



General Certificate of Education  
Advanced Subsidiary Examination  
June 2010

# Economics

# ECON2

## Unit 2 The National Economy

**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 1 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**.

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**SECTION A: OBJECTIVE TEST**

Answer **all** questions in **Section A**.

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

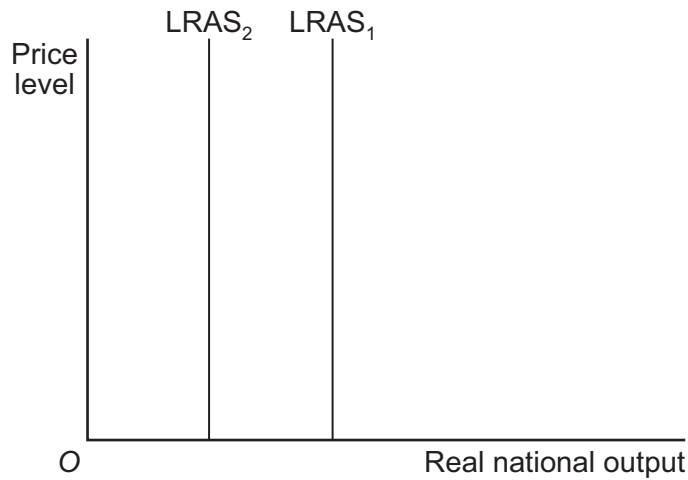
You are advised to spend no more than 25 minutes on **Section A**.

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.

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- 1** An economy is operating below its trend rate of growth and simultaneously experiencing inflation and a deficit on its balance of trade. All other things being equal, a reduction in the rate of income tax is most likely to lead to a decrease in the
- A** inflation rate.
  - B** level of unemployment.
  - C** rate of economic growth.
  - D** balance of trade deficit.
- 2** Which one of the following headlines directly indicates the use of monetary policy?
- A** Government commits itself to reducing poverty through an increase in pensions
  - B** Big increase in public spending announced in the budget
  - C** More money in everyone's pockets as taxes are lowered
  - D** Joy for homeowners as interest rates are slashed
- 3** The current account of the balance of payments comprises
- A** all government income and expenditure in a financial year.
  - B** money that may be withdrawn at any time.
  - C** trade in goods and services, investment income and transfers.
  - D** all transactions involving money leaving or entering the country.

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



The shift in the long-run aggregate supply curve is most likely to have been caused by a fall in

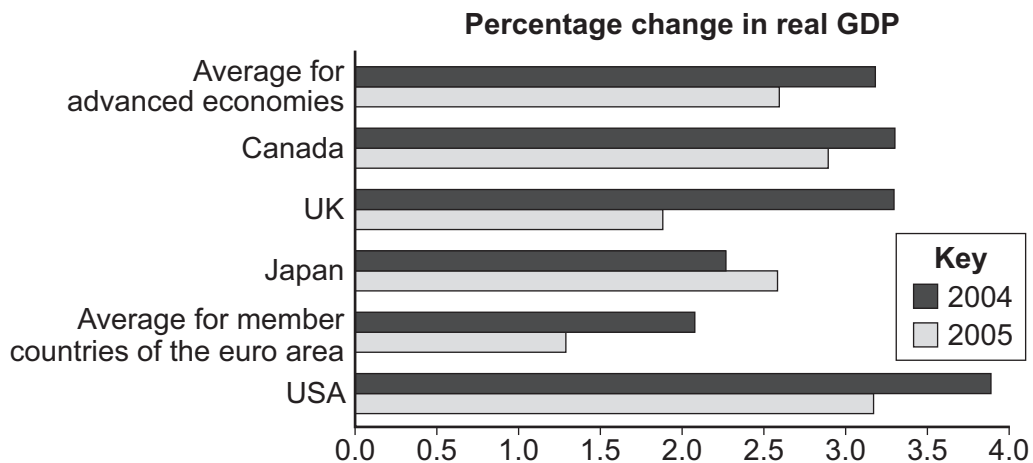
- A the capital stock.
  - B income tax rates.
  - C the growth of labour productivity.
  - D interest rates.
- 5 The exchange rate of a country has fallen. All other things being equal, which one of the following is most likely to occur as a result of this?
- A A fall in aggregate demand and a deterioration in the balance of payments on current account
  - B A rise in aggregate demand and an improvement in the balance of payments on current account
  - C A fall in aggregate demand and an increase in output
  - D A rise in aggregate demand and a fall in the inflation rate

- 6 All other things being equal, which one of the following is most likely to lead to an increase in imports?

A fall in

- A the exchange rate
- B national income
- C government expenditure
- D the savings ratio

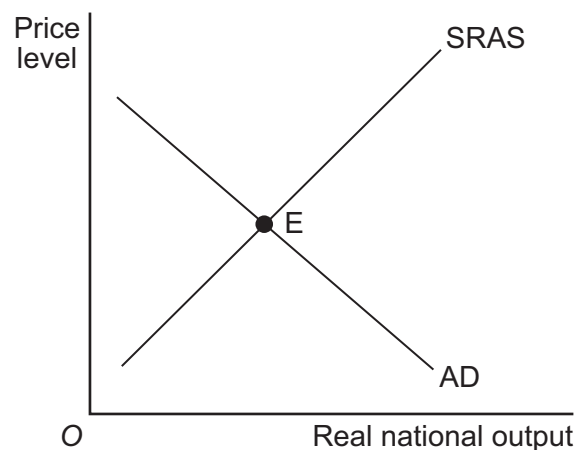
- 7 The graph below shows real growth rates (annual percentage change in real GDP) for advanced economies in 2004 and 2005.



From the graph, it can be inferred that

- A the USA had a higher growth rate in both years than any other advanced economy.
- B all economies shown in the graph had higher rates of growth in 2004 than 2005.
- C the UK had a higher rate of growth than the average for member countries of the euro area in 2004 and 2005.
- D all member countries of the euro area had lower average rates of growth in both years than Canada.

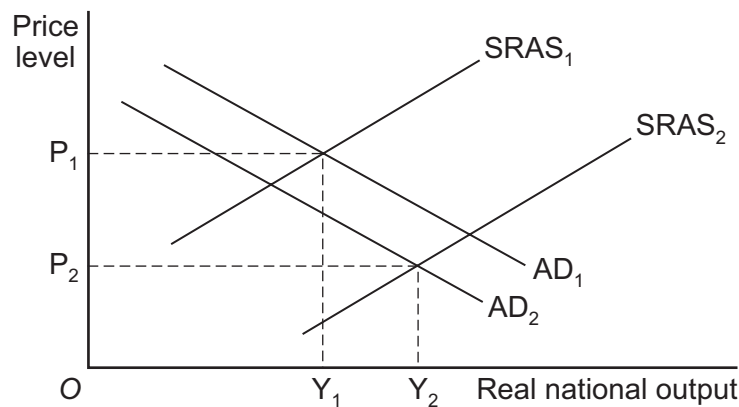
- 8 Which one of the following fiscal policy measures would be most likely to increase aggregate demand?
- A Increasing state retirement pensions and leaving taxation unchanged
  - B Increasing indirect taxes and reducing direct taxes on higher income levels to maintain the same revenue
  - C Reducing welfare payments and leaving taxation unchanged
  - D Reducing government spending and increasing taxation by equal amounts
- 9 'The multiplier' usually refers to how an initial increase in investment, government spending or exports leads to a larger increase in the level of
- A prices.
  - B interest rates.
  - C unemployment.
  - D income.
- 10 The diagram below shows the aggregate demand (AD) and short-run aggregate supply (SRAS) curves for an economy. The economy is in equilibrium at point E.



Which one of the following would be likely to lead to a new equilibrium position, with a fall in the price level?

- A A fall in exports
- B An increase in government spending
- C A fall in productivity
- D An increase in wage rates

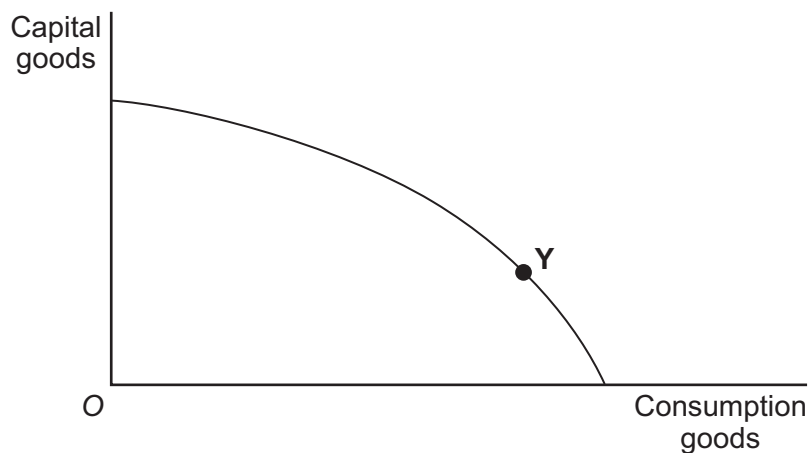
- 11 The government wishes to increase the trend rate of growth of national output through the use of supply-side policies. To achieve its objective, the government would most likely increase its spending on
- A wages for public sector employees.
  - B welfare benefits.
  - C subsidies to failing firms.
  - D education and training.
- 12 A country's banking system is an important part of the institutional structure of its economy because of its role
- A as a source of investment funds for businesses.
  - B in determining the economy's target rate of inflation.
  - C in managing the country's balance of payments.
  - D as a major employer of labour in the economy.
- 13 The diagram below shows the aggregate demand (AD) and short-run aggregate supply (SRAS) curves for an economy.  $OP_1$  is the initial equilibrium price level and  $OY_1$  the initial equilibrium level of real national output.



Which one of the following combination of events, **A**, **B**, **C** or **D**, is most likely to have brought about the change in equilibrium output from  $OY_1$  to  $OY_2$ ?

|          |   |  |
|----------|---|--|
| <b>A</b> | The level of investment rises                 | Money wages in the economy rise                            |
| <b>B</b> | The level of exports decreases                | Business taxes increase                                    |
| <b>C</b> | The level of consumption falls                | The cost of oil and other imported raw materials decreases |
| <b>D</b> | Government spending on welfare benefits falls | Average productivity falls                                 |

- 14 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.
- 15 The rate of inflation is measured by
- A taking the difference between this year's prices and last year's prices.
  - B calculating the percentage change in prices between two points in time.
  - C the level of the RPI (Retail Price Index).
  - D changes in the relative prices of goods and services.
- 16 The production possibility diagram below shows an economy operating on its boundary producing the combination of consumption and capital goods shown at point Y.



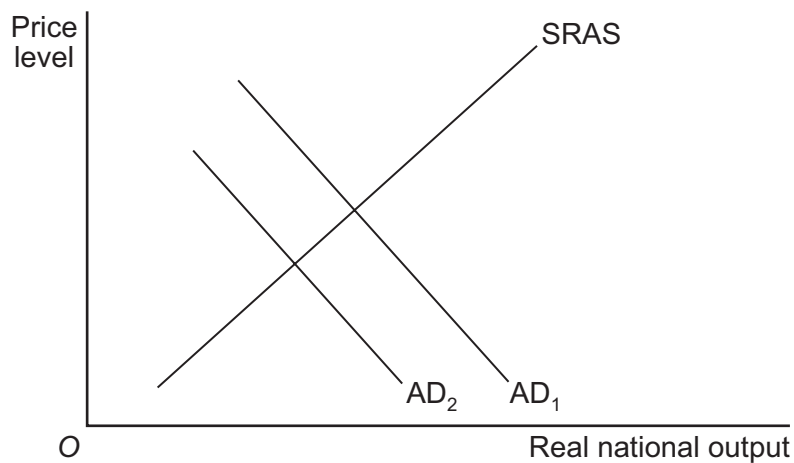
With no change in the position of the production possibility boundary, there is now an increase in the production of capital goods. Which one of the following, **A**, **B**, **C** or **D**, is most likely to happen because of this increase?

|          | Short-run change in consumption goods | Long-run change in consumption goods |
|----------|---------------------------------------|--------------------------------------|
| <b>A</b> | Increase                              | Increase                             |
| <b>B</b> | Increase                              | Fall                                 |
| <b>C</b> | Fall                                  | Fall                                 |
| <b>D</b> | Fall                                  | Increase                             |

Turn over ►

- 17 A government wishing to reduce the level of unemployment through the use of fiscal policy would be most likely to
- A lower interest rates.
  - B increase the size of the budget deficit.
  - C increase interest rates.
  - D encourage a depreciation of the exchange rate.

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



All other things being equal, the movement from  $AD_1$  to  $AD_2$  has most likely been caused by a growth in

- A exports.
  - B imports.
  - C consumption.
  - D investment.
- 19 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 of the Bank of England to increase interest rates
  - C The improving international competitiveness of the Chinese and Indian economies
  - D A fall in consumer confidence that leads to recession in the UK



- 20** The Bank of England is most likely to increase interest rates to prevent an increase in the rate of inflation when
- A** aggregate supply exceeds aggregate demand.
  - B** the economy's underlying rate of growth is increasing.
  - C** aggregate demand is increasing more rapidly than the underlying trend rate of growth.
  - D** an increase in aggregate demand leads to a reduction in unemployment.

- 21** 'Unemployment has begun to rise in the UK. What should policy makers do? Already the Bank of England has cut interest rates. Also, the government has begun to spend more without covering all of the increase by a rise in taxes.'

It can be inferred from the data that, in response to rising unemployment,

- A** both monetary policy and fiscal policy are expansionary.
  - B** monetary policy is expansionary whilst fiscal policy is contractionary.
  - C** monetary policy is contractionary whilst fiscal policy is expansionary.
  - D** both monetary policy and fiscal policy are contractionary.
- 22** Which one of the following is most likely to be an example of a supply-side policy?
- Measures to
- A** reduce inflation
  - B** increase labour mobility
  - C** increase the money supply
  - D** increase imports

- 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** A fall in the exchange rate
  - B** A fall in consumer spending
  - C** A reduction in income tax rates
  - D** A fall in the rate of inflation

- 
- 24** Which one of these is most likely to be reduced by a long-term improvement in UK labour productivity?
- A** UK incomes
  - B** UK exports
  - C** UK inflation
  - D** UK output
- 25** Which one of the following is most likely to rise if the growth of aggregate demand is less than the underlying trend rate of growth of output?
- A** Inflation
  - B** Unemployment
  - C** Tax rates
  - D** Interest rates

**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**

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**Turn over for the next question**

**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**.

**EITHER**

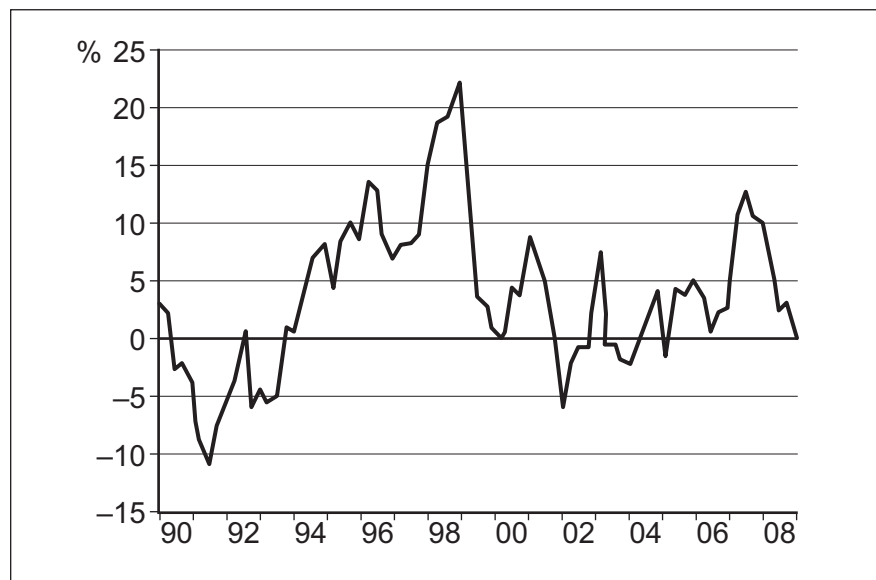
**Total for this Context: 50 marks**

### CONTEXT 1

#### INVESTMENT IN THE UK

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

#### Extract A: Business investment in the UK, annual % change, 1990 – 2008



Source: official statistics, accessed on 7 January 2009

#### Extract B: Investment falls as the recession bites

Investment by UK businesses fell by much more than expected from July to September, according to estimates from the *Office for National Statistics*. Business investment for the third quarter of 2008 was estimated to be 0.1% lower than in the same period of 2007 and 1.3% lower than in the previous quarter. The drop was due to a 1.7% fall in investment by public and private firms outside the manufacturing sector.

1

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UK businesses are struggling in the economic downturn, with sales and profits badly affected across most sectors. Therefore, companies are looking to cut costs and scale back plans for new investment. Weaker demand makes investment less profitable and uncertainty about the severity of the recession leads companies to delay spending on investment projects. The credit crunch means that even those companies wishing to invest are finding it hard to obtain loans from the banks. Confidence in the banking sector has been knocked so severely that banks are keeping very tight controls on their lending to companies.

10

Source: news reports, December 2008

**Extract C: Business investment affects the economy**

|   |        |
|---|--------|
| Business investment accounts for around 10% of GDP. It is a feature of business investment that it typically shows much larger cyclical fluctuations than other components of aggregate demand. Investment by businesses grew rapidly between 2004 and 2007 but, in keeping with its strongly cyclical nature, investment is expected to fall rapidly in 2009, contributing to rising unemployment. | 1<br>5 |
| The role of investment in the economy extends beyond its effect on aggregate demand. It influences future growth and productivity by raising the amount of physical capital available to each worker with which to produce goods and services. Technological advances often require investment by companies in the production process before they benefit the economy.                              | 10     |
| However, when the economy is booming, rapid increases in investment spending can result in rising inflation and a deterioration in the balance of payments.   |        |

Source: news reports, December 2008

- 0 1** Define the term 'investment' (**Extract B**, line 5). (5 marks)
- 0 2** Using **Extract A**, identify **two** main features of the changes in business investment that occurred during the period 1990 to 2008. (8 marks)
- 0 3** **Extract B** (lines 7-8) suggests that 'companies are looking to cut costs and scale back plans for new investment'.  
Explain **two** factors that are likely to cause a fall in investment spending. (12 marks)
- 0 4** **Extract C** (lines 4-5) indicates that 'investment is expected to fall rapidly in 2009'.  
Assess the consequences for the UK economy of a significant fall in investment spending. (25 marks)

Turn over ►

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

OR

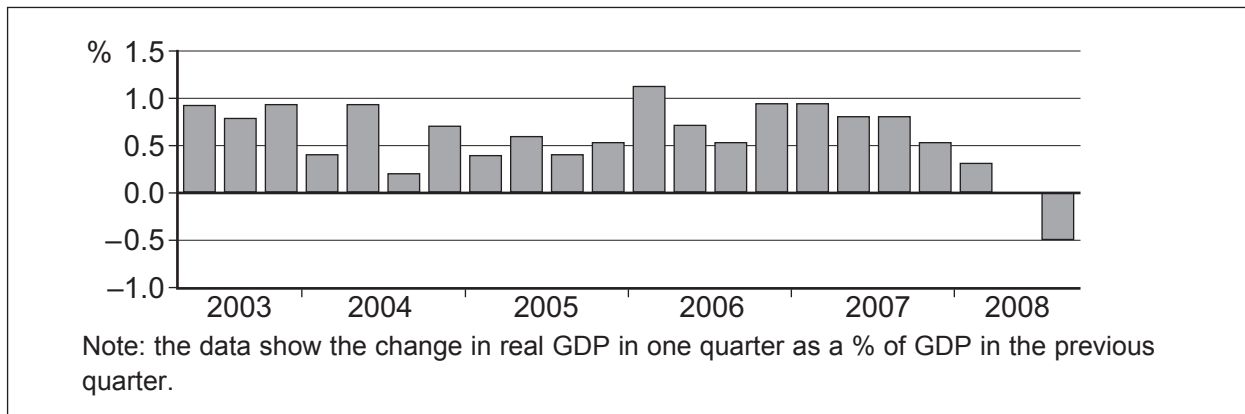
**Total for this Context: 50 marks**

## CONTEXT 2

### ECONOMIES IN RECESSION

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

#### Extract D: Growth in UK real GDP, second quarter 2003 to the third quarter 2008



Source: official statistics, accessed on 7 January 2009

#### Extract E: UK growth falls in the third quarter of 2008

Real GDP in the third quarter of 2008 has shrunk compared to the zero growth in quarter two. This contraction in the United Kingdom economy was driven by negative growth in the services, manufacturing and construction sectors. Both household spending and business investment fell in the third quarter. The fall in household spending reflects the continued impact of the credit crunch combined with falling real disposable income, rising unemployment and a lack of confidence.

1  
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Source: adapted from the *Economic and Labour Market Review*, December 2008

#### Extract F: Global growth also falls in the third quarter of 2008

Preliminary data show that the economies of most major OECD\* countries were in recession in the third quarter of 2008. In the US, GDP growth was  $-0.1\%$ , caused by the fall in domestic demand, particularly consumer spending. Higher unemployment, the credit crunch and the continued weakness in the housing market contributed to this decline. Japan and the eurozone entered a recession in the third quarter of 2008, each having experienced two successive quarters of negative growth.

1  
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In response to these figures, central banks around the world have been cutting interest rates. In November, both the Federal Reserve in the USA and the European Central Bank cut interest rates by  $0.5\%$  to  $1\%$  and  $3.25\%$  respectively, and further reductions are expected.

Source: adapted from the *Economic and Labour Market Review*, December 2008

\* The OECD (Organisation for Economic Co-operation and Development) is an international organisation that includes 30 developed countries, such as France, Germany, Japan, the UK and the USA.

|  |                        |
|--|------------------------|
| The Government can't stop what is coming in the next few months but it can ease the pain and help prevent a prolonged recession. The boost from lower interest rates, a weakening pound, tax cuts and increased government spending will help. The Government has forecast that the budget deficit will rise to £118 billion next year and further fiscal measures may be needed. However, it will take time before such policies have much effect on the economy. Some believe that lower interest rates will be ineffective unless the Government forces the banks to increase lending. Furthermore, the impact of a lower exchange rate may be of little use unless there is also a recovery in the economies of those countries which purchase UK exports. | 1<br><br><br><br><br>5 |
|--|------------------------|

**There are no questions printed on this page**

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