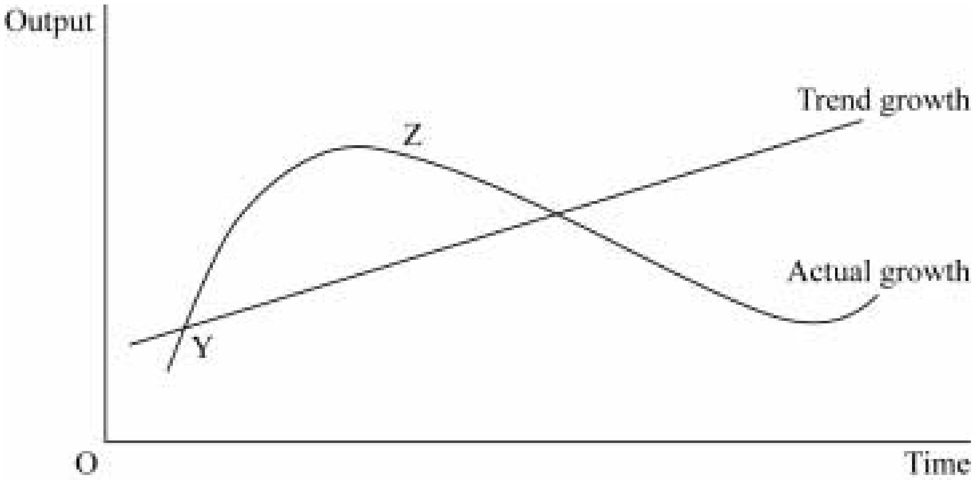
A An increase in government expenditure

B An increase in interest rates

C A reduction in the level of the state old-age pension

D A reduction in the target for the rate of inflation

17 The diagram below shows the trend and actual growth paths for an economy.



Which one of the following combinations, **A**, **B**, **C** or **D**, describes the state of the economy when it moves from point Y to point Z on its growth path?

	Stage of the Business Cycle	Output Gap
A	Boom	Negative
B	Recession	Positive
C	Boom	Positive
D	Recession	Negative

18 Which one of the following statements accurately defines monetary policy? It is a policy concerned with

A the direct control of prices and incomes.

B the control of taxation and government spending.

C the control of interest rates or money supply.

D managing the government's budget.

19 The major objective of the monetary policy currently being pursued by the Bank of England is to achieve

A a target rate of inflation.

B a higher rate of economic growth.

C full employment.

D equilibrium on the current account of the balance of payments.

20 Which one of the following is a supply-side policy aimed at reducing unemployment?

A A cut in interest rates

B An increase in the money supply

C An increase in unemployment benefits

D A cut in the rate of income tax

21 A government can use fiscal policy to decrease aggregate demand by

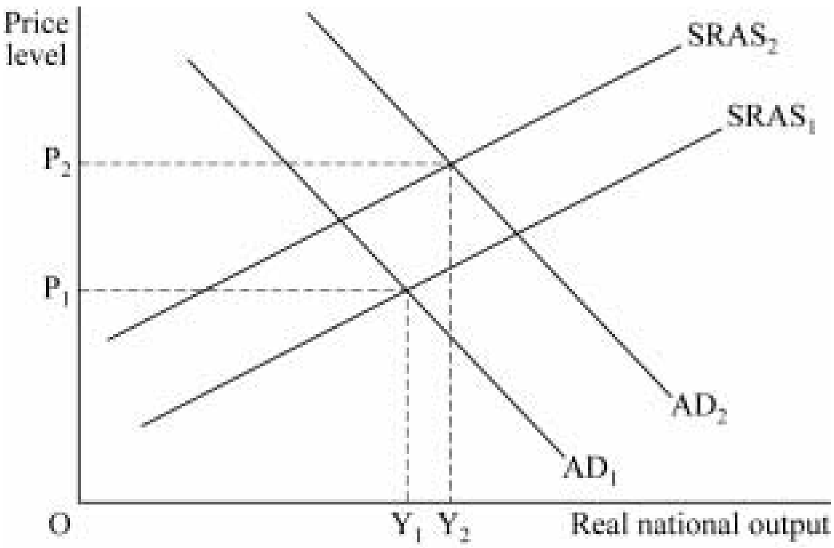
A increasing taxes.

B allowing the exchange rate to rise.

C increasing government expenditure.

D increasing interest rates.

22 The diagram below shows an economy initially in equilibrium producing an output of Y_1 at a price level of P_1.



Which one of the following is most likely to have increased the equilibrium level of output to Y_2 and the price level to P_2?

A An increase in interest rates and a rise in money wages

B A fall in interest rates and a rise in money wages

C An increase in interest rates and a fall in money wages

D A fall in interest rates and a fall in money wages

23 All other things being equal, which one of the following would indicate that a contractionary fiscal policy is being implemented?

A Lower taxes

B Reduced use of supply-side policies

C Higher interest rates

D Cuts in public spending

24 Which one of the following might help to explain the slow growth in export volumes following an appreciation in the sterling exchange rate? The rise in the exchange rate increases

A the average costs of domestic manufacturing companies.

B the average foreign currency price of UK exports.

C the demand for UK products in the home market, and so fewer goods are exported.

D inflation and makes UK products less competitive.

25 An economy has been growing at its underlying trend rate of growth of 3% for several years. The Central Bank forecasts that the rate of growth of aggregate demand in the economy will increase from 3% to 5% over the next twelve months. If the Central Bank takes no action to prevent the rise in the rate of growth of aggregate demand, the economy is most likely to experience an increase in

A its underlying trend rate of growth.

B the government's target for the rate of inflation.

C its rate of inflation.

D the government's budget deficit.

QUESTION 25 IS THE LAST QUESTION IN SECTION A

On your answer sheet ignore rows 26 to 50

Turn over for Section B

SECTION B: DATA RESPONSE

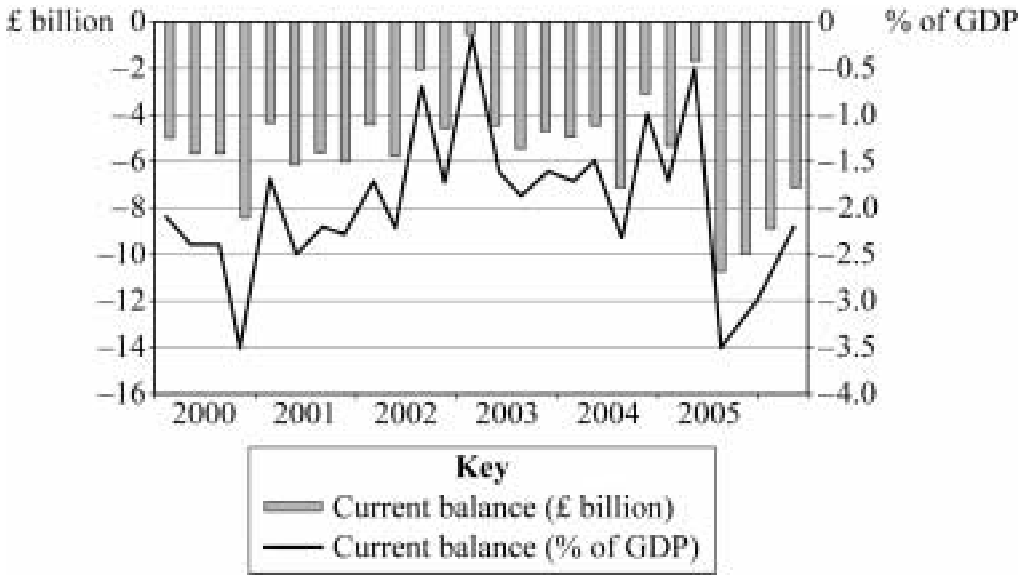
Answer **EITHER** Question 26 **OR** Question 27.
You are advised to spend at least 50 minutes on Section B.

Total for this question: 50 marks

26 UK EXTERNAL PERFORMANCE

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

Extract A: The UK balance of payments on current account, 2000 to 2006, quarterly, £ billion and as a % of GDP



Source: *www.statistics.gov.uk*, accessed on 3 November 2006

Extract B: Can we live with a $2 pound?

In October 2006, the exchange rate of the pound continued to give cause for concern. The prospect of a $2 pound for the first time since 1992 was good news for UK consumers planning mini-breaks in New York, but bad news for UK exporters already struggling in world markets.

Another rise in UK interest rates could bring further upward pressure on the pound, especially if, as expected, US rates are cut. The UK manufacturing sector will, once again, be complaining, as it continues to struggle in world markets. Five years ago, Americans needed just $1.40 to buy £1. UK goods and services could soon be around 50% more expensive in the US market.

The view of some economists, however, is that greater pain was suffered in the late 1990s with a sharp appreciation against the euro coupled with more competition from newly-developing countries. UK businesses have since given far greater attention to productivity at a time of very strong growth in world markets which exporters will hope to exploit. The consequent multiplier effect could give a boost to GDP, employment and inflation. Better export performance could bring a much-needed improvement to the balance of payments performance on current account.

The UK must face up to the fact that its share of global GDP has fallen steadily since the late 1980s but nothing like as fast as its share of world export markets. Many economists agree that not all the blame can be put on a strong pound. Some point to rising raw material prices and to the failure to control labour costs, both potentially inflationary. The business world cannot expect any relief as far as the pound is concerned, partly because sterling is still seen as a safe haven for international funds.

It is not all bad news, however. The Bank of England has pointed to successes in three key industries: pharmaceuticals, computers and communications equipment. Their growth in sales outpaces the growth in world markets generally and these industries have experienced rising market shares.

For further export successes, supply-side reforms, such as technological innovation and productivity, need to go further in other sectors of the economy. Such reforms will help to control some of the costs which have magnified the effects of a strong pound and also have the potential to improve employment, economic growth and the balance of payments on current account.

Question 26

26 (a) Using **Extract A,** identify **three** features in the UK balance of payments on current account over the period shown. *(5 marks)*

26 (b) **Extract B** (lines 2-3) states that a \$2 pound can be 'good news for UK consumers….but bad news for UK exporters'. Explain why this might be the case. *(8 marks)*

26 (c) **Extract B** (lines 11-12) suggests that, if UK exporters successfully exploit the growth in world markets, the 'consequent multiplier effect could give a boost to GDP, employment and inflation'.

Analyse the possible effects of the multiplier process on GDP, employment **and** inflation. *(12 marks)*

26 (d) **Extract B** (line 16) states that, in assessing the reasons for the UK's external weakness, 'not all the blame can be put on a strong pound'.

Using the data and your economic knowledge, evaluate the significance of a strong pound in explaining deficits in the UK balance of payments on current account. *(25 marks)*

Turn over for the next question

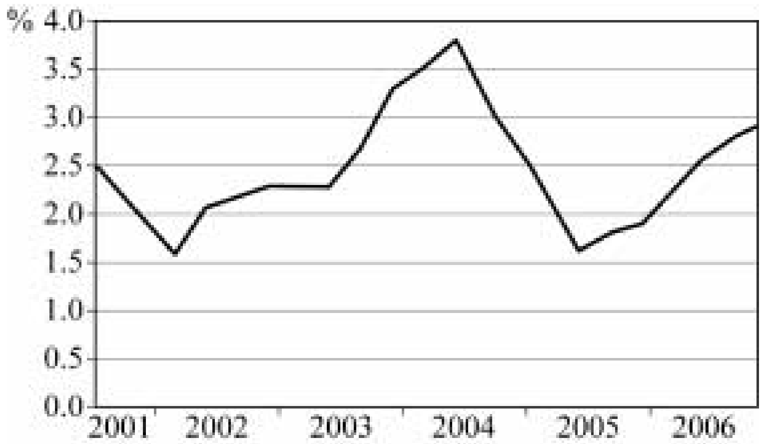
Do **not** answer Question 27 if you have answered Question 26.

Total for this question: 50 marks

27 UK GROWTH, EMPLOYMENT AND PRICE STABILITY

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

Extract C: UK GDP growth (%), 2001 to 2006



Source: *www.statistics.gov.uk*, accessed on 3 November 2006

Extract D: The search for more growth and jobs without inflation

Economic growth in 2005 was around 2%. The 0.7% rise in GDP in the third quarter of 2006 maintained the rate of growth of the previous 9 months. The main contribution to this growth came from services such as transport and finance.

It is important to draw a distinction between short-run and long-run growth, however. An economy's long run trend rate of economic growth relies largely on the supply side of the economy. Short-run growth will fluctuate around trend growth, creating output gaps which may destabilise an economy and perhaps be associated with significant inflation or deflation, booms or recessions.

In recent months, inflation data have given mixed messages. While the UK Consumer Price Index (CPI) was 2.4% in September 2006, when the EU average was 2.3%, the Retail Price Index (RPI), which included housing costs, showed an inflation rate of 3.2%. Higher interest rates have been necessary and may increase further, putting a squeeze on consumer spending.

However, at the moment, it is likely that there are both demand-pull and cost-push pressures at work in the economy. A recent Bank of England *Inflation Report* points to a revival in business investment and household spending.

On the cost side, oil prices rose once again in the summer of 2006 although pay growth was steady. The Bank also pointed out however, that spare capacity in the economy is limited. Problems may therefore arise if aggregate demand (AD) does rise further. Additional investment spending may help overcome the problem by creating more productive capacity, potentially benefiting both the output and sales of the business sector.

Certainly, the unemployment data suggest that the labour market could benefit from a rise in AD. The Labour Force Survey measure of unemployment puts the UK unemployment rate at 5.5%, with unemployment having increased by about a quarter of a million in the year to August 2006.

However, it is improvements to the supply side of the economy which are more likely to achieve the objectives of low unemployment in the long term and non-inflationary economic growth. We need only consider such issues as the level of welfare benefits, the potential incentive-creating reforms to the tax system, education and training, and measures to close the UK productivity gap with our major trading partners, to accept that the argument is an important one.

Nevertheless, neither the importance of the growth of AD nor effective demand-management policies should be totally discounted when considering what is likely to be the best approach to the achievement of a sound macroeconomic performance for the UK economy.

Question 27

27 (a) Define economic growth **and**, using **Extract C**, identify **two** features of the rate of growth of UK GDP over the period shown. *(5 marks)*

27 (b) **Extract D** (line 16) refers to a revival in business investment in the economy in 2006. Explain **two** determinants of investment in an economy. *(8 marks)*

27 (c) **Extract D** (lines 14-15) refers to inflationary ‘demand-pull and cost-push pressures at work in the economy’.

Define the terms ‘demand-pull’ and ‘cost-push’ **and** analyse the causes of these types of inflation. *(12 marks)*

27 (d) **Extract D** (lines 27-29) states that ‘it is improvements to the supply side of the economy which are more likely to achieve the objectives of low unemployment in the long term and non-inflationary economic growth’.

Evaluate the importance of the supply side of the UK economy in achieving these objectives. *(25 marks)*

END OF QUESTIONS

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