



General Certificate of Education
Advanced Subsidiary Examination
June 2015

Economics

ECON2

Unit 2 The National Economy

Tuesday 19 May 2015 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, which one of the following is most likely to increase an economy's underlying trend rate of growth?

A rise in the rate of growth of

- A inflation
- B household income
- C imports of consumer goods
- D labour productivity

- 2 The table below shows an economy's rate of inflation in each of four years.

	Year 1	Year 2	Year 3	Year 4
Inflation rate (%)	4.2	3.6	2.4	1.6

It can be concluded from the data above that, over the 4-year period,

- A the average price level has risen.
- B the purchasing power of money has increased.
- C assuming constant money incomes, real income has risen.
- D prices of goods and services have fallen.

- 3 A government aiming to increase aggregate demand through the use of monetary policy might increase the
- A rate of interest.
 - B exchange rate.
 - C amount of money in circulation.
 - D level of government expenditure.
- 4 Which one of the following is most likely to lead to an increase in spending on imports?
- A A fall in the exchange rate
 - B A rise in unemployment
 - C A rise in the rate of Value Added Tax (VAT)
 - D A cut in income tax rates
- 5 An economy is currently operating at its full employment 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?

	Employment will	The economy will grow
A	fall	below its trend rate
B	fall	above its trend rate
C	rise	above its trend rate
D	rise	below its trend rate

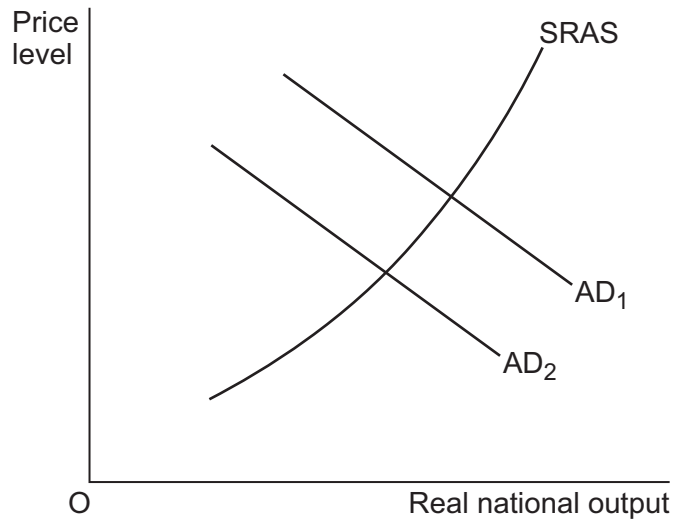
Turn over for the next question

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- 6 A country is experiencing a balance of payments surplus but growing inflationary pressures. Which one of the following measures is most likely to reduce both a balance of payments surplus on the current account and the inflation rate?
- A A cut in interest rates
 - B An appreciation of the exchange rate
 - C A rise in the budget deficit
 - D A decrease in government expenditure
- 7 Which one of the following, **A**, **B**, **C** or **D**, best illustrates the difference between saving and investment?

	Saving	Investment
A	Money deposited in a bank	Money borrowed from a bank
B	Income which is not spent	Spending by firms on capital goods
C	Money deposited in any financial institution	Spending by firms and individuals on stocks and shares
D	A leakage from the circular flow of income	Spending by households and firms on any financial asset

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



The shift in the aggregate demand curve from AD₁ to AD₂ could have been caused by a decrease in

- A imports.
 - B labour productivity.
 - C household savings.
 - D the government budget deficit.
- 9 All other things being equal, a large increase in interest rates in the UK is most likely to
- A decrease the size of the government budget deficit.
 - B increase aggregate investment.
 - C lead to an increase in bank lending.
 - D decrease house prices.

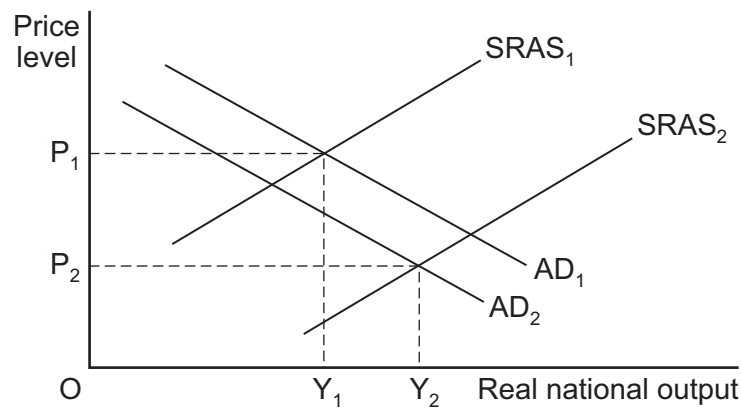
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10 Which one of the following is an example of a contractionary fiscal policy designed to reduce inflationary pressures?

- A An increase in the government budget surplus
- B A reduction in the supply of money available to banks for lending purposes
- C Higher interest rates
- D A reduction in the exchange rate

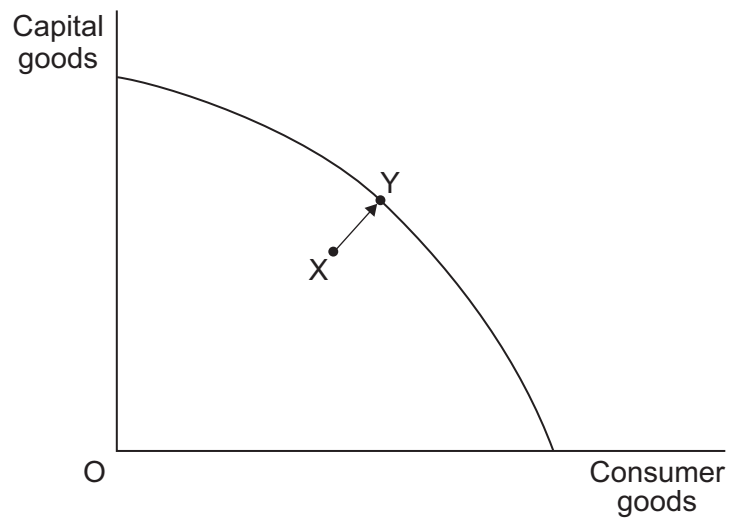
11 The diagram below shows the aggregate demand (AD) and short-run aggregate supply (SRAS) curves for an economy. OP_1 is the initial equilibrium price level and OY_1 is the initial equilibrium level of real national output.



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

A	The level of investment rises	Average productivity rises
B	The level of exports decreases	Business taxes increase
C	The level of consumption falls	The cost of oil and other imported raw materials increases
D	Government spending on welfare benefits falls	Money wage rates in the economy fall

- 12 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 from the economy at any time.
 - C trade in goods and services, investment income and transfers.
 - D all transactions involving money leaving or entering the country.
- 13 The diagram below shows the production possibility frontier for an economy, where the economy is initially at point X.



Assuming that there is no change in the production possibility frontier, a movement from point X to point Y illustrates that there has been

- A long-run economic growth.
- B an increase in spare capacity.
- C a rise in real national income.
- D an improvement in technology.

Turn over for the next question

Turn over ►

- 14** The table below shows an economy's volume of goods and services imported and exported between 2012 and 2014, expressed as index numbers (2012 = 100).

	2012	2013	2014
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

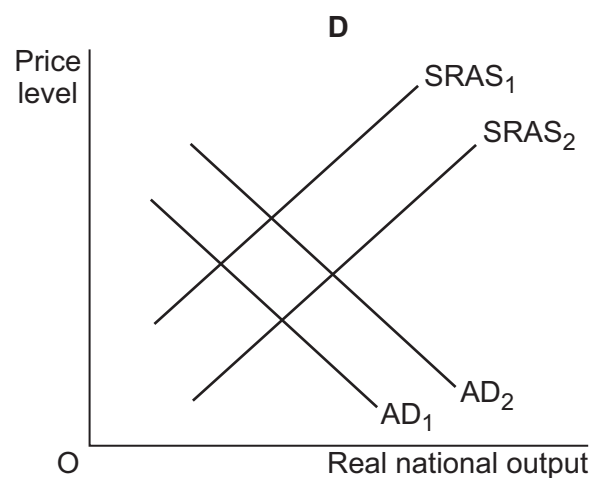
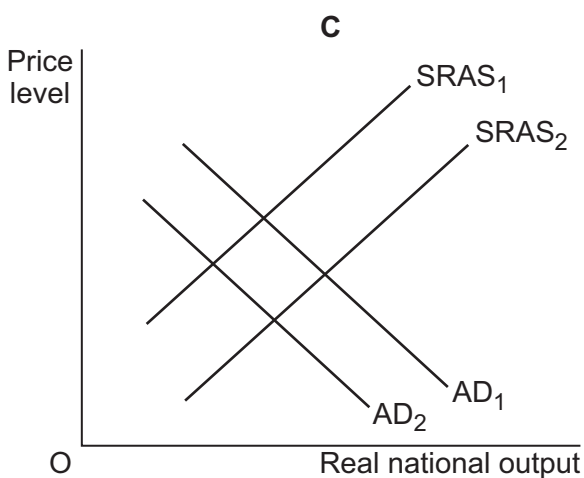
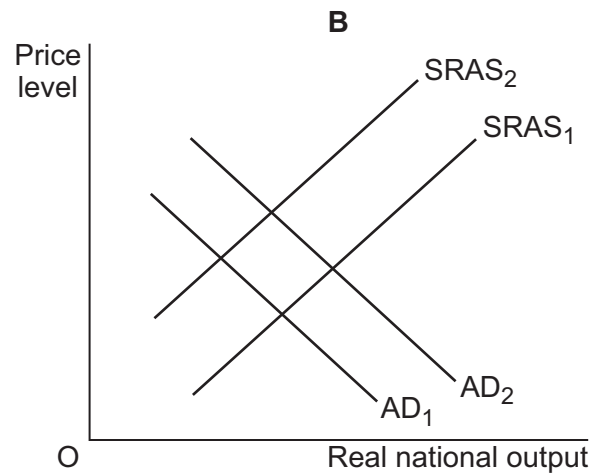
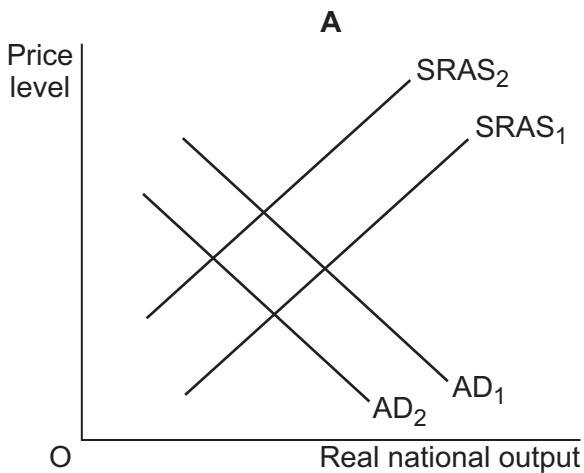
From the data, it can only be concluded that

- A** in 2014, the value of the deficit in the balance of trade in goods and services was £50bn.
- B** apart from in 2012, there was a surplus in the balance of trade in services.
- C** the total value of imports increased over the period while the total value of exports fell.
- D** the total volume of exports fell relative to the total volume of imports over the period.
- 15** Starting from an initial position of equilibrium on a vertical long-run aggregate supply curve, a reduction in the level of aggregate demand will lead to a new long-run equilibrium position with a lower
- A** employment level.
- B** level of real income.
- C** price level.
- D** level of output.
- 16** All other things being equal, a cut in the size of a government's budget surplus is most likely in the short run to both
- A** reduce unemployment and increase economic growth.
- B** reduce unemployment and reduce inflation.
- C** reduce inflation and reduce the balance of payments deficit on current account.
- D** reduce the balance of payments deficit on current account and reduce unemployment.

17 The annual rate of inflation in an economy falls from 5 per cent to 2 per cent but the annual rate of inflation of its main trading partners remains at 5 per cent. As a result, all other things being equal, it is likely that in the long term for this economy

- A exports will increase.
- B imports will increase.
- C the current account balance will deteriorate.
- D withdrawals from the circular flow of income will increase.

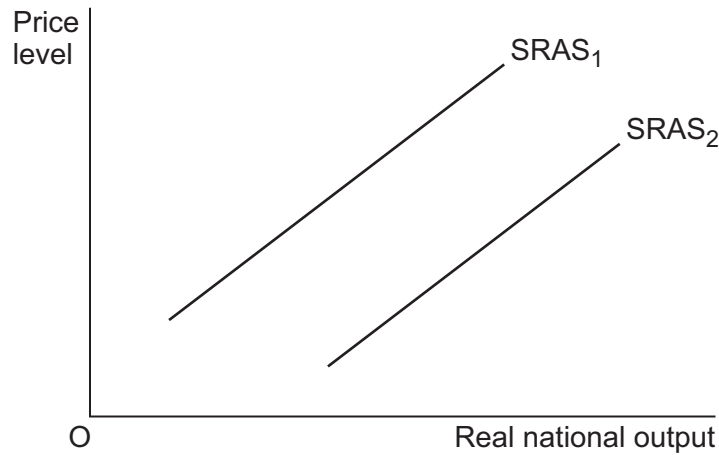
18 A country imports many of its raw materials and exports a large proportion of its finished goods. The diagrams below show the initial aggregate demand (AD_1) and the short-run aggregate supply ($SRAS_1$) curves together with possible shifts of these curves. All other things being equal, which diagram, **A**, **B**, **C** or **D**, best illustrates the likely impact of a rise in the country's exchange rate?



Turn over ►

- 19** All other things being equal, a significant cut in the rate of tax on a company's profits is most likely to
- A** increase both aggregate demand and long-run aggregate supply.
 - B** increase aggregate demand but not long-run aggregate supply.
 - C** increase long-run aggregate supply but not aggregate demand.
 - D** increase neither aggregate demand nor long-run aggregate supply.
- 20** The economy is producing at full capacity when it
- A** grows more slowly than its long-run trend rate of growth.
 - B** has neither a positive nor a negative output gap.
 - C** is also in equilibrium on its balance of trade.
 - D** grows more rapidly than its long-run trend rate of growth.
- 21** A government wants to lower the rate of inflation in the economy but, in the short run, this is likely to conflict with some of its other policy objectives.
- Which one of the following is most likely to deteriorate as a result of contractionary fiscal policy being used?
- A** The current account position
 - B** Unemployment
 - C** Export volumes
 - D** International competitiveness

- 22 The diagram below shows two short-run aggregate supply (SRAS) curves for an economy.



All other things remaining equal, the shift in the short-run aggregate supply curve from SRAS₁ to SRAS₂ could have been caused by a decrease in

- A the savings ratio.
 - B energy prices.
 - C labour productivity.
 - D imports of consumer goods.
- 23 The table below shows different combinations of the foreign currency price of UK exports and the level of UK aggregate demand. All other things being equal, which combination, **A**, **B**, **C** or **D**, is the most likely consequence of a fall in the pound sterling exchange rate?

	The foreign currency price of UK exports	UK aggregate demand
A	Rises	Rises
B	Falls	Rises
C	Rises	Falls
D	Falls	Falls

Turn over for the next question

Turn over ►

- 24** 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 welfare benefits
- 25** 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.

**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 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

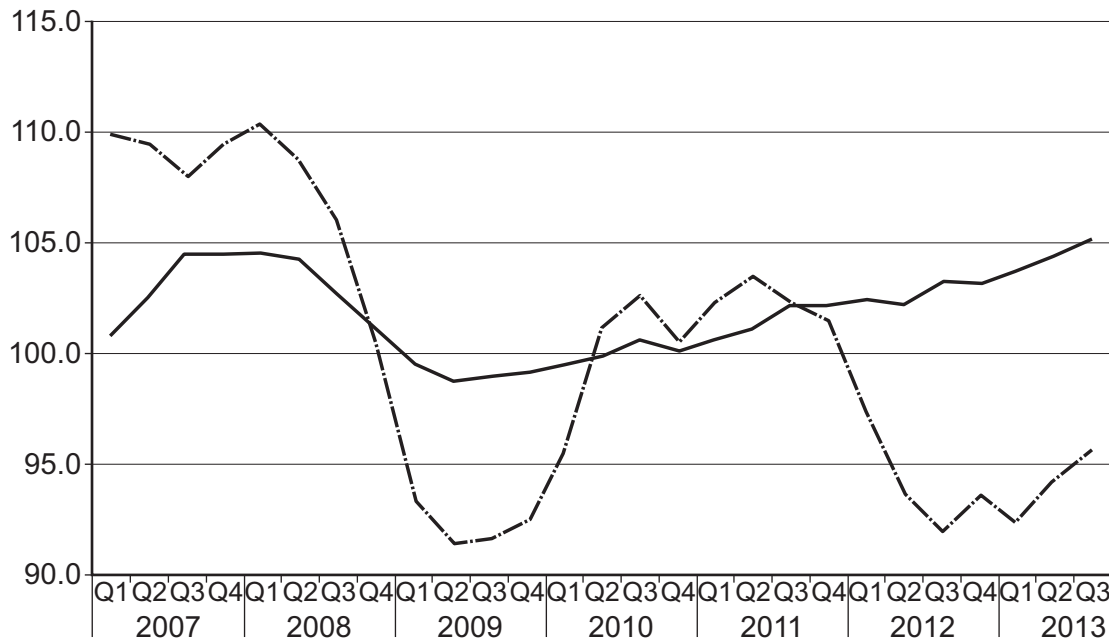
Either

Context 1

THE CONSTRUCTION SECTOR OF THE UK ECONOMY

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

Extract A: Indices of two components of real GDP, 2007 Q1 to 2013 Q3



Key

- Index of services
- - - Index of construction

Source: Official statistics, January 2014

Extract B: Construction matters

<p>Construction affects the lives of everyone in society from the homes we live in, the roads and railways we travel on, to the buildings we work in. The sector employs about 10% of the UK labour force, and many construction employees are low-skilled labourers with relatively limited employment opportunities. In 2013 Quarter 2, the direct contribution of the construction sector to the UK economy amounted to around 6.3% of GDP. But that is not all; for example, when people move house, they also spend money on carpets, curtains and furniture, stimulating other sectors of the economy.</p>	<p>1</p>
<p>An important consequence of the financial crisis of 2007–08 was the decline in demand for the services of the construction industry. This fall in demand was magnified by the</p>	<p>5</p>

operation of the multiplier and led to rising cyclical unemployment and structural unemployment. Spending on construction is one of the best ways of boosting the economy since it has one of the lowest levels of imports of any sector. The stimulus generated by spending on construction stays within the UK economy and helps to create jobs in both manufacturing and service industries. The output of the construction industry does not only create jobs, it also increases investment, providing long-term economic and social benefits. 10

Growth in the UK's construction sector has picked up during 2013; recent surveys have indicated that output, orders and employment in the construction industry have grown for eight months in a row. House building remains the fastest area of growth but commercial building and infrastructure projects are also growing. Tim Moore, a senior economist, said: 'The improving UK economic outlook is helping to boost private sector spending, meaning that the construction recovery has started to broaden out from housing demand and infrastructure projects to include strong growth in commercial building work, such as new offices and shops.' 15

Source: News reports, February 2014

Extract C: Ballooning house prices

According to the Nationwide Building Society, house prices rose by an average of 8.4% in 2013. However, this headline figure masked large regional variations. The value of homes in Manchester soared by 21% but in a few areas, such as Herefordshire and the Isle of Wight, property prices fell. The number of mortgages approved by banks in November was the highest since the beginning of 2008. These figures prompted some people to warn that there was a serious risk that an unsustainable rise in house prices was starting to develop. Increasing confidence and the state-backed Help to Buy and Funding for Lending schemes have been credited with boosting the demand for houses and causing prices to rise. If house prices continue to rise at current rates, the Monetary Policy Committee of the Bank of England will have to consider increasing interest rates. 1

Source: News reports, February 2014

0 1 Define the term 'cyclical unemployment' (**Extract B** line 10). **[5 marks]**

0 2 Using **Extract A**, identify **two** significant points of comparison between the changes in the output of the construction and service sectors of the economy over the period shown. **[8 marks]**

0 3 **Extract C** (lines 9 to 10) states that: 'If house prices continue to rise at current rates, the Monetary Policy Committee of the Bank of England will have to consider increasing interest rates.'

Explain the likely consequences of an increase in interest rates on the output of the construction sector of the UK economy.

[12 marks]

0 4 **Extract B** (lines 16 to 18) states that: 'recent surveys have indicated that output, orders and employment in the construction industry have grown for eight months in a row.'

Using the data and your knowledge of economics, assess the significance of the growth of the construction sector for the UK economy.

[25 marks]

Turn over ►

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

Total for this Context: 50 marks

or

Context 2

CONFLICTING OBJECTIVES

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

Extract D: UK macroeconomic policy objectives, 2006 to 2013

Year	Unemployment rate (%) (Labour Force Survey)	Economic growth (% change in real GDP)	Inflation rate (%) (CPI)	Current account of the balance of payments (% of GDP)
2006	5.5	2.7	2.3	-2.8
2007	5.2	3.5	2.3	-2.2
2008	6.4	-0.6	3.6	-0.9
2009	7.8	-5.4	2.2	-1.4
2010	7.8	1.6	3.3	-2.7
2011	8.4	1.2	4.5	-1.5
2012	7.8	0.3	2.8	-3.8
2013	7.1	1.7	2.6	-4.4

Source: official statistics, March 2014

Extract E: Is the UK economy about to take off?

<p>Improbable as it seemed a year ago, the British economy is now showing signs that a sustainable recovery is under way. The IMF has predicted growth of 2.4% in 2014.</p>	1
<p>Among the large advanced economies, only the USA is expected to do better. Firms are taking on staff and the recovery appears to be robust. Employment set a new record in November 2013, reaching 30.1 million, and unemployment has fallen from 7.8% to 7.1% of the labour force during the past six months. However, the IMF noted that there is still spare capacity in the UK economy and that a positive output gap is unlikely to emerge any time soon.</p>	5
<p>Stripping away the temporary ups and downs, the increase in the size of the labour force and the growth in labour productivity should allow the UK economy to grow by about 2% a year. However, in recent years, labour productivity in the UK has been stagnant but, as consumption continues to grow and confidence returns, investment should follow, boosting productivity and generating a period of sustained growth.</p>	10
<p>Despite the optimism, not everyone is confident that growth will be maintained. One commentator wrote that: 'The underlying problem is that this recovery, like so many during my lifetime, is being built on consumption financed by borrowing, which sucks in endless imports, rather than on investment, which in turn brings productivity gains, competitively-priced output and, ultimately, sustainable growth.'</p>	15
<p>As yet, it is too early to say whether or not the UK economy is on the way to making a full recovery from recession.</p>	20

Source: News reports, January 2014

Extract F: Growing pains

Whilst a return to growth is to be welcomed, it is not all good news. Over five years after the credit crunch hit the world economy, output in the UK was still 1.3% below its 2008 peak. Despite a 20% decline in the value of the pound sterling since 2007, the UK's balance of payments deficit on current account has widened and, over the past few years, has also increased as a percentage of national income. The Coalition Government's stated intention of rebalancing the UK economy through investment and export-led growth seems a long way off. 1 5

Unless productivity improves, the continued growth in demand and output will generate inflationary pressures sooner rather than later. Surveys suggest that inflationary expectations are uncomfortably high and that as the labour market tightens, wages are likely to start increasing again. This contrasts with the situation in some other countries in Europe, such as Greece and Portugal, whose economies have shrunk and where there has been a period of price deflation. 10

Source: News reports, January 2014

0 5 Define the term 'price deflation' (**Extract F** line 13). **[5 marks]**

0 6 Using **Extract D**, identify **two** significant points of comparison between economic growth and inflation in the UK over the period 2006 to 2013. **[8 marks]**

0 7 **Extract E** (lines 11 to 13) states that: 'as consumption continues to grow and confidence returns, investment should follow, boosting productivity and generating a period of sustained growth.'

Explain why a rise in investment should help to increase the rate of growth of the UK economy. **[12 marks]**

0 8 **Extract F** (line 1) states that: 'Whilst a return to growth is to be welcomed, it is not all good news.'

Using the data and your knowledge of economics, assess the extent to which it is likely that the UK economy will be able to continue to grow without experiencing conflicts with the other main objectives of macroeconomic policy. **[25 marks]**

END OF QUESTIONS

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