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# AS ECONOMICS

## Unit 2 The National Economy

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Monday 23 May 2016

Morning

Time allowed: 1 hour 15 minutes

### Materials

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 **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.

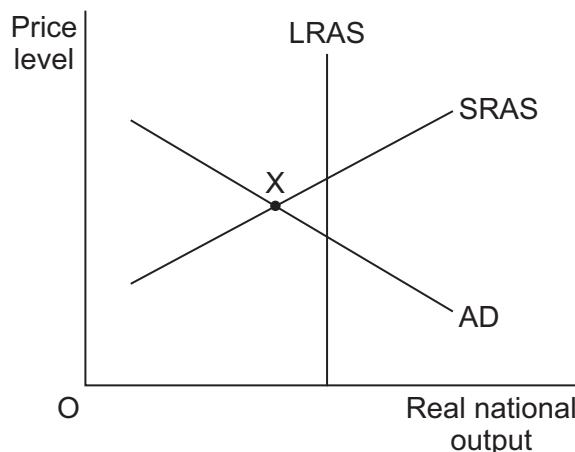
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- 1 All other things being equal, an increase in aggregate demand would result from an increase in the

  - A** deficit in the current account of the balance of payments.
  - B** household saving ratio.
  - C** government's budget surplus.
  - D** ratio of household consumption to national income.
  
- 2 Supply-side policies are aimed mainly at

  - A** improving the underlying trend rate of economic growth.
  - B** dealing with short-term supply-side shocks to the economy.
  - C** combating cyclical unemployment.
  - D** reducing the government's budget deficit.

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

- 4 Which one of the following is an example of expansionary fiscal policy?

- A A reduction in interest rates
- B An increase in the budget deficit
- C An increase in the money supply
- D A reduction in government spending

- 5 In which one of the following combinations of events, **A**, **B**, **C** or **D**, is the Bank of England most likely to reduce interest rates to try to boost demand?

|          | <b>Money wages</b> | <b>Exchange rate</b> | <b>Consumer spending</b> |
|----------|--------------------|----------------------|--------------------------|
| <b>A</b> | Rising             | Falling              | Falling                  |
| <b>B</b> | Falling            | Rising               | Rising                   |
| <b>C</b> | Rising             | Falling              | Rising                   |
| <b>D</b> | Falling            | Rising               | Falling                  |

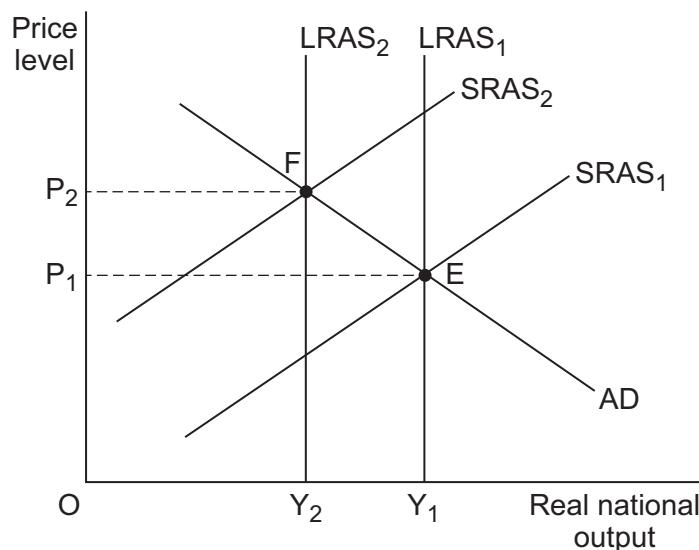
**Turn over ►**

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- 6 Deflation in the domestic economy is most likely to
- A cause consumers to delay their purchases of consumer durables.
  - B lead to a rise in interest rates for both borrowers and lenders.
  - C lead to a rise in both exports and imports.
  - D reduce the real value of any money that has been lent.
- 7 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
- 8 All other things being equal, which one of the following combinations, A, B, C or D, indicates the most likely consequences for the UK of a decline in the value of the pound (£) against other major currencies?

|          | <b>Exports</b> | <b>Unemployment</b> | <b>Economic Growth</b> |
|----------|----------------|---------------------|------------------------|
| <b>A</b> | Increase       | Decrease            | Increase               |
| <b>B</b> | Decrease       | Increase            | Decrease               |
| <b>C</b> | Increase       | Decrease            | Decrease               |
| <b>D</b> | Decrease       | Increase            | Increase               |

- 9 Which one of the following is a correct statement?
- A Fiscal policy can be used to affect the pattern of economic activity.
  - B The Bank of England is responsible for fiscal policy.
  - C Fiscal policy is only used to affect the demand side of the economy.
  - D The government uses fiscal policy to control the exchange rate.

- 10** The diagram below shows the aggregate demand (AD), the short-run aggregate supply (SRAS) and the long-run aggregate supply (LRAS) curves for an economy. The economy's initial equilibrium is at point E.



Which one of the following developments affecting the economy, **A**, **B**, **C** or **D**, is most likely to account for the movement of macroeconomic equilibrium from E to F?

- A** An increase in labour productivity and wage rates
- B** A decrease in the underlying trend rate of growth and a decrease in world commodity prices
- C** A decrease in government expenditure and an increase in indirect taxation
- D** A fall in productivity and an increase in world commodity prices

- 11** In which one of the following situations is a government most likely to pursue an expansionary fiscal policy?

- A** When there is a positive output gap
- B** When the long-run trend rate of economic growth is too low
- C** When there is a high level of structural unemployment
- D** When cyclical unemployment is increasing

- 12** The table below shows changes in macroeconomic indicators for an economy. During a time of rising unemployment, labour productivity has increased whilst at the same time income per head has fallen.

All other things being equal, which combination, **A**, **B**, **C** or **D**, is most likely to result from these changes?

|          | <b>The rate of inflation</b> | <b>The balance of payments deficit on current account</b> |
|----------|------------------------------|---|
| <b>A</b> | Increases                    | Decreases   |
| <b>B</b> | Decreases                    | Increases   |
| <b>C</b> | Increases                    | Increases   |
| <b>D</b> | Decreases                    | Decreases   |

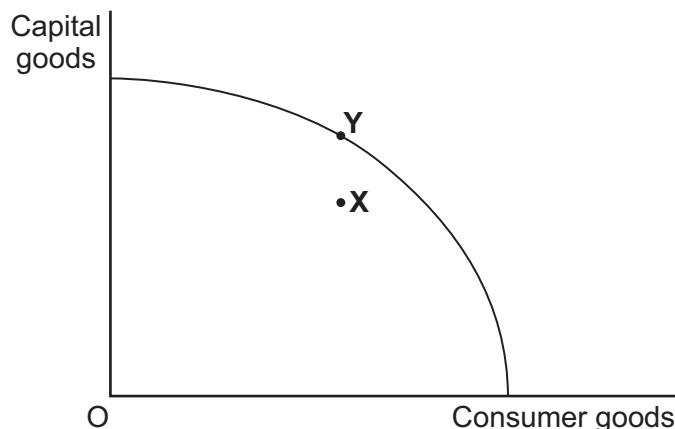
- 13** The UK economy is most likely to be in the boom phase of the economic cycle when there is a rise in

- A** the demand for imports.
- B** the saving ratio.
- C** spare capacity.
- D** business pessimism.

- 14** Which one of the following best illustrates the accelerator process?

- A** A change in one of the components of aggregate demand leading to a much greater increase in national income
- B** An increase in national income resulting in a proportionately larger rise in investment
- C** Government subsidies to firms for research and development helping to increase the rate of innovation
- D** An increase in government spending during a recession helping to stimulate investment

- 15** The diagram below shows an economy operating on its production possibility frontier at point **Y**.



All other things being equal, which one of the following is most likely to move the economy from point **Y** to point **X** within its production possibility frontier?

A decrease in

- A** inflation
- B** investment expenditure
- C** productive capacity
- D** the trend rate of growth

- 16** If the world economy goes into recession, this is likely to increase unemployment in the UK because the

- A** ability of other economies to supply UK industry with basic commodities will be reduced.
- B** value of goods and services exported from the UK will fall.
- C** price of oil and other raw materials is likely to rise.
- D** value of the pound will fall on the foreign exchange market.

**Turn over for the next question**

**Turn over ►**

- 17 A country has seen the following changes to two macroeconomic indicators over the period 2012 to 2015.

| Year | CPI inflation (%) | Average earnings growth (%) at current prices |
|------|-------------------|---|
| 2012 | 2.5               | 3.0   |
| 2013 | 2.4               | 2.7   |
| 2014 | 0.6               | 0.2   |
| 2015 | 0.5               | 0.8   |

Which one of the following can be concluded from the data?

- A The nominal value of earnings was lower in 2015 than in 2012
- B Prices and average earnings were higher in 2015 than in 2012
- C The real value of average earnings declined each year
- D Prices fell between 2012 and 2015

- 18 The table below shows possible causes of shifts in the aggregate demand (AD), the short-run aggregate supply (SRAS) and the long-run aggregate supply (LRAS) curves for an economy. All other things being equal, which one of the following combinations, A, B, C or D, is correct?

|   | AD shifts to the right   | SRAS shifts to the left         | LRAS shifts to the right                     |
|---|--|---------------------------------|--|
| A | Spending on imports increases                                    | Factory rents increases         | Investment increases                         |
| B | The budget surplus increases                                     | Wages rise                      | Productivity increases                       |
| C | The current account deficit on the balance of payments decreases | The cost of imports rises       | The size of the working population increases |
| D | Consumer confidence improves                                     | Value Added Tax (VAT) increases | Wages fall                                   |

- 19 Which one of the following combinations of policy instruments involves only the use of monetary policy measures?

- A Lower taxes and more government spending
- B Lower interest rates and a budget deficit
- C A reduction in the exchange rate and a cut in the tax on firms' profits
- D Lower interest rates and a reduction in the exchange rate

**20** All other things being equal, an economy is most likely to experience demand-pull inflationary pressure when it has

- A** a high rate of productivity growth.
- B** a positive output gap.
- C** an increase in the value of its exchange rate.
- D** an increase in the rate of interest.

**21** The table below shows the components of an economy's current account balance in 2015.

|                       | £bn  |
|-----------------------|------|
| Export of goods       | 500  |
| Export of services    | 400  |
| Import of goods       | 800  |
| Import of services    | 300  |
| Net investment income | +50  |
| Net transfers         | +100 |

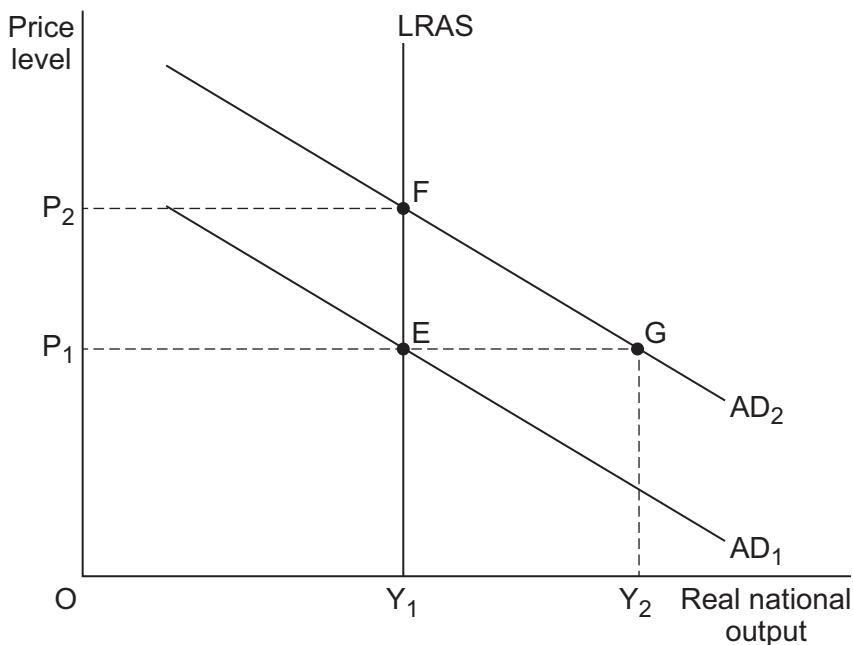
It follows that the balance on current account for 2015 is

- A** + £2150bn
- B** + £200bn
- C** – £200bn
- D** – £50bn

**Turn over ►**

22

The diagram below shows the aggregate demand (AD) and the long-run aggregate supply (LRAS) curves for an economy. The economy is in equilibrium at point E.



The government predicts that aggregate demand will increase in the long run from AD<sub>1</sub> to AD<sub>2</sub>. All other things being equal, which one of the following policies is most likely to move the economy to a new long-run equilibrium at point G rather than point F?

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

23

The growth of an economy is below its trend rate and it is 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.

- 24** The table below shows the growth rates (% change over previous period), of an economy's real GDP per capita between 2011 and 2015.

| 2011 | 2012 | 2013 | 2014 | 2015 |
|------|------|------|------|------|
| 2.9  | -1.6 | -4.6 | -1.0 | 0.1  |

From the data in the table it can be inferred that the

- A average amount produced per person was lower in 2015 than in 2011.
- B the rate of growth of nominal GDP must also have been positive in 2015.
- C rate of inflation declined after 2013.
- D rate of population growth varied between 2011 and 2015.

- 25** A negative output gap necessarily means that the economy

- A is in recession.
- B is suffering from demand-pull inflation.
- C is operating inside its production possibility frontier.
- D has a productive potential below its current level of Gross Domestic Product.

**QUESTION 25 IS THE LAST  
QUESTION IN SECTION A**

**On your answer sheet  
ignore rows 26 to 50**

**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**

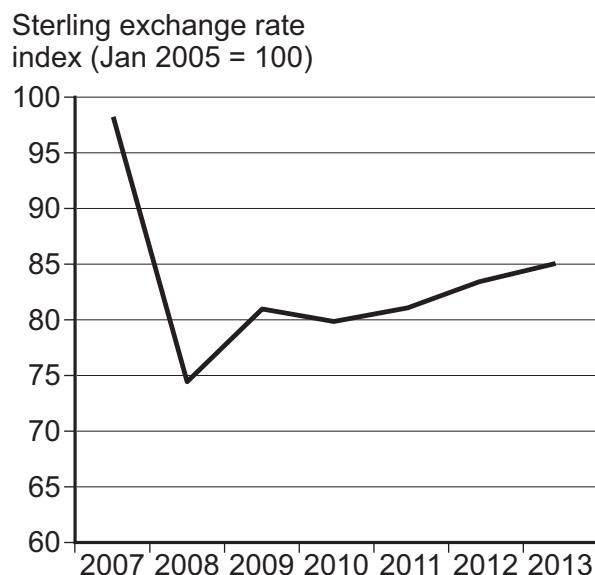
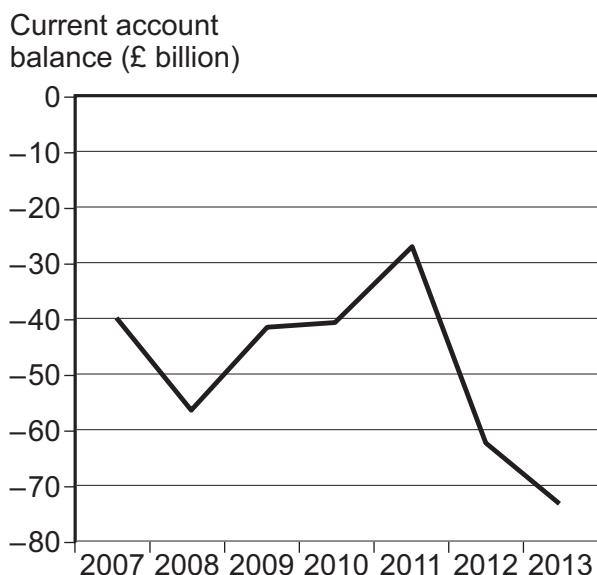
**Either**

**Context 1**

#### **THE UK BALANCE OF PAYMENTS ON CURRENT ACCOUNT**

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

**Extract A: UK current account balance (£bn) and the sterling exchange rate index, 2007 to 2013**



Source: Official statistics, January 2015

Note: The sterling exchange rate index measures the value of the pound against a basket of other currencies.

#### **Extract B: The largest current account deficit on record**

Since the 2008-09 financial crisis, the government has focused on the need to reduce the budget deficit but the UK's growing deficit on the current account of the balance of payments is rarely mentioned. Although the budget deficit as a percentage of GDP has fallen, the UK's current account deficit has increased to record levels. The current account deficit for the third quarter of 2014, increased to £27 billion, or 6% of GDP, up from 5.5% of GDP in the second quarter of 2014. The size of the deficit has prompted some economists to express their concern about its impact on the future performance of the UK economy; they believe the current account deficit is worryingly large. 1  
5

In the third quarter of 2014, the UK imported £31.9 billion more goods than it exported but this was offset by a surplus of £22.9 billion on its trade in services. The service sector is currently running a surplus equal to 5.1% of GDP, the largest surplus since records began in 1955. 10

Until recently, the UK received more income from its investments abroad than it paid to foreigners for their investments in the UK. This surplus has changed into a substantial deficit and is the main reason for the increase in the current account deficit that has taken place in the last few years. 15

In 2008, the value of the pound depreciated by almost 25%. This was expected to reduce the current account deficit and give a significant boost to UK manufacturers. However, there has been little, if any, improvement in the balance of trade in goods and the current account deficit is larger than ever.

Source: News reports, December 2014

### Extract C: Dealing with the deficit

The current account deficit has been well above 5% of GDP for more than a year. The government was hoping that there would be a rebalancing of the economy towards manufacturing but, during the past 10 years, although the volume of manufactured exports rose by 21.7%, the volume of manufactured imports rose by 28.4%. 1

Recently, the UK economy has been growing more strongly but this has been accompanied by increased spending on imports. Low growth in Europe and some other parts of the world has made it hard for UK firms to increase exports. The World Bank has just downgraded its forecast for the growth of the world economy in 2015 from 3.4% to 3.0%. 5

If the UK continues to run a large current account deficit, there is a danger that the value of the pound could fall rapidly. A large fall in the sterling exchange rate could be inflationary and reduce living standards. However, some believe that this is necessary to reduce the deficit and sustain economic growth. Others maintain that, in the long run, the current account deficit will only be reduced if there are supply-side improvements that increase labour productivity and improve the competitiveness of UK manufacturers. 10 15

Source: News reports, December 2014

**0 | 1** Define the term 'budget deficit' (**Extract B**, line 2).

**[5 marks]**

**0 | 2** Using **Extract A**, identify **two** significant points of comparison between the UK balance of payments on current account and the sterling exchange rate index over the period shown.

**[8 marks]**

**0 | 3** **Extract C** (lines 14 to 15) states: 'the current account deficit will only be reduced if there are supply-side improvements that increase labour productivity'.

Explain why an increase in labour productivity is likely to reduce the deficit on the current account of the balance of payments.

**[12 marks]**

**0 | 4** **Extract C** (lines 10 to 11) states: 'there is a danger that the value of the pound could fall rapidly'.

Using the data and your knowledge of economics, assess the consequences for the performance of the UK economy of a substantial reduction in the pound sterling exchange rate.

**[25 marks]**

**Turn over ►**

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

**Total for this Context: 50 marks**

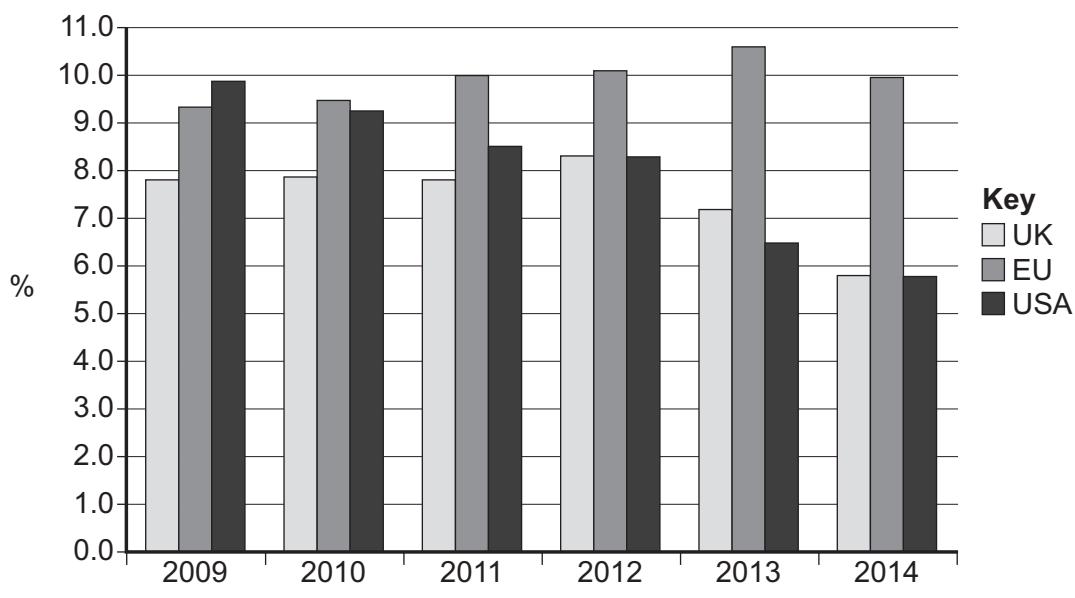
or

### Context 2

#### UNEMPLOYMENT

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

#### Extract D: The rate of unemployment (%) in the UK, EU and USA, 2009 to 2014



Source: Official statistics, January 2015

#### Extract E: Is the UK close to achieving full employment?

During the past year, unemployment in both the USA and the UK has fallen rapidly but in the EU as a whole unemployment remains stubbornly high. The unemployment rate in both Greece and Spain is well over 20%, although in Germany and Austria the unemployment rate is low at around 5%. 1

Job vacancies in the UK have risen to their highest level in 14 years and, at 5.8%, the unemployment rate is the lowest it has been since the middle of 2008. Some economists have warned that the high number of vacancies could signal a mismatch between the type of jobs available and skills of those who are seeking work, with firms struggling to recruit the right workers. Some construction companies have been recruiting bricklayers from Portugal and, in some regions, the NHS is struggling to find qualified nurses and doctors. 5 10

Recent data suggest that further reductions in unemployment may be accompanied by rising wages. After a number of years when pay rises have been below inflation, the past few months have seen real wages start to increase.

During the past 12 months, average earnings have risen by 1.8%, faster than the 0.5% CPI inflation rate. Companies have expressed concerns about skill shortages, indicating that there is less spare capacity in the UK economy than some economic forecasters have suggested. 15

Source: News reports, January 2015

### Extract F: Keeping unemployment down

In March 2009, the Bank of England cut Bank Rate to 0.5%, the lowest rate of interest it has ever set. Bank Rate has remained at this record low level ever since. The Bank has also used a number of other monetary policy measures, such as quantitative easing, to encourage banks and other financial institutions to increase their lending to firms and households. Expansionary monetary policy has undoubtedly contributed to the fall in unemployment and the recovery of the UK economy. 1  
5

Although monetary policy has encouraged spending by the private sector, many believe that cuts in government spending have delayed the recovery in the economy. However, now that unemployment has fallen to levels not seen since 2008, fiscal measures designed to increase incentives and help people to return to work are viewed by some as the only way to reduce unemployment further without an unwelcome rise in inflation. Falling oil and commodity prices have led to a temporary reduction in inflation and should help to boost short-run growth, but these price reductions are unlikely to continue. 10

Persistently slow growth in Europe and a strengthening of the value of the pound against the euro have led some to predict that the fall in unemployment in the UK will soon come to an end. In January 2014, a pound bought €1.20 whereas in January 2015 a pound was worth €1.33. Many UK businesses are already struggling to export to Europe and a stronger pound will not help. 15

Source: News reports, January 2015

**0 5** Define the term 'unemployment rate' (**Extract E**, line 6).

[5 marks]

**0 6** Using **Extract D**, identify **two** significant points of comparison between the rate of unemployment in the UK and the USA over the period 2009 to 2014.

[8 marks]

**0 7** **Extract E** (lines 15 to 17) states: 'Companies have expressed concerns about skill shortages, indicating that there is less spare capacity in the UK economy than some economic forecasters have suggested'.

Explain how a sustained reduction in the amount of spare capacity in the UK is likely to affect inflation.

[12 marks]

**0 8** **Extract F** (lines 14 to 16) states: 'Persistently slow growth in Europe and a strengthening of the value of the pound against the euro have led some to predict that the fall in unemployment in the UK will soon come to an end'.

Using the data and your knowledge of economics, evaluate the relative merits of monetary and fiscal policy measures for a government attempting to achieve a further reduction in unemployment in the UK.

[25 marks]

**END OF QUESTIONS**

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

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