AQA

General Certificate of Education
Advanced Subsidiary Examination
June 2014

Economics

ECON2

Unit 2 The National Economy

Wednesday 21 May 2014 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 12-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.

1 All other things being equal, a large rise in interest rates is most likely to lead to an increase in

A economic growth.

B investment.

C unemployment.

D aggregate supply.

2 The following table shows figures for population and index numbers for inflation (CPI) and money national income (GDP at current prices) in the years 2012 and 2013 in an economy.

Year	Population (millions)	Consumer Prices Index (CPI)	GDP at current prices
2012	20	100	100
2013	21	110	105

In 2013, compared to 2012, which one of the following statements can be inferred from the data?

A Real national income rose

B Money national income rose by 10%

C Population grew at a faster percentage rate than prices

D Real national income per head fell

3 Which one of the following is most likely to be regarded as a supply-side cause of higher economic growth?

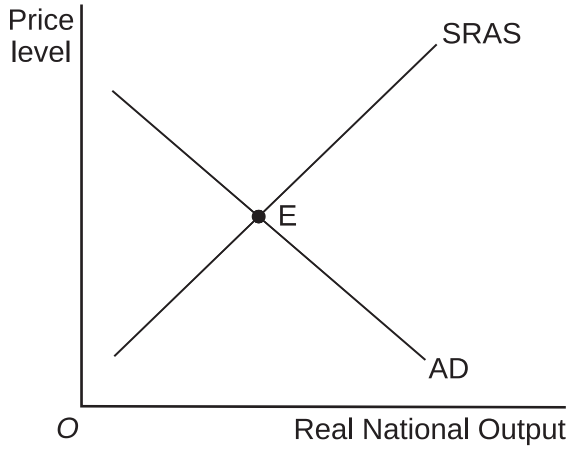
A Cheaper consumer credit

B Higher welfare benefits for the unemployed

C Increased exports of goods and services

D Lower tax rates on income

4 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

5 Foreign companies build new factories in a country to take advantage of cheap labour and cheap land. All other things being equal, the result of this investment for that country's economy would be

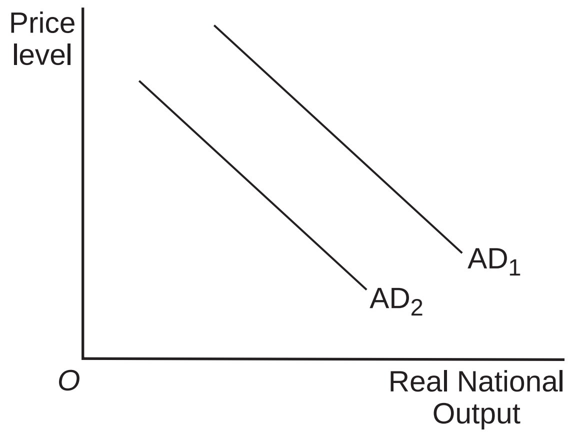
A a movement along both its aggregate demand curve and long-run aggregate supply curve.

B a movement along its aggregate demand curve and a shift in its long-run aggregate supply curve.

C a shift in its aggregate demand curve and a movement along its long-run aggregate supply curve.

D a shift in both its aggregate demand curve and long-run aggregate supply curve.

6 The diagram below shows a shift in aggregate demand (AD) in an economy.



Which one of the following combinations, **A**, **B**, **C** or **D**, is most likely to have caused the shift from AD_1 to AD_2?

	Rate of interest	**Exchange rate**
A	Fall	Fall
B	Fall	Rise
C	Rise	Rise
D	Rise	Fall

7 The table below shows the expenditure components of Gross Domestic Product (GDP) in Year 1 and Year 2 (£ billion).

Year	Government and private consumption expenditure	Government and private investment expenditure	Exports	Imports
1	100	20	30	40
2	110	25	35	50

Between Year 1 and Year 2, aggregate demand increased by

A £10 billion.

B £15 billion.

C £20 billion.

D £30 billion.

8 The relationship between the growth of national income and the resulting increase in investment is known as the

A accelerator.

B output gap.

C economic cycle.

D multiplier.

9 Which one of the following is most likely to be deflationary?

A reduction in

A income tax

B interest rates

C bank lending

D spending on imports

10 All other things being equal, which one of the following combinations, **A**, **B**, **C** or **D**, is most likely to lead to a deterioration in the UK balance of payments on current account?

	UK inflation rate	**Exchange rate of the £**	**UK unemployment**
A	Increase	Decrease	Decrease
B	Decrease	Increase	Increase
C	Increase	Increase	Decrease
D	Decrease	Decrease	Increase

11 Which one of the following is an instrument of monetary policy?

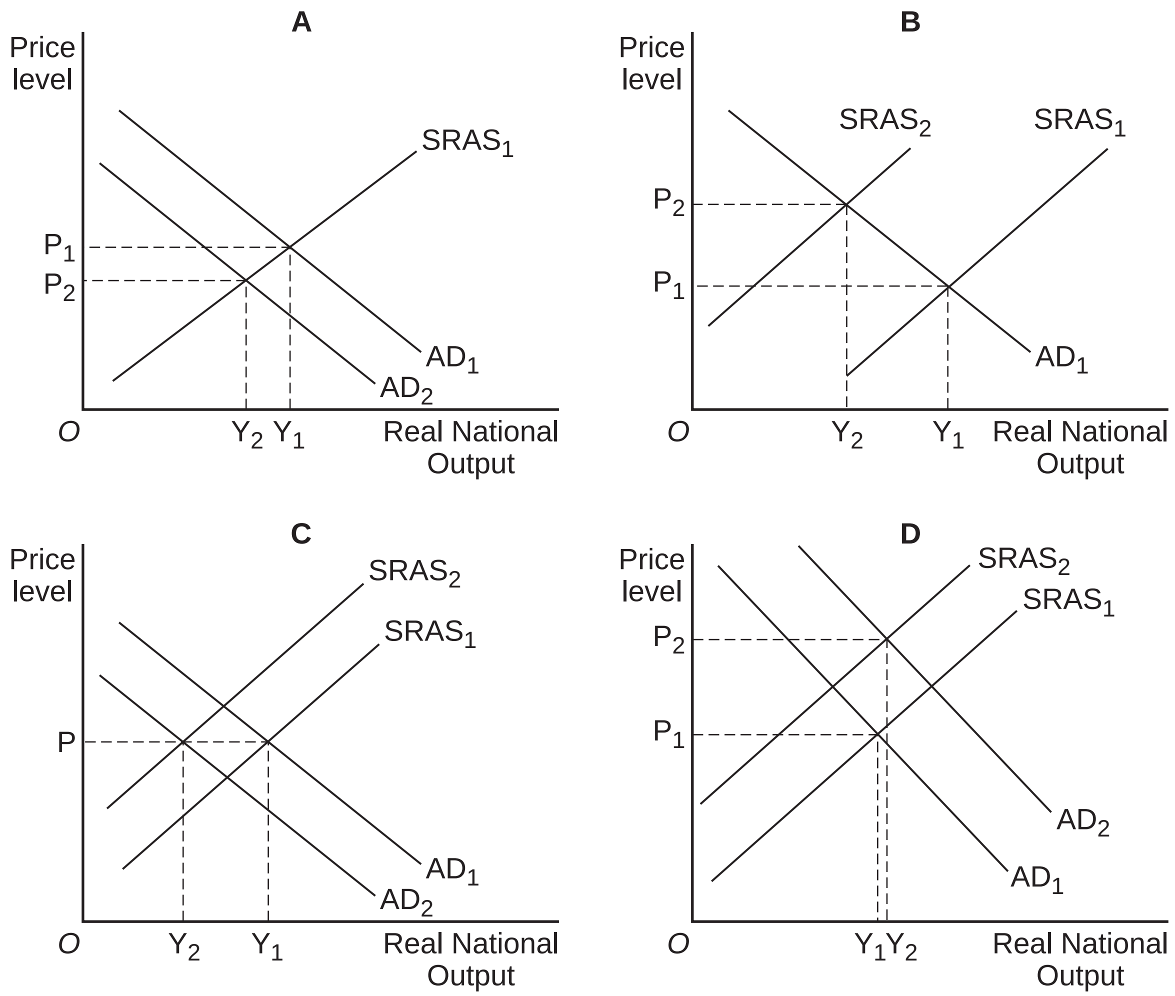
A Taxation

B The exchange rate

C The inflation rate

D Government spending

12 In the diagrams below, AD_1 and $SRAS_1$ represent the initial aggregate demand and short-run aggregate supply curves for an economy. Which one of the following diagrams, **A**, **B**, **C** or **D**, illustrates the most likely effects of a simultaneous increase in oil prices and an increase in savings?



13 An economy is experiencing inflation and a balance of payments deficit on current account. All other things being equal, which policy is most likely to reduce both inflation and the balance of payments deficit?

A A reduction in the exchange rate

B A cut in interest rates

C A decrease in the rate of income tax

D A fall in government spending

14 The table below shows the value of a country's currency against other currencies, in index number form.

Year	**Exchange rate index, 2010 = 100**
2009	97
2010	100
2011	104
2012	107

All other things being equal, the most likely consequence of the changes in the exchange rate index for the period shown in the table is that

A inflationary pressures eased.

B the price of imports increased.

C the balance of payments on current account improved.

D there was growth in employment in manufacturing.

Turn over for the next question

15 '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.

16 A government attempts to reduce the rate of inflation by reducing aggregate demand (AD). All other things being equal, in the short run, which one of the following combinations, **A**, **B**, **C** or **D**, is most likely to result from the reduction in AD?

	Level of unemployment	**Economic growth**	**Balance of payments on current account**
A	Increases	Decreases	Worsens
B	Decreases	Increases	Improves
C	Decreases	Increases	Worsens
D	Increases	Decreases	Improves

17 All other things being equal, which one of the following is most likely to reduce cyclical unemployment in the short run?

A A reduction in the budget deficit

B A reduction in the budget surplus

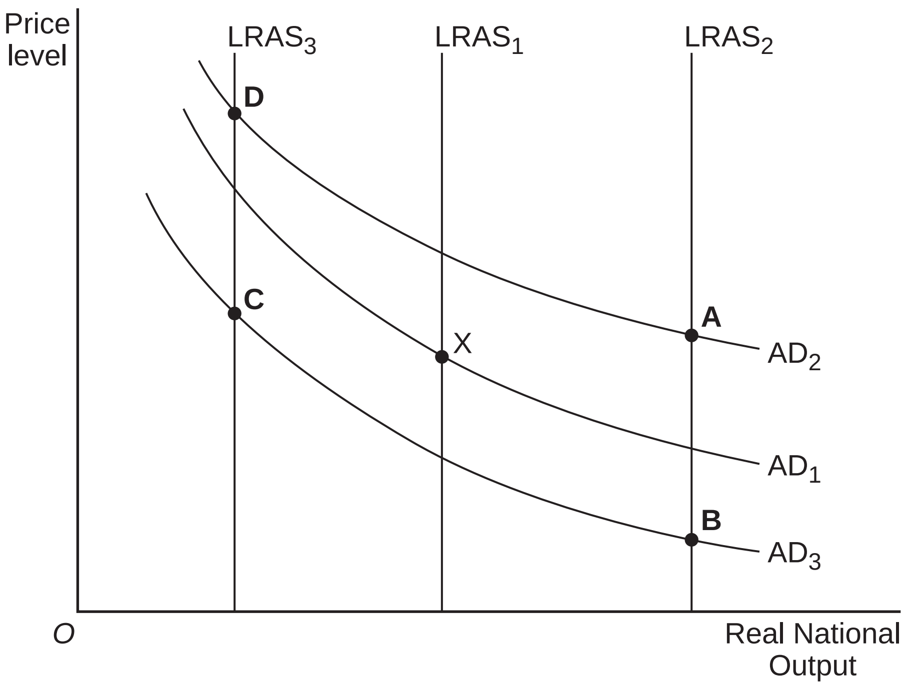
C An increase in the exchange rate

D An increase in interest rates

18 In which one of the following combinations of events, **A**, **B**, **C** or **D**, is the Bank of England most likely to increase interest rates to try to reduce inflation?

	Money wages	Exchange rate	Consumer spending
A	Rising	Rising	Rising
B	Falling	Falling	Falling
C	Rising	Falling	Rising
D	Falling	Rising	Rising

19 The diagram below shows three aggregate demand (AD) and three long-run aggregate supply (LRAS) curves for an economy, with the initial equilibrium at X.



What would be the most likely new long-run equilibrium position, **A**, **B**, **C** or **D**, following government policy to lower the exchange rate and to improve the quality of the labour force through retraining programmes?

Turn over for the next question

20 Which one of the following is most likely to result in a demand-side shock to the UK economy?

A large rise in

A world commodity prices

B UK wage rates

C UK interest rates

D the price of imported manufactured goods

21 The Consumer Prices Index (CPI) is a measure of changes in the

A pattern of consumer expenditure.

B average standard of living.

C effective demand for consumer goods.

D average cost of living.

22 Which one of the following is most likely to reduce the level of investment in a particular economy? A fall in

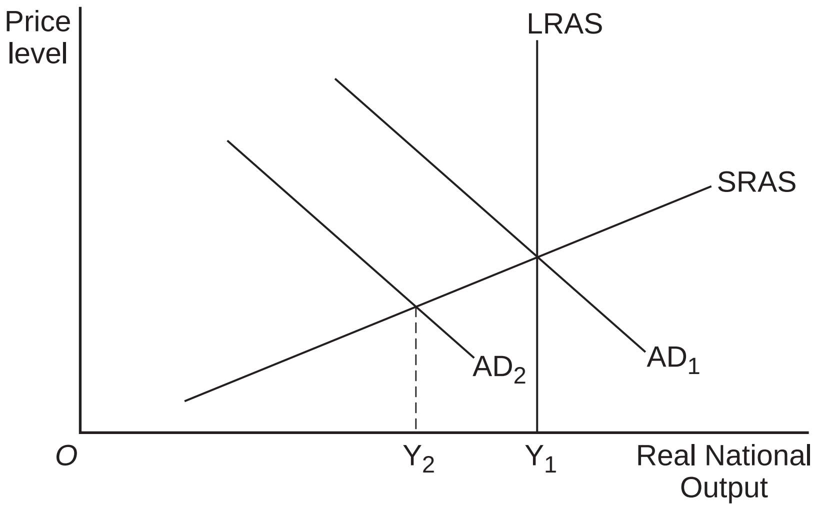
A the value of a country’s currency on the foreign exchange market.

B aggregate demand in the economy.

C the level of unemployment.

D the spare capacity of the economy.

23 In the diagram below, a decline in consumer confidence in an economy is represented by a leftward shift in its aggregate demand curve from AD_1 to AD_2.



In the short run, output falls from Y_1 to Y_2 and unemployment rises. The type of unemployment that results is best described as

A structural unemployment.

B cyclical unemployment.

C seasonal unemployment.

D frictional unemployment.

Turn over for the next question

24 An economy, operating at full capacity, exports and imports final goods and services. It also imports a large proportion of the raw materials and components used for its domestic manufacturing production.

All other things being equal, a depreciation of the exchange rate is likely to

A increase both demand-pull and cost-push inflationary pressures.

B increase demand-pull inflationary pressures but reduce cost-push inflationary pressures.

C reduce demand-pull inflationary pressures but increase cost-push inflationary pressures.

D reduce both demand-pull and cost-push inflationary pressures.

25 Choosing between faster economic growth and a satisfactory balance of payments best illustrates

A a choice between different macroeconomic policy instruments.

B that the short-run aggregate supply curve is vertical.

C a possible conflict between competing policy objectives.

D a government sacrificing future consumption in favour of current consumption.

QUESTION 25 IS THE LAST QUESTION IN SECTION A

On your answer sheet ignore rows 26 to 50

Now turn to page 14 for Section B

Turn over for the next Section

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

INVESTING IN INFRASTRUCTURE

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

Extract A: UK public sector investment and borrowing, 2003 to 2011 (£ billion)

Year	Investment	Borrowing
2003	15.06	34.89
2004	16.98	37.95
2005	23.95	42.59
2006	23.79	32.17
2007	25.98	36.36
2008	38.61	69.00
2009	52.98	156.21
2010	40.12	149.21
2011	28.96	121.04

Source: official statistics, September 2012

Extract B: Business leaders call for measures to boost growth

Britain's economy has suffered a period of unimpressive growth since the depths of the recession in 2008 and 2009. In 2011, the growth in real GDP was just 0.7% and official estimates for the second quarter of 2012 show a contraction in GDP of 0.5%, a third consecutive quarterly decline. The Government blames external shocks, such as the ongoing crisis in the eurozone[1], and the slowdown in growth in America and China for the weak recovery of the UK economy. However, many believe that the UK Government's austerity policy of reducing the budget deficit, by reducing government spending and increasing taxation, has meant that the recovery has been much weaker than necessary.

Many business leaders want to see more measures to stimulate growth. They tend to support the policy of cutting the budget deficit in order to reduce borrowing by the public sector, but they also argue for investment in infrastructure (such as building new roads and rail networks) to reduce costs, increase productive capacity, create jobs and improve Britain's long-term competitiveness.

Source: news reports, September 2012

Note 1 The eurozone consists of those countries that have adopted the euro as their currency.

Extract C: Is investment in infrastructure the solution to low growth?

The weak recovery of the UK economy has led to renewed demands for a boost to investment in the infrastructure of the UK economy. The Coalition Government has responded by relaxing planning rules and by providing construction companies with a guaranteed return on their investment to try to encourage the private sector to finance large scale projects. The Government says that it hopes to encourage infrastructure investment in, for example, transport, energy supplies, housing, and faster broadband and mobile phone networks. However, it is reluctant to finance such investment in the infrastructure by increasing government spending. More government spending on infrastructure projects could mean cuts elsewhere, tax increases or more borrowing.

Investing in infrastructure can be expected to result in a multiplier process and is important for growth. It can increase real GDP by reducing unproductive journey times, improving labour mobility, providing better access to overseas markets, attracting foreign firms to set up in the UK and by increasing aggregate demand during the construction phase of the projects. However, any increase in spending might, in the short run, also lead to higher inflation and an increase in the balance of payments deficit.

Source: news reports, September 2012

0 1 Define the term ‘multiplier process’ (**Extract C,** line 10).

[5 marks]

0 2 Using **Extract A**, identify **two** significant points of comparison between public sector investment **and** borrowing over the period shown.

[8 marks]

0 3 **Extract B** (lines 4 to 6) states: ‘The Government blames external shocks, such as the ongoing crisis in the eurozone, and the slowdown in growth in America and China for the weak recovery of the UK economy.’

With the help of an appropriate diagram, explain why low growth in the rest of the world is likely to affect the recovery of the UK economy.

[12 marks]

0 4 **Extract C** (lines 1 and 2) states: ‘The weak recovery of the UK economy has led to renewed demands for a boost to investment in the infrastructure of the UK economy.’

Using the data and your economic knowledge, assess the likely consequences of increased spending on infrastructure for the performance of the UK economy.

[25 marks]

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

Total for this Context: 50 marks

OR

Context 2

PRODUCTIVITY IN THE UK

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

Extract D: Productivity (real GDP per worker)[1], index numbers, 2007 = 100

Year	UK	US
2003	93	95
2004	94	97
2005	95	98
2006	97	99
2007	100	100
2008	98	100
2009	96	101
2010	97	104
2011	97	105

Source: official statistics, September 2012

Note 1 The table shows the changes in labour productivity for each country between 2003 and 2011.

Extract E: The productivity puzzle

Data published this week indicate that, in 2011, British workers were 20% less productive than the average for the G7 countries[2] and almost 40% less productive than the average worker in the US. This is the biggest gap since such statistics were first published in 1990.

In the US, between 2007 and 2011, real Gross Domestic Product (GDP) rose by 1% but the number of people in work fell by 4%. By contrast, over the same period of time, real GDP in the UK fell by 2.4% while employment rose by 0.3%. The UK economy has been creating jobs despite the slowest economic recovery in living memory. Many people would argue that it is better to have more people working less productively than having rising productivity and rising unemployment.

However, in the long run, productivity growth is the key to prosperity. Rising living standards, generated by economic growth, are most likely to be achieved if the amount produced per worker rises. Productivity growth reduces costs and allows us to compete more effectively with other countries. Rising exports, required to reduce the UK's large deficit on the current account of the balance of payments, depend upon us achieving an increase in productivity, particularly in the manufacturing sector.

Source: news reports, September 2012

Note 2 The G7 countries are: Canada, France, Germany, Italy, Japan, the UK and the US.

Extract F: Low productivity growth means more jobs but higher inflation

The output of the UK economy is still 3% below what it was in 2007 and output is 15% smaller than it would have been if the UK economy had grown at its previous post-war trend rate. The failure of the UK economy to grow over this period has meant that many UK residents have seen their standard of living fall. Furthermore, low productivity growth is one reason why inflation has remained above the Government's 2% target.

One explanation for the fall in labour productivity is that, because it is costly to train and to hire and fire staff, firms may have retained workers in the expectation that demand will pick up. Therefore, government action to stimulate aggregate demand, leading to an increase in output, should also be accompanied by a rise in labour productivity.

Investment in both physical and human capital affects productivity. Both the shortage of credit and the high cost of borrowing have reduced investment and the capital stock. As well as making it easier and cheaper for firms to borrow, appropriate supply-side policies may be required to give a boost to productivity.

The US, unlike the UK, has not experienced a fall in labour productivity during the past five years. The fall in labour productivity has helped employment in the UK in the short run but the long-run consequences of low productivity growth are likely to be less favourable.

Source: news reports, September 2012

0 5 Define the term 'capital stock' (**Extract F,** line 11).

[5 marks]

0 6 Using **Extract D**, identify **two** significant points of comparison between the change in real GDP per worker in the UK **and** the change in real GDP per worker in the US over the period shown.

[8 marks]

0 7 **Extract F** (lines 14 and 15) states: 'The US, unlike the UK, has not experienced a fall in labour productivity during the past five years'.

Explain **two** policies that the government could adopt to try to increase labour productivity in the UK.

[12 marks]

0 8 **Extract E** (line 10) states that 'in the long run, productivity growth is the key to prosperity'.

Using the data and your economic knowledge, assess the likely impact of a sustained period of low productivity growth on the performance of the UK economy.

[25 marks]

END OF QUESTIONS

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