

ECONOMICS

6841

Thursday 30 June 2005 Morning Session

In addition to this paper you will require:
a 16-page answer book.
You may use a calculator.

Time allowed: 3 hours

Instructions

- Use blue or black ink or 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 6841.
- Answer **all** parts of Question 1 from Section A, **one** question from Section B and **one** question from Section C.
- **At the very start of the examination**, detach page 5 by tearing along the perforations.

Information

- The maximum mark for this paper is 160.
- Mark allocations are shown in brackets.
- Section A carries 50% of the total marks for the paper. Sections B and C each carry 25% of the total marks for the paper.
- You will be assessed on your ability to use an appropriate form and style of writing, to organise relevant information clearly and coherently, and to use specialist vocabulary where appropriate. The degree of legibility of your handwriting and the level of accuracy of your spelling, punctuation and grammar will also be taken into account.

Advice

- You are advised to spend 90 minutes on Section A, 45 minutes on Section B and 45 minutes on Section C.

SECTION A: Interpreting Economic Data

Study the data on pages 2–4 and then answer **all** parts of Question 1 which follows on page 5.

1 FISCAL POLICY IN THE UNITED KINGDOM

Total for this question: 80 marks

Extract A: Changes, actual and estimated, for the public sector net cash requirement (PSNCR) and public sector net debt in the UK, 2001–2009

	Per cent of GDP							
	Actual		Estimate	Projections				
	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09
Public sector net cash requirement*	0.3	2.1	3.6	2.6	2.3	2.2	1.8	1.6
Public sector net debt	30.2	30.9	32.8	33.8	34.6	35.1	35.4	35.5

*A positive (+) number for the public sector net cash requirement is a fiscal deficit.

Source: UK Government Pre-Budget Report, The Treasury, December 2003

Extract B: Public sector finances and the economic cycle

The economic cycle, with its associated changes in unemployment and GDP growth, has significant short term effects on public sector finances. This means it is important to distinguish between the effects on public sector finances resulting from the economic cycle and those resulting from underlying, ‘structural’ changes in the economy. UK experience suggests that serious mistakes in fiscal policy can occur if purely cyclical improvements are treated as if they were structural, or if a structural deterioration is interpreted as cyclical.

Source: adapted from UK Government Pre-Budget Report, The Treasury, December 2003

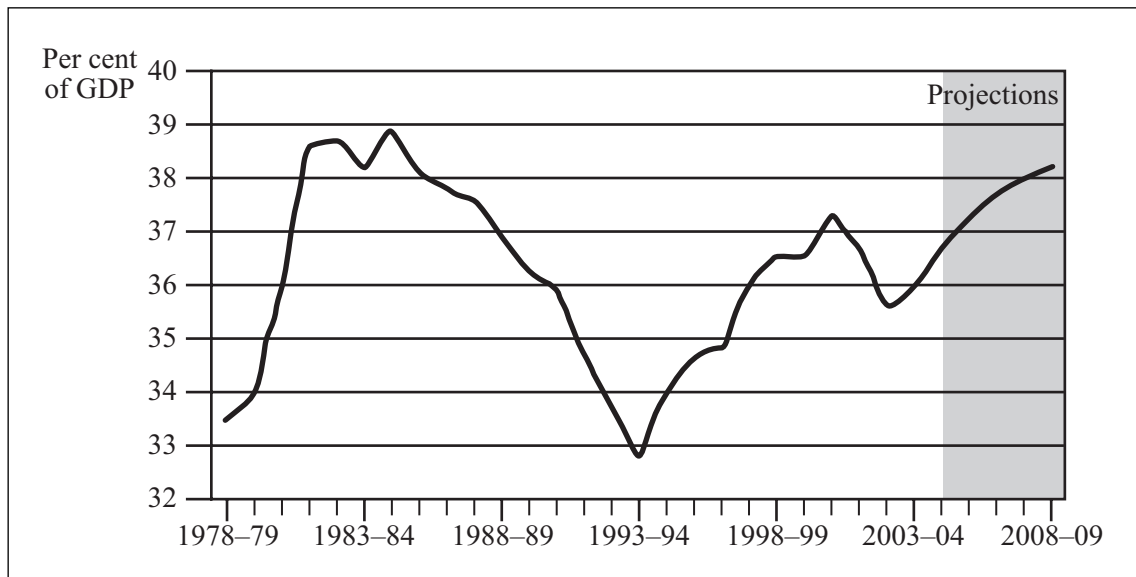
Extract C

This was an extract of text. It has not been reproduced here due to third-party copyright constraints.

Extract D:

This was an extract of text. It has not been reproduced here due to third-party copyright constraints.

Turn over ►

Extract E: UK tax revenue as a proportion of GDP, 1978–79 to 2008–09

Source: UK Government Pre-Budget Report, The Treasury, December 2003

Extract F: Take the politics out of fiscal policy

Around the world today, there is quiet satisfaction with the management of monetary policy but it is impossible to feel similarly comfortable about fiscal policy. Although recently Britain has seemed to manage its public finances well, politics, as in other countries, interferes with honest budgeting. There is a growing case for setting up a fiscal policy commission, similar to the Monetary Policy Committee at the Bank of England, to bring to fiscal policy the detachment that has worked so well for monetary policy. 1 5

Is this conceivable? The right to tax is the fundamental prerogative of democratic government. However, on more careful analysis, the idea is less radical than it seems. Britain has declared adherence to the golden rule of neutral fiscal policy over the whole economic cycle. And the purpose of the European Stability and Growth Pact is to rein in irresponsible financing by individual states. 10

The fiscal policy commission's job would be to assess the overall level of taxation needed to meet the government's declared goals: fiscal stability, cyclically adjusted budget balance, consistency with the policies and practice of a common currency zone. The assessment would probably best be expressed as a recommendation on the required standard rate of value added tax. 15

The creation of a fiscal policy commission is not a new idea: according to the Governor of the Bank of England, the aim is to make fiscal policy as boring as he hopes monetary policy will soon become. The fiscal policy commission should, in the first instance, be a purely advisory body. However, if it acquired expertise and reputation, as it should, it would become increasingly difficult for government to ignore it without political damage and adverse reaction from financial markets. 20

Source: adapted from JOHN KAY, *Financial Times*, 27 February 2003

You may detach this page by tearing along the perforations.

Question 1

- (a) Explain the relationship shown in **Extract A** between the UK's public sector net cash requirement (PSNCR) and public sector net debt. *(10 marks)*
- (b) Lines 5–6 of **Extract B** state that “serious mistakes in fiscal policy can occur if purely cyclical improvements are treated as if they were structural, or if a structural deterioration is interpreted as cyclical”.
- Explain this statement. *(10 marks)*
- (c) Assess the view that “macroeconomic equilibrium is best secured through free market forces operating in competitive markets, rather than through government policies to manage aggregate demand” (**Extract C**, lines 13–15). *(20 marks)*
- (d) Assess the view that taxes are too high in the United Kingdom and that the government should reduce taxation as a proportion of GDP. *(20 marks)*
- (e) Discuss the case **for** and **against** setting up a fiscal policy commission to assist in the implementation of fiscal policy in the UK. *(20 marks)*

SEE PAGE 7 FOR QUESTIONS 2–5

Turn over ►

THERE ARE NO QUESTIONS PRINTED ON THIS PAGE

SECTION B: Markets and Market Failure

Answer **EITHER** Question 2 **OR** Question 3 from this Section.

- 2 “Government subsidies granted to firms and consumers affect the demand for different goods and services, and generally increase economic welfare.”

Discuss the case **for** and **against** using subsidies to influence the pattern of demand for goods and services.
(40 marks)

- 3 Evaluate the view that a government’s competition policy should be based solely on making markets contestable.
(40 marks)
-

SECTION C: The National and International Economy

Answer **EITHER** Question 4 **OR** Question 5 from this Section.

- 4 In 2002, the UK government estimated that the economy’s trend rate of growth had increased from 2.25% a year to 2.75% a year.

Evaluate the **benefits** and **costs** that might occur if a higher trend rate of growth is maintained in future years.
(40 marks)

- 5 Between 1 January 2000 and 31 December 2001, the US dollar’s exchange rate rose in value against the euro by 14%. Between 1 January 2002 and 31 December 2003, the dollar’s exchange rate fell against the euro by 28%.

Discuss the possible **causes** and **effects** of a change in the dollar’s exchange rate against the euro.
(40 marks)

END OF QUESTIONS

THERE ARE NO QUESTIONS PRINTED ON THIS PAGE

ACKNOWLEDGEMENT OF COPYRIGHT-HOLDERS AND PUBLISHERS

Permission to reproduce all copyright material has been applied for. In some cases, efforts to contact copyright-holders have been unsuccessful and AQA will be happy to rectify any omissions of acknowledgements in future if notified.

Extracts A, B and E: Crown copyright material is reproduced with the permission of the Controller of HMSO and the Queen's Printer for Scotland.

Copyright © 2005 AQA and its licensors. All rights reserved.

G/M141548/S05/6841