General Certificate of Education
Advanced Subsidiary Examination
January 2013

Economics ECON2

Unit 2 The National Economy

Monday 28 January 2013 1.30 pm to 2.45 pm

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

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. No deductions will be made for wrong answers.
- 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 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

2 'Economists predict that the negative output gap in the economy 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 Central Bank raising interest rates

B The government taking action to increase the exchange rate of the currency

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

3 All other things being equal, which one of the following is most likely to lead to an increase in both saving and investment?

An increase in

A the exchange rate

B unemployment

C the interest rate

D incomes

4 Which one of the following combination of policies, **A**, **B**, **C** or **D**, is most likely to reduce inflation?

Combination	Money supply	Interest rates	Government spending	Income tax
A	Falls	Fall	Falls	Falls
B	Falls	Rise	Rises	Falls
C	Rises	Rise	Rises	Rises
D	Falls	Rise	Falls	Rises

5 When an economy is operating inside its production possibility frontier, it must have a

A low underlying trend rate of growth.

B negative output gap.

C declining labour force.

D negative rate of economic growth.

6 All other things being equal, a rise in the exchange rate is likely to

A reduce the price of exports.

B increase import prices.

C increase domestic demand.

D reduce domestic employment.

7 Which one of the following is most likely to lead to an increase in structural unemployment in the UK?

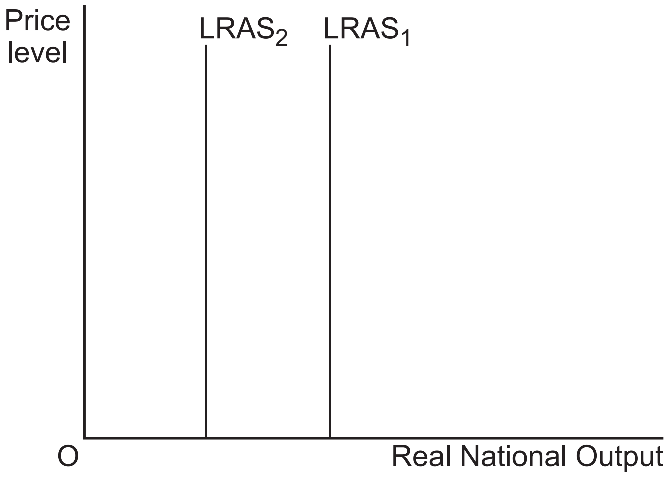
A An increase in the size of the UK government's budget deficit

B A decision by the Monetary Policy Committee (MPC) of the Bank of England to increase interest rates

C Improving international competitiveness of the Chinese and Indian economies

D A fall in consumer confidence which leads to a recession in the UK

8 The diagram below shows a shift in the long-run aggregate supply curve for an economy from $LRAS_1$ to $LRAS_2$.



The shift is most likely to have been caused by a fall in

A the capital stock.

B income tax rates.

C the growth of labour productivity.

D interest rates.

9 In the circular flow of income model, which one of the following equations is correct?

A Income = Output = Expenditure

B Income = Output = Injections

C Output = Expenditure = Withdrawals

D Expenditure = Income = Injections = Withdrawals

10 Which one of the following would be considered to be a supply-side policy?

A A cut in Value Added Tax (VAT) to boost aggregate demand

B A cut in income tax rates to boost incentives to work

C An increase in government spending to reduce cyclical unemployment

D An increase in government spending on welfare benefits to reduce inequality

11 Which one of the following fiscal policy measures would be most likely to reduce aggregate demand?

A Reducing state retirement pensions and leaving taxation unchanged

B Reducing indirect taxes and increasing direct taxes on higher income levels to maintain the same revenue

C Increasing welfare payments and leaving taxation unchanged

D Increasing government spending and reducing taxation by equal amounts

12 The table below shows money GDP (Gross Domestic Product) for an economy, expressed as index numbers.

Year	**GDP 2010 = 100**
2008	90
2009	96
2010	100
2011	105
2012	112

Between 2008 to 2012, there must have been an increase in

A aggregate demand.

B the size of the labour force.

C the rate of inflation.

D the government's budget deficit.

Turn over ▶

13 An economy is in recession, with falling real GDP (Gross Domestic Product). The accelerator theory predicts that

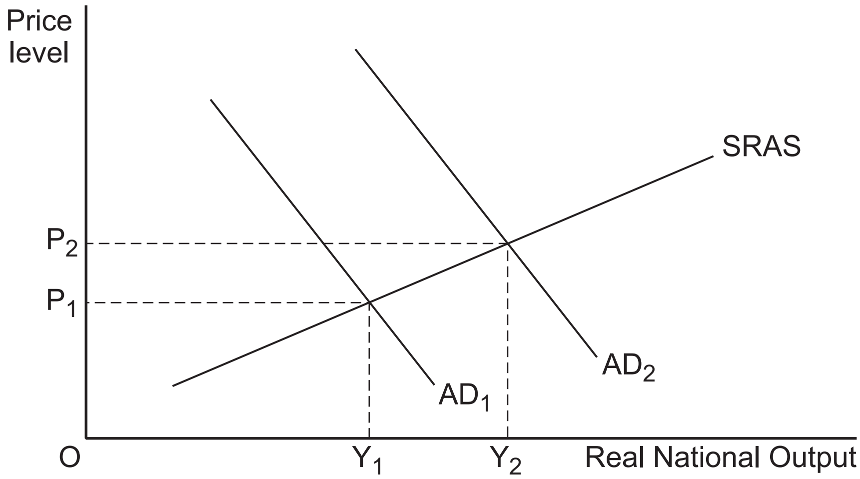
A the level of investment will fall.

B a rise in investment will bring the economy out of recession.

C interest rates will fall, leading to a rise in investment.

D a fall in the rate of investment will lead to further falls in GDP.

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



The shift in aggregate demand 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.

15 Which one of the following is most likely to contribute to an increase in inflation in an economy?

A A rise in the value of the country's currency on the foreign exchange market

B A growing positive output gap

C A sustained increase in productivity

D A persistent recession in the economy

16 An expansionary monetary policy designed to increase aggregate demand is less likely to achieve this objective if, at the same time, the government

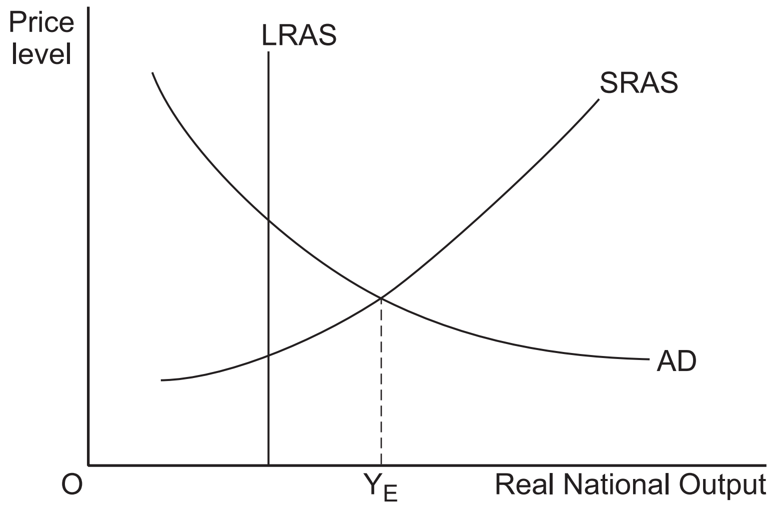
A increases spending on defence.

B cuts the basic rate of income tax.

C increases unemployment benefits.

D reduces the budget deficit.

17 The diagram below shows aggregate demand (AD), short-run aggregate supply (SRAS) and long-run aggregate supply (LRAS) curves for an economy.



The economy is operating with

A inflationary pressures.

B cyclical unemployment.

C under-used capacity.

D a negative output gap.

18 An economy is most likely to be in the boom phase of the economic cycle when there is a rise in

A the demand for imports.

B the savings ratio.

C spare capacity.

D business pessimism.

19 Which one of the following statements relating to fiscal policy in the UK is correct?

Fiscal policy

A is used to achieve macroeconomic objectives but not microeconomic objectives.

B influences aggregate demand but not aggregate supply.

C affects the level of economic activity but not the pattern of economic activity.

D is controlled by the UK government but not by the Bank of England.

20 The table below shows an economy's volume of goods and services imported and exported between 2010 and 2012, expressed as index numbers (2010 = 100).

	2010	**2011**	**2012**
Volume of goods exported	100	90	80
Volume of goods imported	100	108	115
Volume of services exported	100	95	90
Volume of services imported	100	102	105

The changes shown in the data are most likely to have been caused by

A an improvement in labour productivity in the domestic economy relative to labour productivity abroad.

B a rise in inflation in the domestic economy relative to inflation abroad.

C a fall in domestic incomes.

D a fall in the external exchange rate of the domestic currency.

21 All other things being equal, in the short run a decrease in aggregate demand in an economy is most likely to result in a reduction in

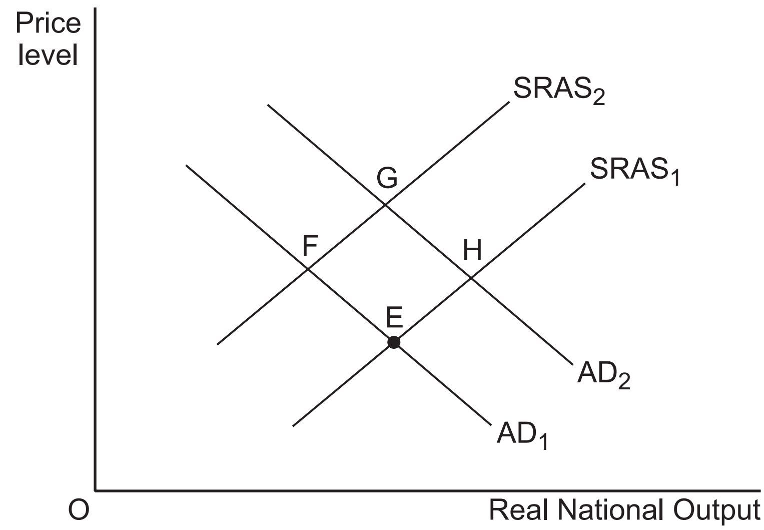
A government spending on welfare benefits.

B the unemployment rate.

C the budget deficit.

D the balance of payments deficit on current account.

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



The country experiences a significant increase in both world commodity prices and exports. As a result of these two events, the equilibrium will

A remain at point E.

B move to point F.

C move to point G.

D move to point H.

23 All other things being equal, which one of the following is most likely to lead to an increase in the size of the UK's current account deficit on the balance of payments?

A fall in

A the exchange rate of the £

B UK consumer spending

C UK income tax rates

D the UK rate of inflation

24 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.

25 The government reduces its spending. At the same time, the Bank of England increases interest rates. All other things being equal, the most likely outcome is that

A aggregate demand will fall but inflation will rise.

B aggregate supply will fall but economic growth will rise.

C unemployment will fall but the current account on the balance of payments will improve.

D inflation will fall but unemployment will rise.

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

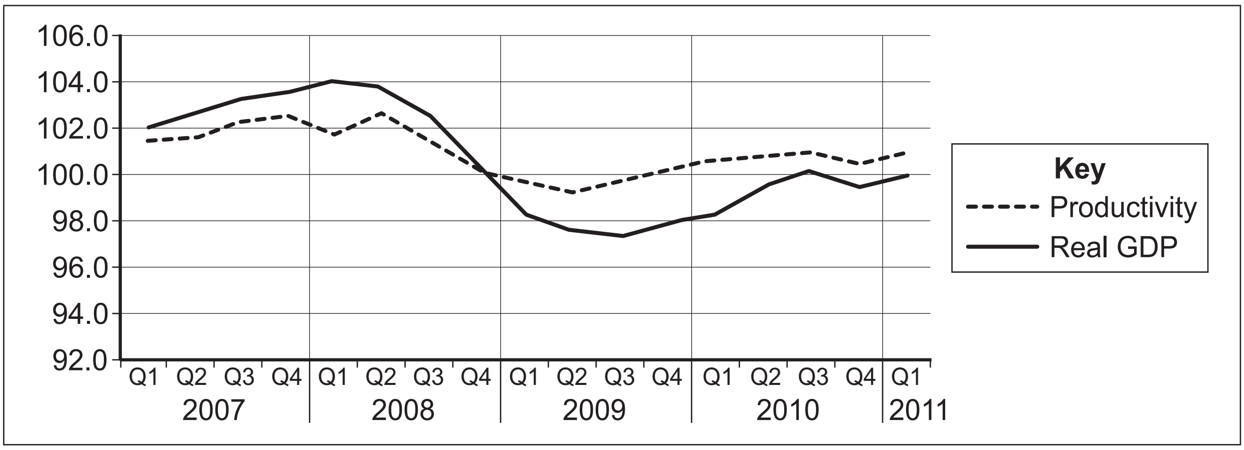
EITHER

Context 1

CYCLICAL FLUCTUATIONS IN THE UK ECONOMY

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

Extract A: UK real GDP index and productivity index, quarterly, 2006 Q1 = 100



Source: official statistics, September 2011

Note: The measure of productivity shown in the chart is output per hour worked for the whole economy

Extract B: Is the recovery in the UK economy grinding to a halt?

After the period of prolonged growth, known as the NICE (non-inflationary, constant expansion) decade, in 2008 the UK entered the worst recession it has experienced since the Second World War. The trigger for the downturn was the problems experienced in the world's financial markets and the subsequent credit crunch*, although some economists believe that the underlying cause was the expansionary policies that were pursued by governments around the world. These policies led to an unsustainable boom and an unavoidable recession.

The UK economy started to recover in the last quarter of 2009 but the recovery has been weak and faltering. The latest figures for the second quarter of 2011 show an increase in real GDP of just 0.1% which is not very encouraging at this point in the economic cycle. Some economists are predicting that third quarter growth will be negative. The fear that the UK and some other big economies around the world will suffer a double-dip recession is very real. The economic problems in Europe have hit confidence. Households have cut back on consumption and firms have been reluctant to invest.

Source: news reports, September 2011

* A credit crunch is when bank lending is severely restricted and the cost of borrowing rises rapidly.

Extract C: Is a rise in inflation inevitable?

The recovery in the UK economy has been fairly weak and yet inflation has been above the Government's target of 2.0% for the past 21 months. Above-target inflation has been blamed on rising world commodity prices, increases in Valued Added Tax (VAT) and the fall in the exchange rate. According to the Bank of England, these are temporary factors. However, if inflation is above target when the recovery is weak, unemployment is high and there is plenty of spare capacity in the economy, what will happen when the pace of the recovery quickens? A further increase in inflation is inevitable, or is it? At present, wages are only increasing slowly and there is little evidence to suggest that people expect the current above-target rate of inflation to continue.

When the recovery comes, it is likely to be accompanied by an increase in investment and by a rise in the rate of growth of labour productivity. Many large companies have funds to invest but are reluctant to do so because they are not confident that there will be sufficient demand to justify an increase in capacity. An increase in the productivity of labour will help to offset the inflationary impact of any increase in wages.

Source: news reports, September 2011

0 1 Define the term the 'economic cycle' (**Extract B**, line 11). *(5 marks)*

0 2 Using **Extract A**, identify **two** significant points of comparison between UK real GDP and productivity over the period shown. *(8 marks)*

0 3 **Extract C** (line 11) suggests that 'When the recovery comes, it is likely to be accompanied by an increase in investment'.

Explain why a sustained recovery in an economy is likely to be accompanied by an increase in investment. *(12 marks)*

0 4 **Extract C** (lines 5–8) suggests that as the pace of the recovery quickens a further increase in inflation is inevitable.

Using the data and your economic knowledge, discuss the view that a sustained recovery in the UK economy will inevitably lead to an increase in inflation. *(25 marks)*

Do **not** answer Context 2 if you have answered Context 1.

Total for this Context: 50 marks

OR

Context 2

CONSUMPTION AND SAVING

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

Extract D: **Households' income, consumption and saving**

Year	Households' real disposable income £ billion	Households' real consumption expenditure £ billion	Households' saving ratio* %
2004	824	788	3.7
2005	840	805	3.9
2006	853	820	3.4
2007	857	837	2.6
2008	866	842	2.0
2009	876	815	6.0
2010	869	821	5.3

Source: official statistics, September 2011

*The households' saving ratio is households' savings as a percentage of households' disposable income.

Extract E: Savings fall as high inflation reduces real incomes

Data released by the Office for National Statistics (ONS) suggest that weak consumer spending is preventing the economy from staging a sustained recovery. The ONS said that households' disposable income fell for the second consecutive quarter, forcing consumers to use their savings to maintain their lifestyles. Tax increases, inflation and minimal pay rises have put an unprecedented squeeze on living standards.

Source: news reports, September 2011

Extract F: Savers need to be encouraged

Low interest rates mean that, after taking inflation into account, a sum of £10 000 deposited in an instant access savings account is worth almost £1000 less than two years ago. Despite the unfavourable savings environment, 70% of Britons are savers, making an effort to provide for their own futures and to protect themselves in times of uncertainty.

We are now suffering from the consequences of a decade of growth fuelled by a massive increase in consumer debt. Politicians tell us that we should save rather than spend money we do not have. However, persistently low interest rates are encouraging people to save less and to borrow more.

Source: news reports, September 2011

Extract G: Economic recovery depends on demand

The Chancellor's gamble has not paid off. The Coalition's decision to make severe cuts in public expenditure and to increase taxes in an attempt to eliminate the budget deficit has hit the economy hard. Without sufficient demand, the economy will not recover. Recent statistics show clearly that the recovery in the UK economy is far from secure. A low rate of interest is not enough to encourage households and firms to increase their spending and sustain the growth in demand that the UK economy needs.

A reversal of the recent increases in Value Added Tax (VAT) would encourage households to spend but some think that cuts in income tax are more likely to help the economy in the long run, as well as giving it a much-needed boost in the short run. An immediate increase in the amount people can earn without paying tax, from the current £7475 to £10 000, would benefit the poorer sections of the community and stimulate consumption. People calling for the abolition of the recently introduced 50% tax rate argue that it is discouraging individuals and companies from locating in Britain and encouraging some to leave. A cut in the top tax rate, as well as having supply-side benefits, is also likely to increase spending.

Source: news reports, September 2011

0 5 Define the term 'rate of interest' (**Extract G**, line 5). *(5 marks)*

0 6 Using **Extract D**, identify **two** significant points of comparison between households' real disposable income and real consumption expenditure over the period shown. *(8 marks)*

0 7 **Extract F** (lines 7 – 8) states: 'Politicians tell us that we should save rather than spend money we do not have.'

Explain **two** factors that might lead to a rise in household saving. *(12 marks)*

0 8 **Extract G** (lines 8 – 9) claims that 'some think that cuts in income tax are more likely to help the economy in the long run, as well as giving it a much-needed boost in the short run'.

Using the data and your economic knowledge, assess the view that a reduction in income tax is the best way to improve the performance of the UK economy in **both** the short run **and** the long run. *(25 marks)*

END OF QUESTIONS

There are no questions printed on this page

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