

Version 1.1



General Certificate of Education
Advanced Subsidiary Examination
June 2009

Economics

ECON2

Unit 2 The National Economy

Specimen paper for examinations in June 2010 onwards

This question paper uses the new numbering system and new AQA answer book

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

- 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.
- For **Section A**, do all rough work in your answer book, **not** on your objective test answer sheet.

Section A (ECON2/1)

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

Section B (ECON2/2)

- 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** 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**.

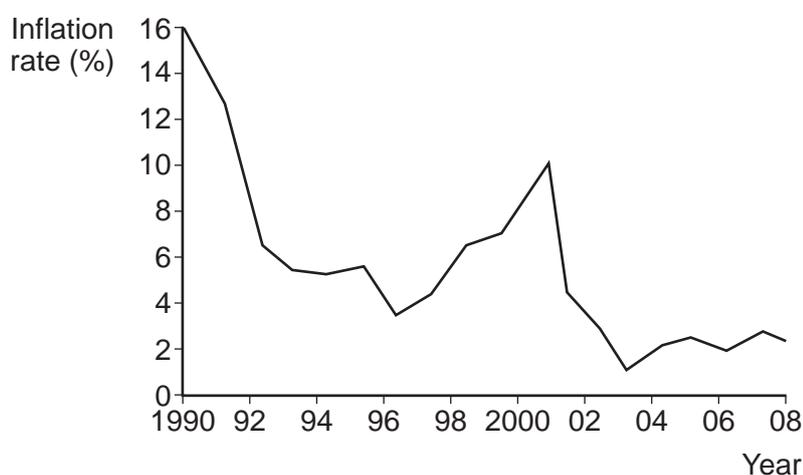
Each question carries 1 mark. No deductions will be made for wrong answers.

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 An increase in imports of consumer goods is most likely to be caused by a
- A rise in household saving.
 - B rise in household income.
 - C fall in the exchange rate.
 - D fall in employment.
- 2 Real incomes rise whenever
- A nominal incomes rise by more than the price level.
 - B the price level rises by more than nominal incomes.
 - C nominal incomes rise.
 - D the rate of inflation slows down.
- 3 A current account deficit on the UK's balance of payments means that generally
- A the total value of imports exceeds the total value of exports.
 - B government expenditure exceeds government revenue.
 - C the value of exports of services is less than the value of imports of services.
 - D the volume of imports of goods and services exceeds the volume of exports of goods and services.

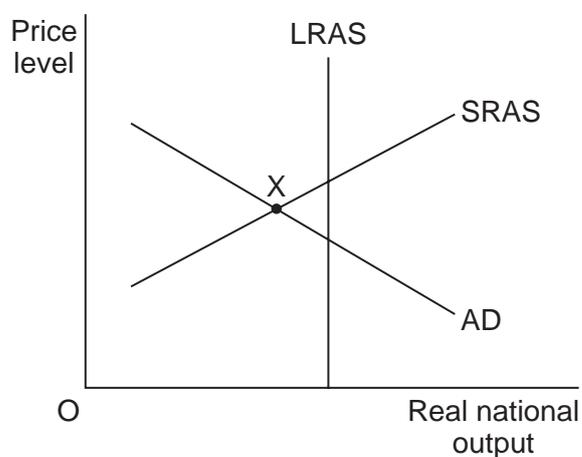
- 4 Which one of the following is an example of fiscal policy? A decision by the government to
- A decrease the exchange rate
 - B raise the minimum wage
 - C increase its budget surplus
 - D reduce the rate of interest
- 5 The economy is currently operating at its normal capacity level of output. It is estimated that the long-run trend rate of growth of the economy is around 2.5% per annum. In the coming year, it is expected that inflation will be 4% per annum and money national income will grow by 5%. Which one of the following is most likely?
- A Unemployment will fall and the economy will grow below its trend rate
 - B Employment will be stable and the economy will grow at its trend rate
 - C Employment will rise and the economy will grow above its trend rate
 - D Unemployment will increase and the growth of the economy will be below its trend rate
- 6 The graph below shows an economy's inflation rate from 1990 to 2008.



From the graph, it may be deduced that average prices

- A were lower in 2008 than in 1990.
- B fell sharply from 1990 to 1992.
- C increased each year from 1990 to 2008.
- D were lowest in 2003.

- 7 All other things being equal, when an increase in exports leads to a larger increase in national income, this illustrates
- A an improvement in the balance of payments.
 - B demand-pull inflation.
 - C an increase in long-run aggregate supply.
 - D the operation of the multiplier.
- 8 The diagram below shows the aggregate demand curve and the short-run and long-run aggregate supply curves of an economy.



The economy is currently operating at point X. At this point, the economy must be experiencing

- A inflation caused by excess demand.
 - B inflation caused by increasing costs.
 - C unemployment of labour.
 - D a low rate of economic growth.
- 9 In the short run, a decrease in aggregate demand is most likely to result in a reduction in
- A government spending on welfare benefits.
 - B the unemployment rate.
 - C the budget deficit.
 - D the balance of payments deficit on the current account.

- 10** An economy is operating at full employment. Which one of the following is most likely to lead to an increase in real national output without an increase in the rate of inflation in the short term?
- A** An increase in exports
- B** A reduction in interest rates
- C** An increase in manufacturing productivity
- D** An increase in government expenditure
- 11** Which one of the following is most likely to lead to a fall in aggregate investment?
- A** A reduction in the level of unemployment
- B** An increase in spare capacity in the economy
- C** A reduction in the average level of interest rates
- D** An increase in aggregate demand
- 12** Inflation in an economy is currently at 10%. Which of the following changes in monetary and fiscal policy, **A**, **B**, **C** or **D**, is most likely to bring down the rate of inflation in the economy?

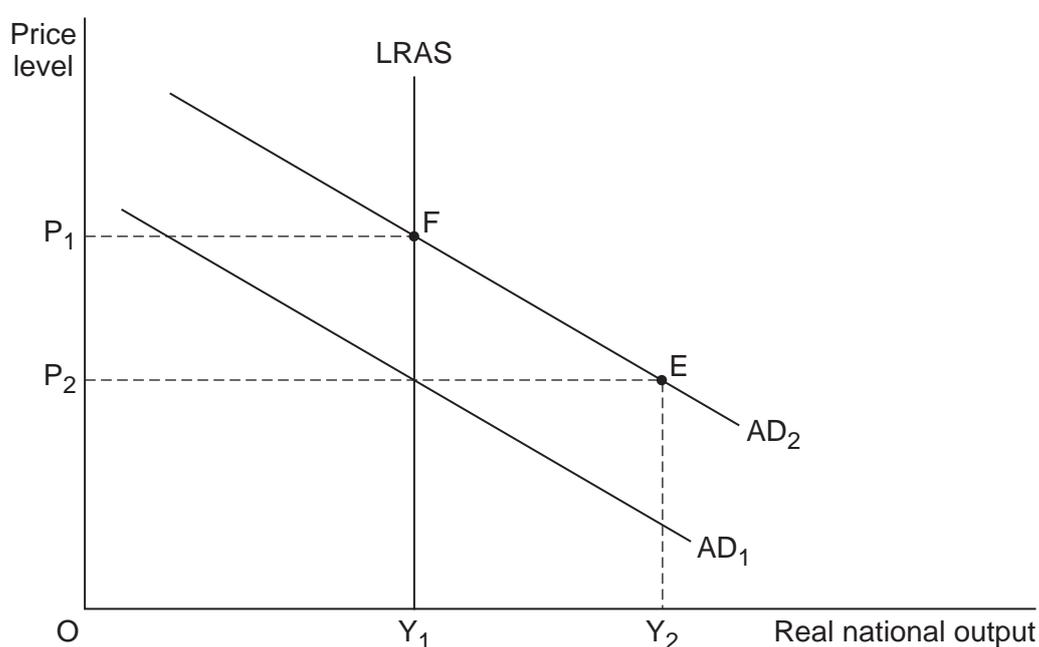
	Interest rates	Government expenditure	Taxation revenue
A	Increase	Increase	Decrease
B	Decrease	Decrease	Increase
C	Increase	Decrease	Increase
D	Decrease	Increase	Increase

- 13** A rise in the exchange rate of the pound sterling is likely to assist UK government policies aimed at reducing the
- A** rate of inflation.
- B** level of unemployment.
- C** level of imports.
- D** balance of payments deficit.

14 The Consumer Prices Index (CPI) rises from 100 to 105. This shows that

- A the inflation rate has increased by 5%.
- B the average price level has increased by 5%.
- C the price of every good has increased by 5%.
- D inflation in the economy is rising at a constant 5% per annum.

15 The diagram below shows two aggregate demand curves and the long-run aggregate supply curve for the UK economy.



The government predicts that aggregate demand will increase in the long run from AD_1 to AD_2 . Which one of the following policies is most likely to move the economy to a new long-run equilibrium at point E rather than point F?

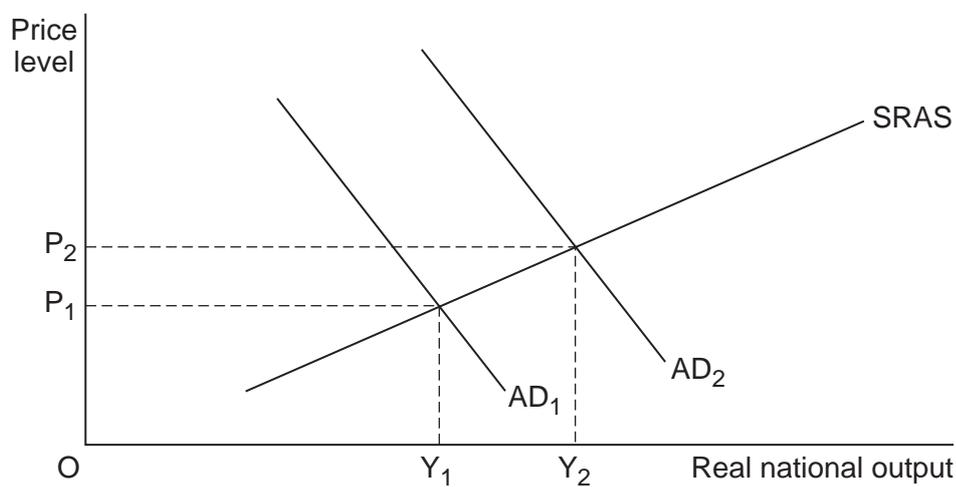
- A Pursuing an expansionary monetary policy
- B Allowing the exchange rate to rise
- C Increasing taxation
- D Improving the mobility of labour

- 16 Which one of the following, **A**, **B**, **C** or **D**, is most likely to be associated with an accelerator process in an economy?

	Rate of change of consumer income	Spare productive capacity in manufacturing	Supply of investment funds
A	Rising	High	Low
B	Falling	Low	High
C	Rising	Low	High
D	Falling	Low	Low

- 17 Between 2004 and 2006, an estimated 600 000 workers arrived in the UK from new members of the European Union (EU) in Eastern Europe. At the same time, inflation remained low, economic growth was strong, unemployment hardly changed and the current account position on the balance of payments deteriorated. Given this information, which one of the following is most likely to have been correct between 2004 and 2006?
- A** Inflation was low because increases in costs of imported raw materials to firms were very low.
- B** Economic growth was strong because the 600 000 workers from Eastern Europe increased the productive potential of the UK economy.
- C** Unemployment hardly changed because the arrival of 600 000 workers in the UK widened its output gap.
- D** The current account position deteriorated because inflation remained low throughout the period.
- 18 The underlying trend rate of growth in an economy is declining and the economy is also experiencing an increase in its rate of unemployment. Which one of the following is likely to be most effective in dealing with these problems?
- A** An expansionary fiscal policy and a restrictive monetary policy
- B** A restrictive monetary and fiscal policy
- C** An expansionary monetary policy and supply-side policies
- D** A restrictive fiscal policy and supply-side policies

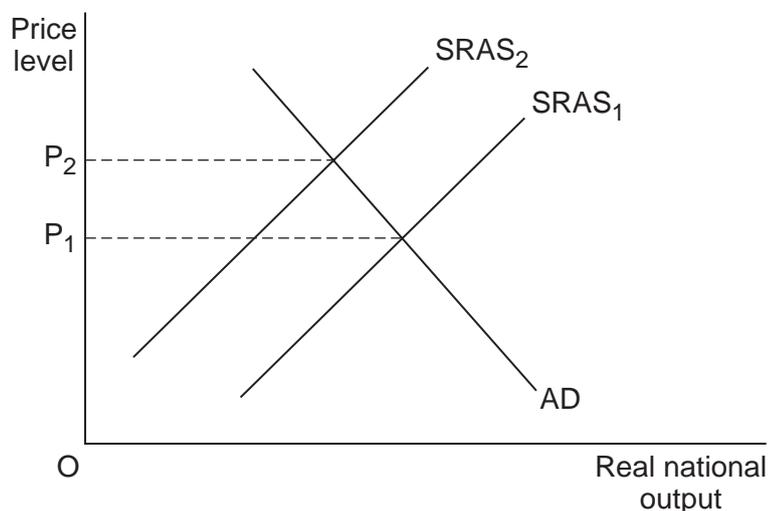
- 19 Which one of the following is most likely to be classified as a supply-side policy?
- A An increase in subsidies on essential goods
 - B An increase in the government budget deficit
 - C A reduction in the exchange rate
 - D A reduction in the tax on company profits
- 20 An economy is experiencing a balance of payments deficit and inflation. All other things being equal, which policy is most likely to reduce both the balance of payments deficit on current account and the rate of inflation?
- A A fall in government spending
 - B A cut in interest rates
 - C A decrease in the rate of income tax
 - D A reduction in the exchange rate
- 21 The diagram below shows how real national output and the price level are affected by a change in aggregate demand.



All other things being equal, the shift in the aggregate demand schedule from AD_1 to AD_2 could have been caused by an increase in

- A the price of raw materials.
- B the exchange rate.
- C labour productivity.
- D the budget deficit.

- 22 A fall in the value of the pound relative to the euro would be expected to affect the UK economy because it is likely to lead to
- A an increase in aggregate demand.
 - B a fall in raw material prices.
 - C a rise in the euro price of UK exports.
 - D a reduction in the rate of interest.
- 23 A cut in the central bank's lending rate is an example of
- A monetary policy.
 - B supply-side policy.
 - C fiscal policy.
 - D deflationary policy.
- 24 The diagram below represents an economy that has experienced inflation, with the price level rising from P_1 to P_2 .



The most likely cause of the inflationary pressures shown in the diagram is

- A a sustained increase in the money supply.
- B a growing budget deficit.
- C money wages increasing faster than productivity.
- D a period of time when interest rates are too low.

-
- 25** Other things being equal, increased innovation in an economy is likely to lead to a
- A** fall in the equilibrium level of output.
 - B** fall in the size of the labour force.
 - C** leftward shift of the aggregate demand curve.
 - D** rightward shift of the long-run aggregate supply curve.

**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

Turn over for the next question

Section B Data Response

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

EITHER

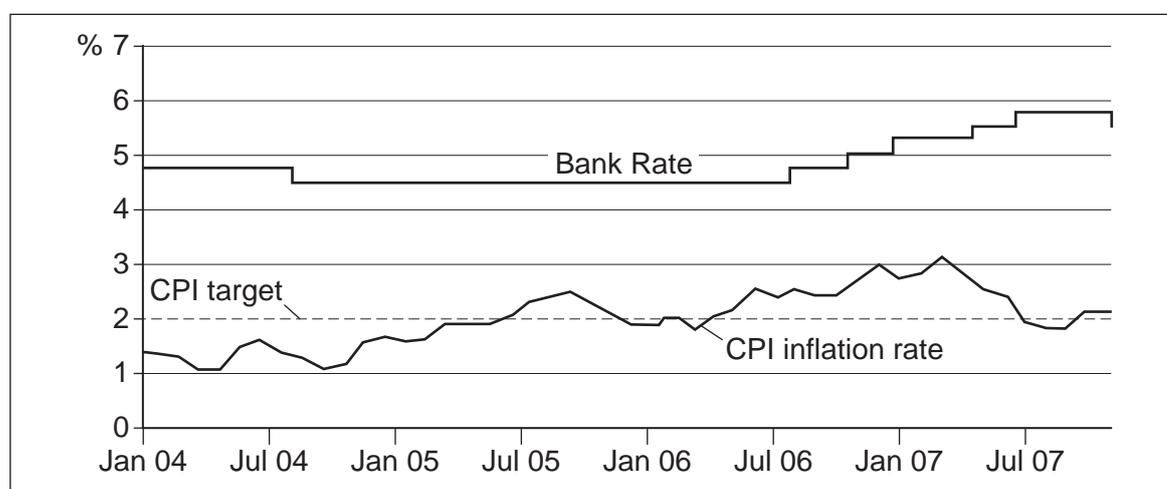
Total for this question: 50 marks

Question 26

UNITED KINGDOM INFLATION AND MONETARY POLICY

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

Extract A: UK inflation rate and Bank Rate, January 2004 to December 2007



Source: adapted from official statistics

Extract B: Monetary policy in the United Kingdom

The Bank of England's monetary policy objective is to deliver price stability and, having achieved that, to support the Government's economic objectives including those for growth and employment. Price stability is defined by the Government's inflation target of 2%. The inflation target of 2% is expressed in terms of an annual rate of inflation based on the Consumer Prices Index (CPI). If the annual rate of CPI inflation is more than 3% or less than 1%, the Governor of the Bank must write an open letter to the Chancellor explaining the reasons why inflation has increased or fallen to such an extent, and what the Bank proposes to do to ensure inflation comes back to the target.	1 5
The Bank of England uses interest rates to try to achieve the inflation target. [When the Bank changes the interest rate (currently known as the Bank Rate) it is attempting to influence the overall level of spending in the economy. When total spending grows more quickly than the volume of output produced, inflation is the result.]	10

Source: adapted from www.bankofengland.co.uk, accessed on 5 January 2008

Extract C: Bank Rate cut in December 2007

In the November <i>Inflation Report</i> , the forecast had been for GDP growth to slow during the next year to below its long-run average. In the United States and the euro area, the United Kingdom's largest trading partners, there appear to be signs of slower growth. However, emerging market economies [such as China and Brazil] continue to grow strongly.	1 5
The November forecast had been for CPI inflation to rise above the 2% target during 2008, reflecting the impact of energy and food price increases, and also the depreciation of the pound sterling. Although oil prices have fallen back in recent days, they have remained at very high levels. The exchange rate of the pound has declined further, putting upward pressure on the price of imports into the UK. CPI inflation had been forecast to return to target, as spare capacity and a negative output gap emerged.	10
On balance, in its December meeting, the Monetary Policy Committee thought that the risk of a slowdown in the economy was greater than the potential risk of higher inflation from short-run cost pressures. Against this background, the Committee judged that a decrease in Bank Rate of 0.25% was necessary to meet the inflation target.	15

Source: adapted from the minutes of the Monetary Policy Committee (MPC) meeting, *Bank of England*, 5 and 6 December 2007

Question 26

- 0 1** Define the term 'negative output gap' (**Extract C**, line 12). (5 marks)
- 0 2** Using **Extract A**, identify **two** points of comparison between the changes in Bank Rate and the changes in the CPI inflation rate between 2004 and 2007. (8 marks)
- 0 3** Using an AD/AS diagram to help you, explain the likely effect of an increase in interest rates upon inflation. (12 marks)
- 0 4** **Extract B** (lines 12-14) states: 'When total spending grows more quickly than the volume of output produced, inflation is the result.'
- Assess the view that inflation is always caused by an increase in aggregate demand. (25 marks)

Turn over for the next question

Turn over ►

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

OR

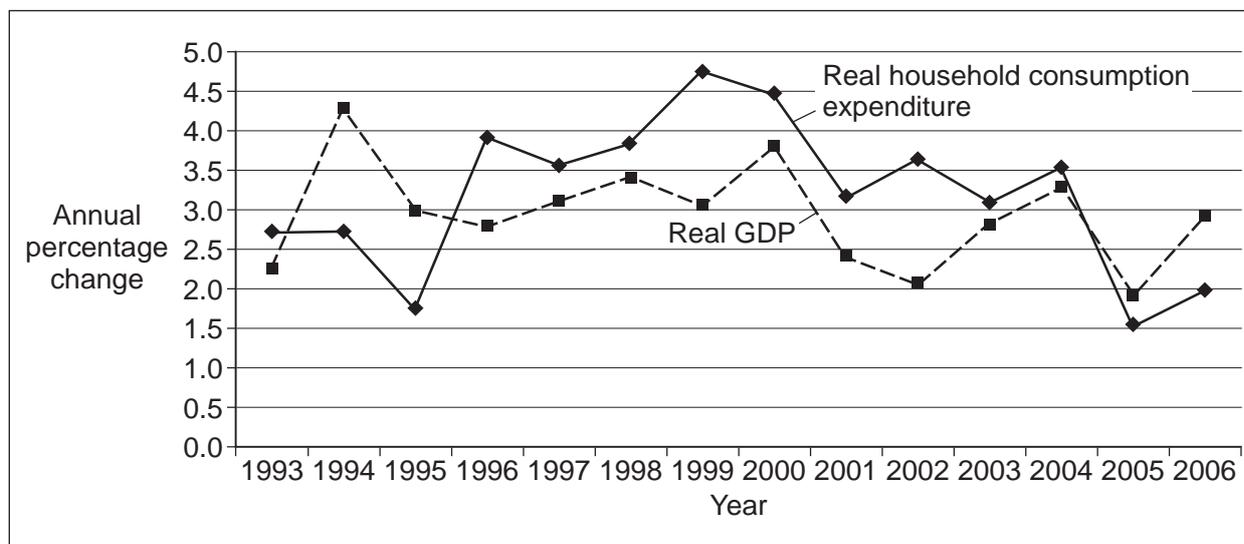
Total for this question: 50 marks

Question 27

CONSUMPTION EXPENDITURE AND THE UNITED KINGDOM ECONOMY

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

Extract D: Growth in real household consumption expenditure and real GDP, 1993 to 2006



Source: *www.statistics.gov.uk*

Extract E: The prospects for consumption in the United Kingdom

In 2007, the United Kingdom economy grew at a strong and steady pace. Economic activity has been supported in particular by the continued increase in consumer spending. However, future growth is likely to be affected by tighter availability of credit. If the reduction in lending also leads to a fall in house prices, this is likely to result in a further reduction in the growth of consumer expenditure.	1 5
Increased uncertainty about the future state of the economy may also lead to a rise in savings, particularly given the current high level of household debt. If real disposable income falls and job prospects deteriorate, the impact on consumption could be significant. However, the recent reduction in Bank Rate and the expectation that further cuts are on the way will help to maintain spending.	10

Source: news reports, January 2008

Extract F: Consumption and the performance of the economy

In the United Kingdom, consumption expenditure accounts for around 64% of GDP and the level of consumption is generally a good indicator of the strength of the economy. Rising consumption encourages firms to increase output and to increase employment. In the short run, rising consumption expenditure boosts economic growth but other factors, such as investment, changes in technology, productivity and the size of the working population, are likely to have a more enduring influence.	1 5
The strength of consumption relative to potential supply is also a factor in determining inflationary pressure in the economy. The balance of trade in goods and services is affected by consumer spending; United Kingdom consumers spend heavily on imports, so that when real incomes and consumption are rising, so too are imports.	10

Source: news reports, January 2008

Question 27

0 | 5 Define the term 'economic growth' (**Extract F**, line 5). (5 marks)

0 | 6 Using **Extract D**, identify **two** points of comparison between the growth in real household consumption expenditure and the growth of real GDP between 1993 and 2006. (8 marks)

0 | 7 **Extract E** (lines 3-4) state that 'future growth is likely to be affected by tighter availability of credit'.

Using an AD/AS diagram to help you, explain the likely effect of 'tighter availability of credit' upon output **and** employment. (12 marks)

0 | 8 **Extract F** (lines 2-3) state that 'the level of consumption is generally a good indicator of the strength of the economy'.

Assess the view that rising consumer expenditure is always beneficial for an economy. (25 marks)

END OF QUESTIONS

There are no questions printed on this page

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