PEARSON EDEXCEL A-LEVEL ECONOMICS B · 9EB0

ECONOMICS



EXAM QUESTION PACK

2.5 THE ECONOMIC CYCLE

NATIONAL INCOME

SCORE	PERCENTAGE
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Questions

Q1.

In 2014 the Bank of England estimated the marginal propensity to consume of UK consumers to be 0.5.

In 2014 the Chancellor of the Exchequer announced a £15 billion investment programme into UK road infrastructure.

(Sources: http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q405.pdf and https://www.gov.uk/government/news/autumn-statement-2014-16-things-you-should-know)

(a) Using the information above, calculate the total increase in national income, resulting from the £15 billion investment.

(3)

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(b) Which **one** of the following is most likely to cause a rightward shift in the aggregate supply curve?

(1)

☒ **A** A decrease in real output

☒ **B** A rise in price level

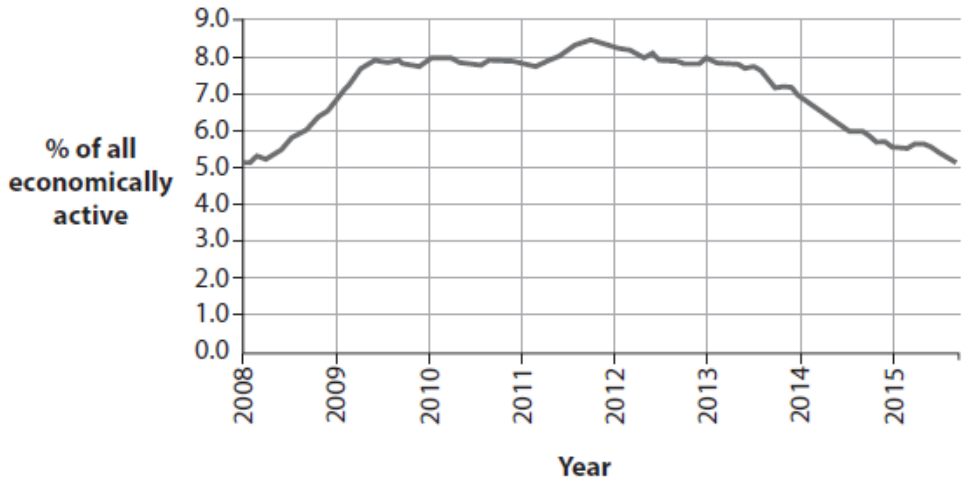
☒ **C** A fall in price level

☒ **D** An increase in productivity

(Total for question = 4 marks)

Q2.

The chart below shows the UK unemployment rate, seasonally adjusted, from 2008 to 2015



(Source: http://www.ons.gov.uk/ons/rel/lms/labour-market-statistics/december-2015/statistical-bulletin.html#tab-8--Unemployment)

(a) Which **one** of the following types of unemployment best explains the change in the data between 2008 and 2010?

(1)

☒ **A** Cyclical

☒ **B** Frictional

☒ **C** Seasonal

☒ **D** Voluntary

(b) Explain the likely effects on the circular flow of income of the change in unemployment between 2013 and 2015.

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(Total for question = 5 marks)

Q3.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

Answer the question with a cross in the box you think is correct ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

After the Global Financial Crisis of 2008, the US President introduced expansionary fiscal policies of $800 billion. The International Monetary Fund estimated that the multiplier at the time was approximately 1.5.

(Source adapted from: https://www.economist.com/the-economist-explains/2016/09/07/what-is-the-keynesian-multiplier)

(a) Which **one** of the following is a withdrawal from the circular flow of income?

(1)

☒ **A** Exports

☒ **B** Government spending

☒ **C** Investment

☒ **D** Taxation

(b) Calculate the total final increase in US aggregate demand as a result of the President's 'expansionary fiscal policies', assuming no other changes.

(2)

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(c) Explain the impact of annual fiscal deficits on the US national debt.

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(Total for question = 5 marks)

Q4.

(a) With reference to Extract C, explain what can be inferred about the price elasticity of demand for coffee beans.

(5)

(b) With reference to Figure 4, examine the likely impact of the 19% increase in the price of coffee beans between January and February 2014, on the price of a cup of coffee bought from a coffee shop.

(8)

(c) Discuss the different degrees of contestability in the farming of coffee beans **and** in the UK coffee shop market.

(12)

EITHER

(d) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic effects of fluctuating coffee bean prices on coffee-producing countries.

(25)

OR

(e) With reference to the information provided and your own knowledge, evaluate the likely microeconomic and macroeconomic effects of the depreciation of the *real* on Brazil's economy.

(25)

(Total for question = 50 marks)

Q5.

(a) Explain the difference between 'good' deflation (Extract B, line 16) and 'bad' deflation (Extract B, line 27).

(5)

(b) With reference to Figure 1 and Extract A, examine the likely reasons for the fall in oil prices since the middle of 2014.

(8)

(c) With reference to Extract A, discuss the factors necessary for the success of a cartel.

(12)

EITHER

(d) With reference to the information provided and your own knowledge, evaluate the microeconomic and macroeconomic effects of a sustained period of deflation.

(25)

OR

(e) With reference to the information provided and your own knowledge, evaluate the microeconomic and macroeconomic effects of a sustained fall in global oil prices.

(25)

(Total for question = 50 marks)

Q6.

(a) With reference to Figure 1, calculate the annual CPI inflation rate for China in October 2014.

(5)

(b) With reference to Figure 2 and Extract A, examine **two** factors that may have caused disinflation in China in 2014.

(8)

(c) Assess the likely effects of investment in China on Chinese real GDP since 2009.

(10)

(d) **Apart from its effects on investment**, discuss the likely benefits to the Chinese economy of the Government devaluing the currency.

(12)

(e) Discuss the likely economic effects of 'the European Commission applying high tariffs on Chinese mobile equipment entering the EU' (Extract C, lines 5-6).

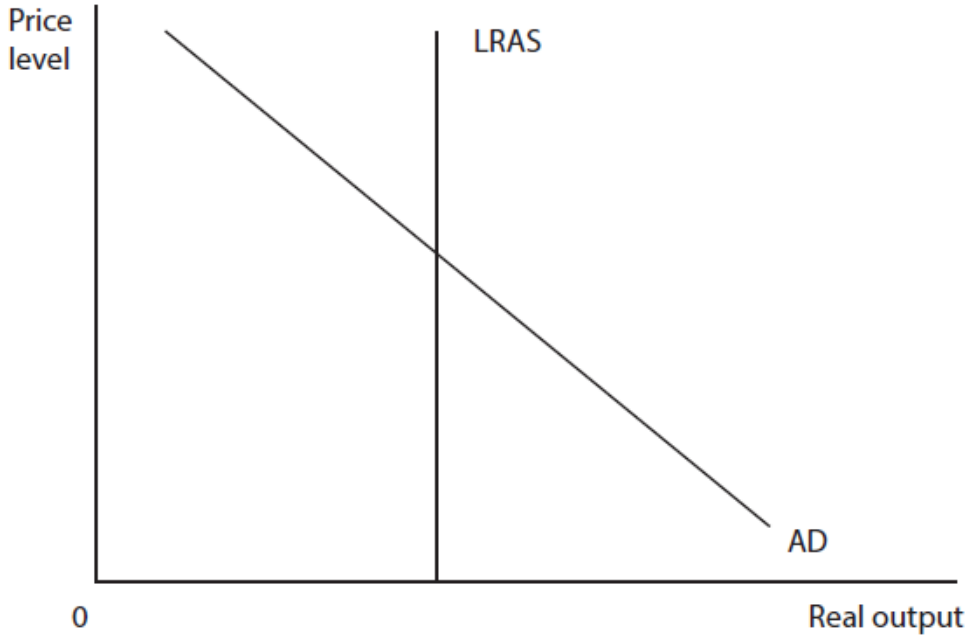
(15)

(Total for question = 50 marks)

Q7.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

The diagram below shows the aggregate demand (AD) and a possible long-run aggregate supply (LRAS) for the UK.



(a) Define the term 'price level'.

(1)

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(b) Annotate the diagram above to show the likely impact of government policy to promote business competition on the equilibrium level of real output and price level.

(2)

(c) Which **one** of the following is an interventionist supply-side policy?

(1)

☒ **A** An improvement in infrastructure

☒ **B** An increase in indirect taxation

☒ **C** An increase in interest rates

☒ **D** An increase in the regulation of markets

(Total for question = 4 marks)

Q8.

(a) With reference to Figure 1, explain **one** possible cause of the forecast change in total energy use.

(5)

(b) With reference to Figure 4, examine the likely impact on the USA's circular flow of income of the trends in exports and imports of natural gas between 2000 and 2020.

(8)

(c) With reference to the information provided, discuss the likely impact of a change in the price of gas on the markets for solar energy and nuclear energy.

(12)

EITHER

(d) With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects on the UK economy of a decision by the government to encourage fracking.

(25)

OR

(e) With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects on the global economy of lower energy prices.

(25)

(Total for question = 50 marks)

Q9.

Some questions must be answered with a cross in a box (☒). If you change your mind about an answer, put a line through the box (☒) and then mark your new answer with a cross (☒).

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

The UK exchange rate changed from £1 = $1.53 in January 2015 to £1 = $1.22 in October 2019.

(a) Define the term 'exchange rate'.

(1)

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(b) Which **one** of the following represents the percentage change in the £ sterling and US$ exchange rate?

(1)

☒ **A** 0.31%

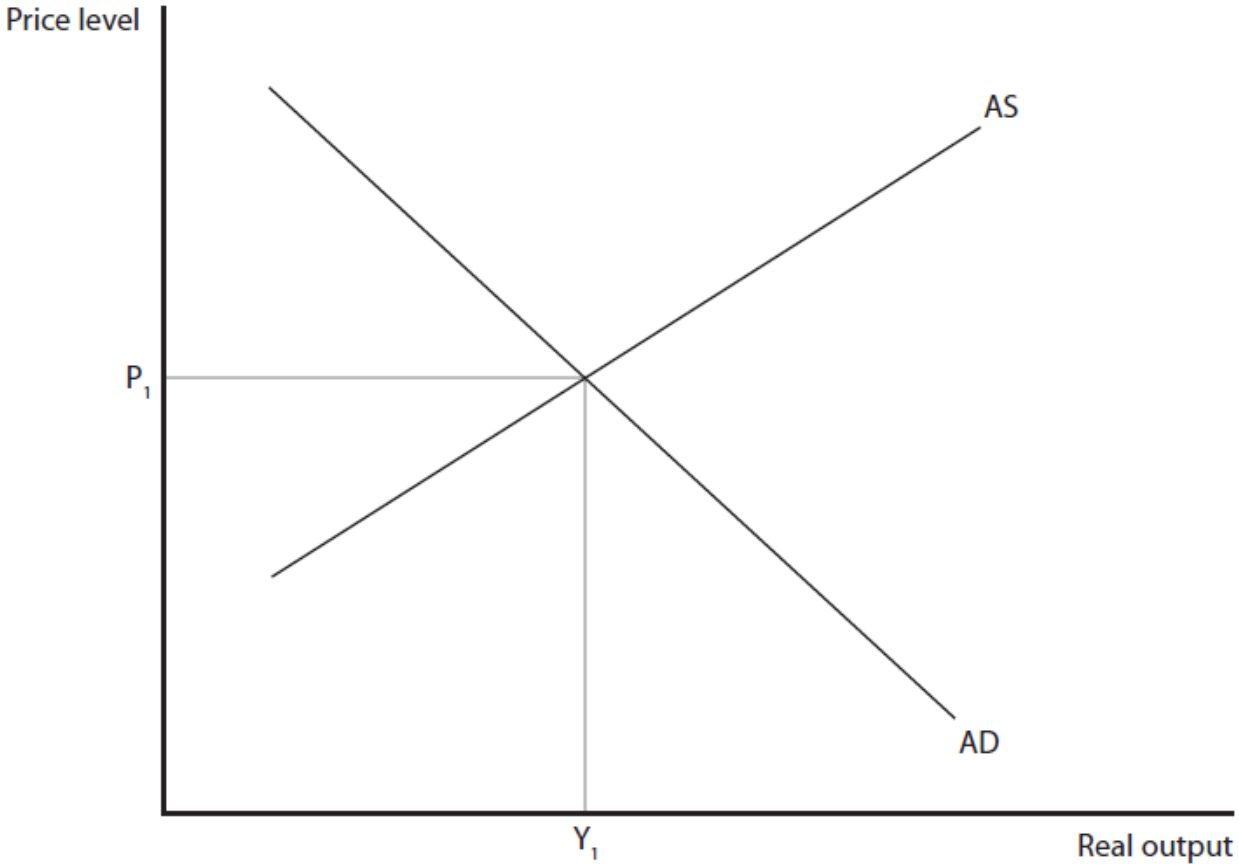
☒ **B** 20.26%

☒ **C** 25.41%

☒ **D** 79.74%

(c) Annotate the aggregate demand (AD) and aggregate supply (AS) diagram below to show the likely impact of an improvement in net trade on the equilibrium level of real output and the price level.

(2)



(Total for question = 4 marks)

Q10.

The table below shows marginal propensity to save data for an economy.

Year	Marginal propensity to save (mps)
2010	0.11
2011	0.09
2012	0.07
2013	0.05
2014	0.05
2015	0.04

(a) Explain **one** possible reason for the changes in the marginal propensity to save as shown in the table.

(2)

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(b) Explain the likely effect of a fall in the marginal propensity to save on the value of the multiplier if other things remain equal.

(2)

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An economy has marginal propensity to save of 0.1, marginal propensity to tax of 0.2 and marginal propensity to import of 0.1.

(c) Which **one** of the following is the correct size of the multiplier?

(1)

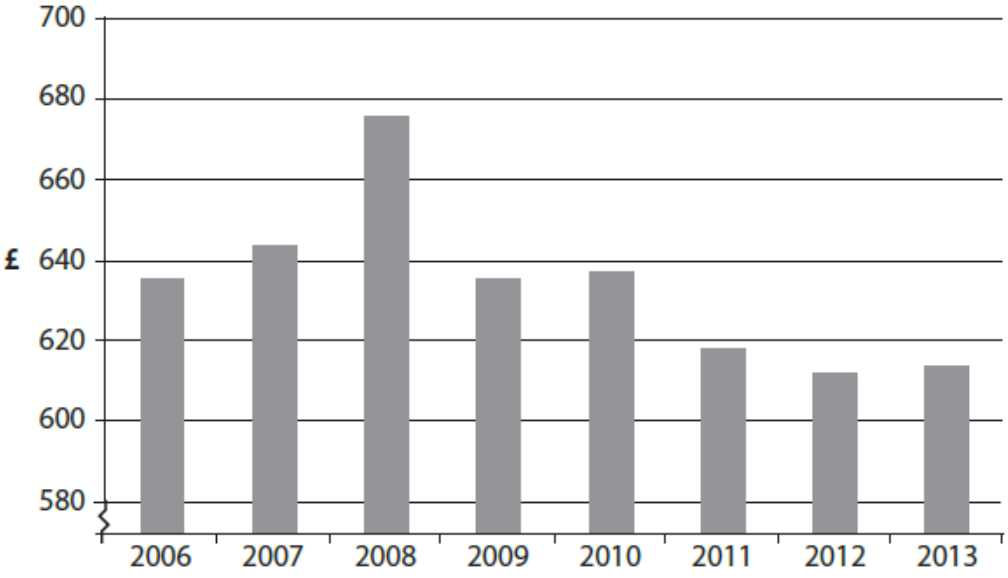
- ☒ **A** 0.4
- ☒ **B** 0.6
- ☒ **C** 1.7
- ☒ **D** 2.5

(Total for question = 5 marks)

Q11.

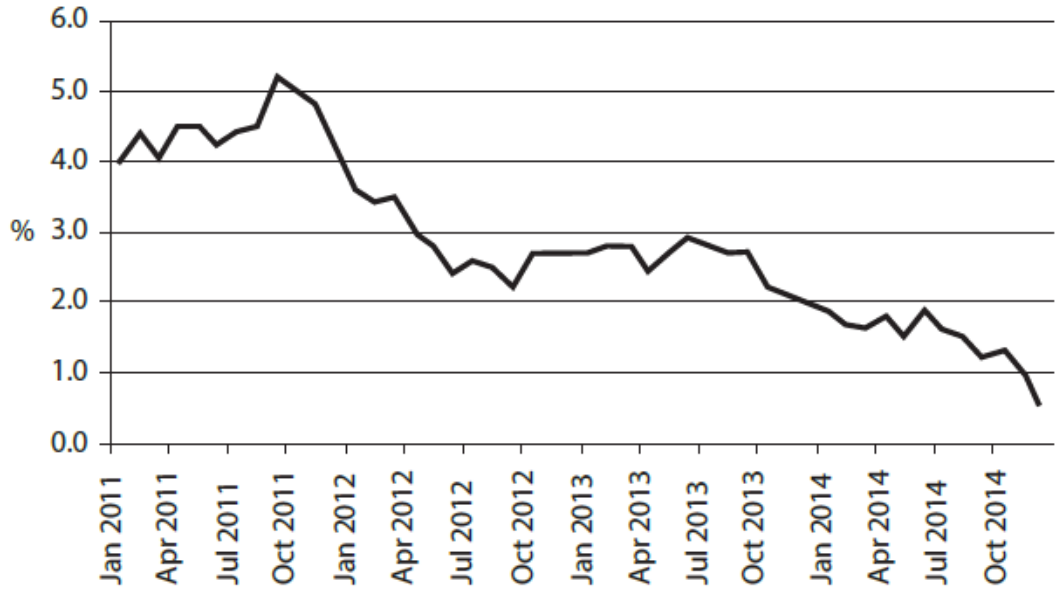
UK incomes, inflation and monetary policy

Figure 1 – UK average weekly household real income



(Source: http://www.ons.gov.uk/ons/rel/family-spending/family-spending/2014-edition/rft-a44-final-2013.xls)

Figure 2 – UK inflation rate as measured by percentage changes in the Consumer Price Index (CPI)



(Source: http://www.bankofengland.co.uk/publications/Pages/inflationreport/2015/feb.aspx)

Extract A

Britons should not fear rise in interest rates

The Monetary Policy Committee (MPC) of the Bank of England is prepared to raise interest rates "in the near future" if inflation increases, one of its senior policymakers has warned.

Kristin Forbes, a member of the MPC, said a rise in borrowing costs would also be necessary should household debt reach unhealthy levels. However, she stressed that this was not yet a cause for concern.

With the UK's base rate of interest at 0.5% and inflation at a record low and expected to be negative, the MPC is currently under no pressure to raise interest rates, despite Britain's economic recovery.

UK inflation is being driven lower by the slump in global oil prices, which have roughly halved since summer 2014, and the Bank's governor Mark Carney warned earlier this month that a strong domestic economy would translate into higher UK inflation over the medium term. "The most likely next move in monetary policy is an increase in interest rates. The message is clear," Carney said.

Forbes said that "even the more lagged effects of the rise in the value of the pound will likely peak in the first part of this year and also gradually fade. Inflation will then most likely bounce back.

"Since interest rates take well over a year to be fully effective, they should be adjusted to respond to inflationary risks at that time horizon – when all of these effects have diminished – rather than respond to today's inflation."

(Source: adapted from http://www.theguardian.com/money/2015/feb/24/britons-should-not-fear-rise-in-interest-rates- when-they-come-says-boe-member)

Extract B

Deflation is bad news

The problem with deflation is that once you have it you can't get rid of it. Central banks know what to do about inflation but they do not have the policy tools to deal with deflation when interest rates are almost as low as they can go. Just look at Japan, which had deflation in nine separate years from 1999-2012, with two additional years at zero, averaging minus 0.3%. The highest in any single year was minus 1.3% in 2013.

In the European Union (EU) in 2008, at the start of the financial crisis, there were fears of deflation but at that time central banks had the ability to cut interest rates by nearly 5 percentage points. Those fears may now be coming true, with the EU experiencing deflation of 0.5% in 2015.

This was driven primarily by declines in energy prices, but there was also deflation in non-energy industrial goods and telecommunications. The collapse in the cost of shipping goods potentially suggests something deeper is going on and may lead to a more persistent form of deflation than Mark Carney has currently claimed.

(Source: adapted from http://www.independent.co.uk/news/business/comment/david-blanchflower/david-blanchflower-deflation-is-bad-news--and-britain-is-likely-to-be-next-to-get-it-10078832.html)

(a) With reference to Figure 1, explain the term 'real income'.

(4)

(b) Assess the likely impact of falling real incomes on UK consumers.

(10)

(c) With reference to Extract A, explain the likely effect of a rise in the value of the pound on aggregate demand.

(5)

(d) With reference to the data, explain **two** likely reasons for the UK's falling inflation rate.

(6)

(e) With reference to Extracts A and B and your own knowledge, discuss whether the MPC should be concerned about the risk of deflation in the UK economy.

(15)

Answer EITHER

(f) Evaluate whether the MPC has been successful in controlling the UK's inflation rate since 2011.

(20)

OR

(g) Evaluate demand-side policy responses to the Global Financial Crisis of 2008.

(20)

(Total for question = 60 marks)

Q12.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

It is estimated that building a second runway at Gatwick airport will require an investment of £9.3 billion.

The total increase in UK GDP as a result of this injection is expected to be around £44.1 billion.

(Source: adapted from www.gov.uk/government/uploads/system/uploads/attachment_ data/file/452267/AC01_tagged_amend_25_11.pdf © Crown Copyright)

(a) Define the term 'injection' in this context.

(1)

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(b) Calculate the value of the multiplier based on the data given. You are advised to show your working.

(2)

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(c) Which **one** of the following is a likely cause of a decrease in the value of the UK's multiplier?

(1)

☒ **A** A decrease in the marginal propensity to save

☒ **B** A decrease in the marginal propensity to tax

☒ **C** An increase in the marginal propensity to consume

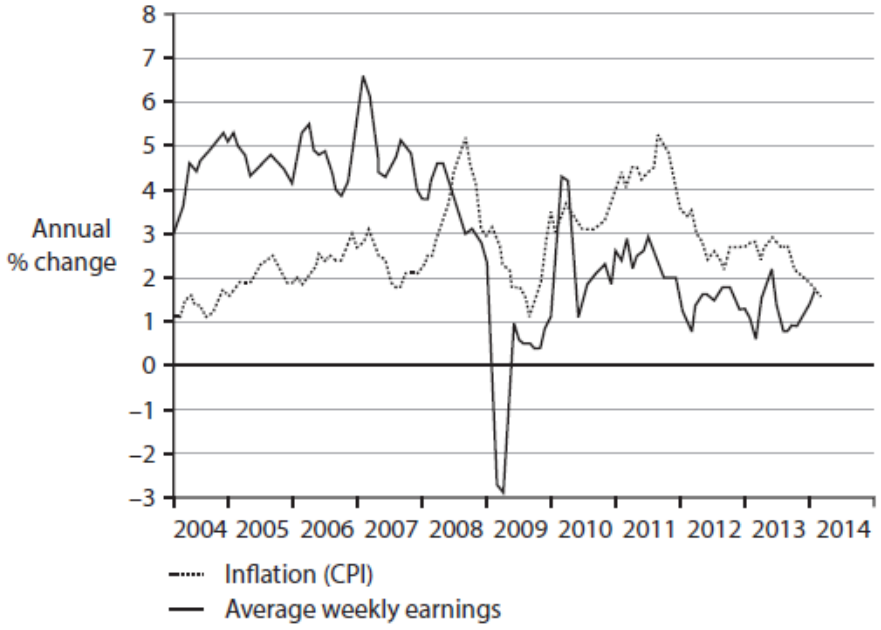
☒ **D** An increase in the marginal propensity to import

(Total for question = 4 marks)

Q13.

The chart below shows the annual percentage change in average weekly nominal earnings and the inflation rate in the UK as measured by changes in the CPI from March 2004 to March 2014.

Annual percentage change in average weekly nominal earnings and inflation rate (CPI), March 2004 to March 2014



(Source: ONS)

(a) Which **one** of the following can be inferred from the chart?

(1)

A Throughout the period shown, average weekly nominal earnings have risen.

B From March 2004 to March 2008, average weekly real earnings were falling.

C Throughout the period shown, average weekly real earnings have risen.

D From April 2010 to December 2013, average weekly real earnings were falling.

Answer ☐

(b) Explain the likely effect of a decrease in average weekly real earnings on the equilibrium level of real national output in the UK. Include an aggregate demand and aggregate supply diagram in your answer.

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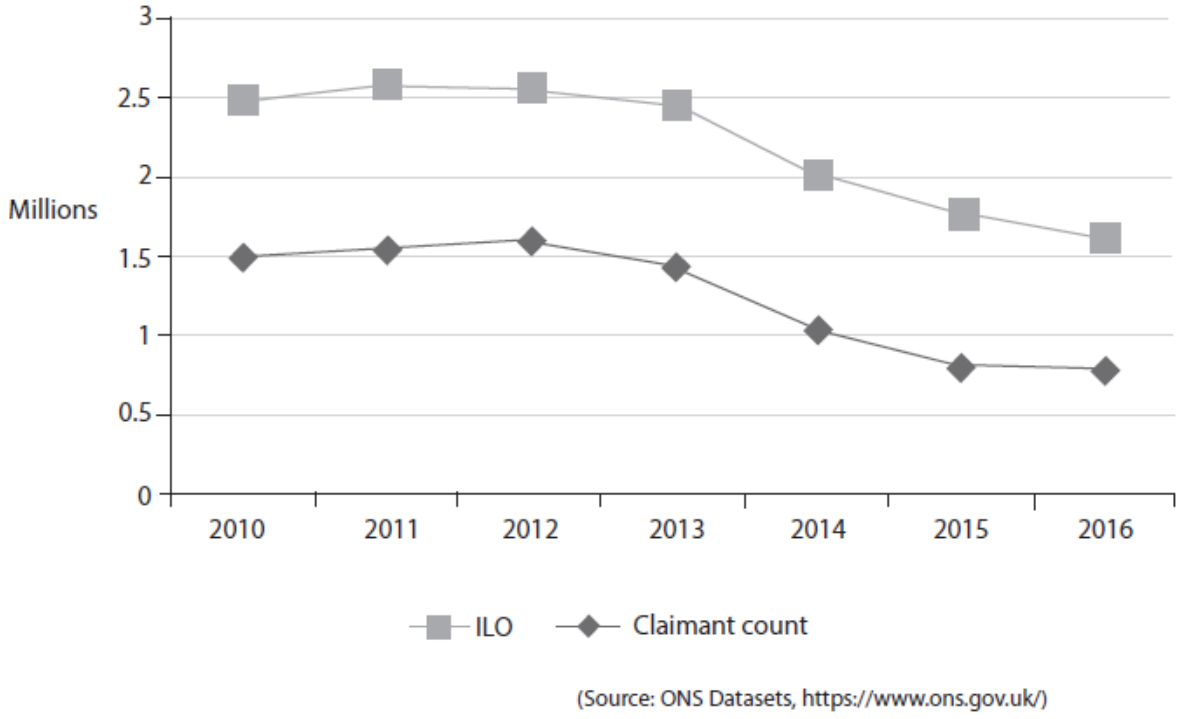
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(Total for question = 5 marks)

Q14.

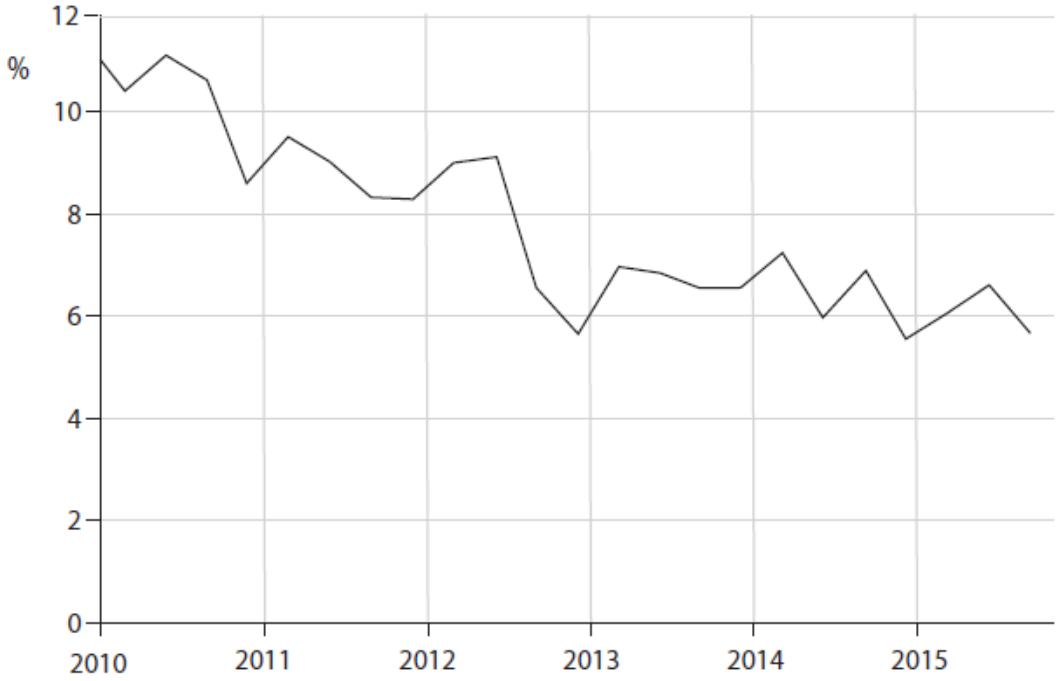
The UK economy

Figure 1: Unemployment – International Labour Organisation (ILO) and the claimant count, millions, 2010–2016



(Source: ONS Datasets, https://www.ons.gov.uk/)

Figure 2: Household savings*, 2010–2015



* Savings as a percentage of household disposable income

(Source: http://www.tradingeconomics.com/united-kingdom/personal-savings)

Figure 3: UK average house prices, 2005–2016



(Source: http://www.telegraph.co.uk/property/house-prices/the-state-of-the-uk-housing-market-in-five-charts/)

Extract A

Soaring house prices

House prices are still rising rapidly. The average UK house price was £214 000 in June 2016, according to the Office for National Statistics (ONS). This is £24 000 more than it was at its peak in September 2007, just before the economic downturn. First-time buyers have experienced the largest rise in house prices.

Even the loss of consumer confidence over Britain's vote to leave the EU did not stop house prices from rising – annual growth increased from 5.2% in July 2016 to 5.6% in August 2016. House price growth was the strongest in London, with annual average prices rising by 9.6%. However, in Wales average house prices actually fell by 0.5% during the same period. In its first post-Brexit referendum forecast, estate agency Countrywide said that house prices will fall by 1% across the UK in 2017, before rising by 2% in 2018.

Real household income in the UK fell by 10.4% in the years following the financial crisis. This increased the difference between real income and house prices. In 1997, a house cost little more than twice the average income. By early 2015, the average price of a house was five times the average annual income.

The rate of home ownership for 25 to 34-year-olds has fallen to 35.8% over the last twenty-five years as houses became less affordable. First-time buyers have to wait longer to save up for a house deposit. Conversely, home ownership has risen to 78.6% among those aged 65 to 74.

(Source: adapted from 'The state of the UK housing market in five charts', The Telegraph, http://www.telegraph.co.uk/property/house-prices/the-state-of-the-uk-housing-market-in-five-charts/; 'UK house price growth slows as demand cools after Brexit vote', The Guardian, https://www.theguardian.com/business/2016/sep/30/uk-house-price-growth-slows-demand-cools-brexit-vote-nationwide)

Extract B

UK migration trends in the year ending June 2016

Inward migration levels are among the highest ever recorded with an estimated 650 000 people moving to the UK. This is an increase of around 11 000 from the previous year.

Employment remains the most common reason for long-term migration (312 000) to the UK, with around 182 000 of these coming with a definite job and 130 000 looking for work.

Long-term migration to the UK for study was estimated to be 163 000. In addition, 80 000 long-term migrants arrived in the UK to accompany their families. There were 41 280 refugees applying for asylum, including dependants, of which 10 547 people were granted asylum. Asylum applicants cannot usually accept offers of employment while their case is being processed.

(Source: adapted from 'Migration Statistics Quarterly Report: December 2016', ONS, https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/bulletins/migrationstatisticsquarterlyreport/dec2016)

(a) With reference to Figure 1, explain one reason why the claimant count and the ILO measure of unemployment differ.

(4)

(b) With reference to Extract A, assess the likely macroeconomic effects of an increase in house prices. Use an aggregate demand and aggregate supply diagram in your answer.

(10)

(c) With reference to the information provided, explain **one** likely factor, other than changes in house prices, that could influence the level of savings of UK households.

(5)

(d) Explain **two** factors that might cause a rise in the value of the multiplier.

(6)

(e) With reference to Extract B and Figure 1, discuss the likely impact of migration on employment **and** unemployment in the UK.

(15)

EITHER

(f) Evaluate government policies, apart from migration policies, that could be used to increase the employment rate in the UK.

(20)

OR

(g) Evaluate the likely impact of high inflation on the UK government's macroeconomic objectives.

(20)

(Total for question = 60 marks)

Q15.

(a) Define the term 'productivity'.

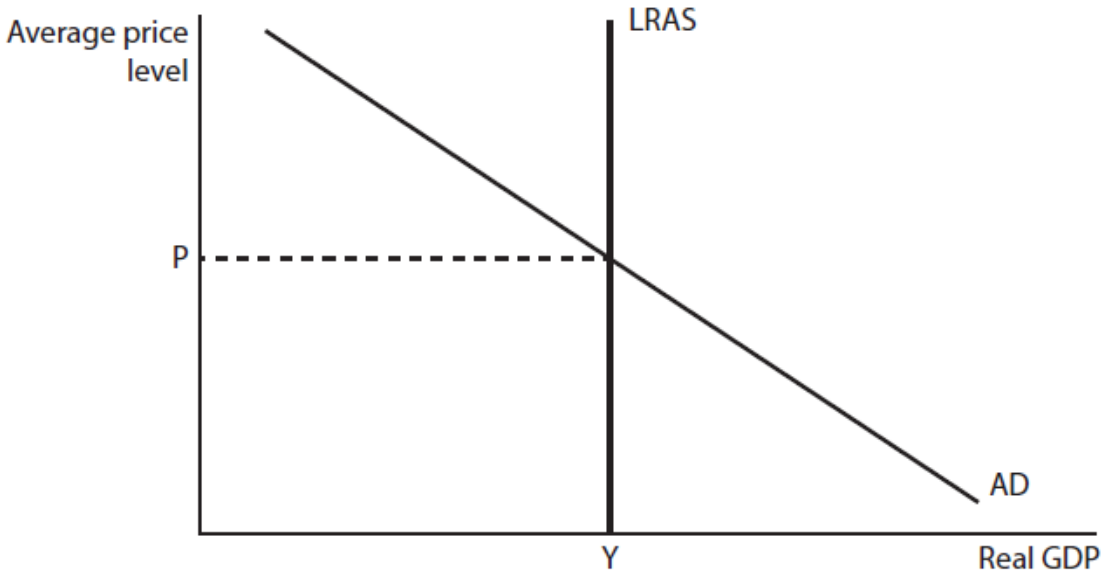
(1)

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(b) Using a classic long-run AS curve, annotate the diagram below to show the effect of an increase in productivity on the equilibrium level of real national output and the average price level of the economy.

(2)



(c) Which **one** of the following statements is correct?

(1)

A The Keynesian long-run AS curve implies that an economy may have a negative output gap in the long run

B The Keynesian long-run AS curve is perfectly inelastic at all levels of real national output

C The classic long-run AS curve implies that an economy may have spare capacity in the long run

D The classical long-run AS curve is perfectly elastic at all levels of real national output

Answer ☐

(Total for question = 4 marks)

Q16.

Some questions must be answered with a cross in a box (☒). If you change your mind about an answer, put a line through the box (☒) and then mark your new answer with a cross (☒).

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

According to the Bank of England, the UK's marginal propensity to consume is estimated to be 0.64.

(Source: adapted from https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2017/the-consumption-response-to-positive-and-negative-income-changes.pdf?)

(a) Using the information above, calculate the total reduction in the UK's GDP from a fall in government spending of £20 million.

(4)

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(b) Which **one** of the following is an injection into the circular flow of income?

(1)

☒ **A** Imports

☒ **B** Investment

☒ **C** Savings

☒ **D** Taxation

(Total for question = 5 marks)

Q17.

Use the data to support your answers where relevant. You may annotate and include

diagrams in your answers.

Answer the question with a cross in the box you think is correct ☒. If you change your mind about an answer, put a line through the box ☒ and then mark your new answer with a cross ☒.

The planned investment in the redevelopment of Dover Port will cost £115 million. The Chief Executive said it will lead to many 'new job opportunities for local people and a transformed waterfront experience' with new cafés, bars, and shops.

(Source adapted from: https://www.kentonline.co.uk/dover/news/docklands-redevelopment-work-to-start-118581/)

(a) If the value of the multiplier is 1.8, which one of the following will be the total increase in GDP from the

redevelopment, assuming other things are equal?

(1)

☒ **A** £64 million

☒ **B** £115 million

☒ **C** £207 million

☒ **D** £230 million

(b) Using the example above, explain how the multiplier process leads to an increase in aggregate demand.

(4)

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(Total for question = 5 marks)