



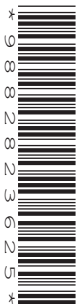
Oxford Cambridge and RSA

Monday 20 May 2024 – Morning

AS Level Economics

H060/02 Macroeconomics

Time allowed: 1 hour 30 minutes



You can use:

- a scientific or graphical calculator
- an HB pencil



Please write clearly in black ink. **Do not write in the barcodes.**

Centre number

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Candidate number

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First name(s)

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Last name

StemUp Model Solution

INSTRUCTIONS

- Use black ink. You can use an HB pencil, but only for graphs and diagrams.
- Write your answer to each question in the space provided. You can use extra paper if you need to, but you must clearly show your candidate number, the centre number and the question numbers.
- Answer **all** the questions in Sections A and B and **one** question in Section C.

INFORMATION

- The total mark for this paper is **60**.
- The marks for each question are shown in brackets [].
- Quality of extended response will be assessed in questions marked with an asterisk (*).
- This document has **16** pages.

ADVICE

- Read each question carefully before you start your answer.

2
SECTION A

Write your answer to **each** question in the box provided.

1 A government budget deficit occurs when:

- A** imports exceed exports
- B** its expenditure is less than its revenue
- C** its expenditure is more than its revenue
- D** the national debt is decreasing

Your answer C

[1]

2 What is **not** an example of a supply side policy?

- A** Increasing expenditure on education
- B** Increasing the rate of income tax
- C** Investing in road infrastructure
- D** Providing subsidies for research and development

Your answer B

[1]

3 What would be the **least** effective way to increase long run economic growth?

- A** Increase government expenditure on welfare payments
- B** Increase labour productivity
- C** Increase the level of technology
- D** Increase the number of women joining the workforce

Your answer A

[1]

4 What is the difference between real and nominal values of economic variables?

- A The exchange rate
- B The inflation rate
- C The interest rate
- D The tax rate

Your answer B

[1]

5 Which stage of the economic cycle occurs when actual GDP is above its trend value?

- A Boom
- B Recession
- C Recovery
- D Trough

Your answer A

[1]

6 In 2022, a basket of goods and services cost £1350.
In 2023, the same basket cost £1674.

What is the value of the price index for 2023 based on 2022 being the base year?

- A 48
- B 81
- C 124
- D 193

Your answer C

[1]

7 What is an example of a contractionary monetary policy?

- A Increasing government expenditure by £1bn
- B Increasing interest rates by 1%
- C Increasing quantitative easing by £100m
- D Increasing VAT by 2%

Your answer B

[1]

8 Which of these is **most** likely to cause an increase in the rate of inflation?

- A An increase in labour productivity and a higher price of oil
- B An increase in technological advancements and falling employment
- C An increase in the budget deficit and falling consumer confidence
- D An increase in the minimum wage and a depreciation of the exchange rate

Your answer D

[1]

9 The table shows the tax paid by an individual at different levels of income.

Annual income (£)	Tax paid (£)
15 000	1200
25 000	1700
35 000	2500
50 000	4000

What is the marginal tax rate for an individual whose annual income increases from £25 000 to £35 000?

- A 2%
- B 5%
- C 7%
- D 8%

Your answer D

[1]

10 Which group will be part of the labour force survey measure of unemployment?

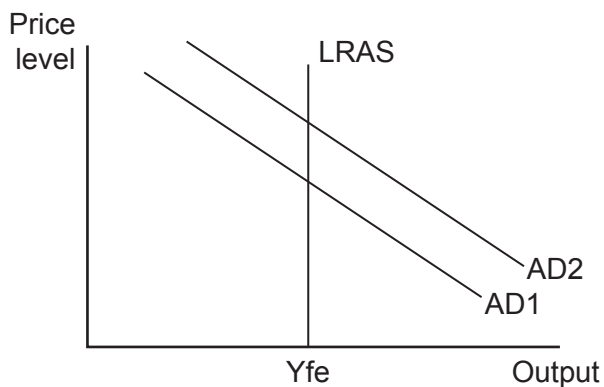
- A People claiming job seeker's allowance and not available for work
- B People without a job and actively seeking work in the last two weeks and available to start work the next week
- C People without a job and actively seeking work in the last four weeks and available to start work in the next two weeks
- D People working part-time but seeking other work

Your answer

C

[1]

11 The diagram shows an increase in aggregate demand from AD1 to AD2.



What impact will this have on the economy?

- A Increased output only
- B Increased unemployment
- C Inflation and increased output
- D Inflation only

Your answer

D

[1]

12 Which option will **not** improve labour market flexibility?

- A Better information about job vacancies
- B Increasing the minimum wage
- C Limiting the power of trade unions
- D Retraining of workers

Your answer

B

[1]

- 13 The table shows expected changes in the next year to the main components of aggregate demand.

Component	Change in value (£m)
Consumption	+5
Exports	+8
Government expenditure	−7
Imports	+6
Investment	−2
Savings	0
Taxation	0

What impact will this have on the value of aggregate demand?

- A Decreases
- B Increases
- C Stays the same
- D Unable to say

Your answer A

[1]

- 14 Which factor is assumed to be fixed when constructing a short run aggregate supply curve?

- A Exchange rates
- B Oil prices
- C Technology
- D Wage rates

Your answer C

[1]

- 15 The table shows the nominal GDP for a country.

Year	Nominal GDP (£m)
2021	160 000
2022	220 000

The price index was 110 in 2022 (2021 = 100).

What is the country's real growth rate from 2021 to 2022 (to the nearest whole number)?

- A 25%
- B 27%
- C 38%
- D 51%

Your answer A

[1]

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TURN OVER FOR SECTION B

SECTION B

UK exports to the European Union fall by 40%

The UK's exports of goods to the European Union (EU) fell by 40.7% in January 2021, according to the Office for National Statistics (ONS), while imports decreased by 28.8%. The figures showed the biggest drop since records began in 1997 and were the first since new trading rules between the UK and the EU came into existence. In contrast, the UK's trade with non-EU countries grew by 1.7% in January.

5

It is not just tariffs that could threaten exports. The additional risk is that non-tariff barriers – such as checks on meat and poultry – will increase exporters' costs sharply. These costs will have to be passed on in higher prices, reducing exporters' competitiveness. Food exporters especially are now feeling the impact.

The ONS found that in January 2021 GDP in the UK was down 2.9%, compared to the previous month, which was a "notable hit". The economy was 9% smaller than it was before the start of the Covid pandemic. Estimates for November 2020 to January 2021 showed 1.7 million people were unemployed, about 5.1% of the workforce. The unemployment rate was at a near five-year high, having risen by 1.1% over the previous 12 months.

10

Retailers, restaurants, and hairdressers were all affected by lockdowns during the Covid pandemic. Research found a 28% fall in output from the food services and accommodation sectors between December 2020 and January 2021. This "reflected many cafés and restaurants giving up on offering takeaway and delivery services, while the pandemic was raging". The research also found that households had cut back on non-essential expenditure, sending retail and wholesale output down by 9%. In contrast, UK household savings peaked in the second quarter of 2020, reaching £92 billion compared to £33 billion in the first quarter of 2020, due to the shutdown of businesses and low confidence in the economy.

15

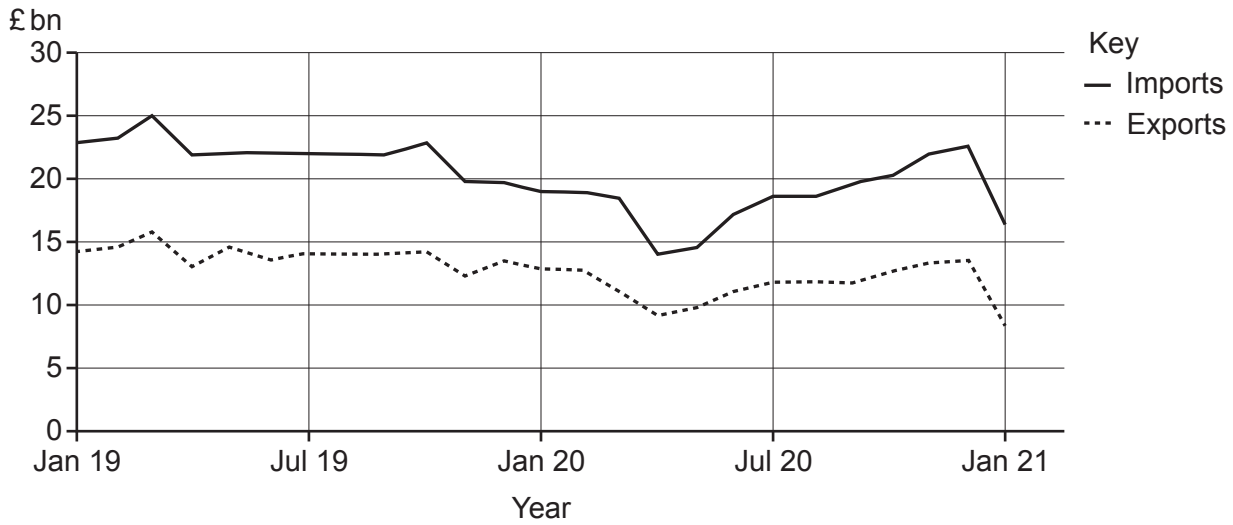
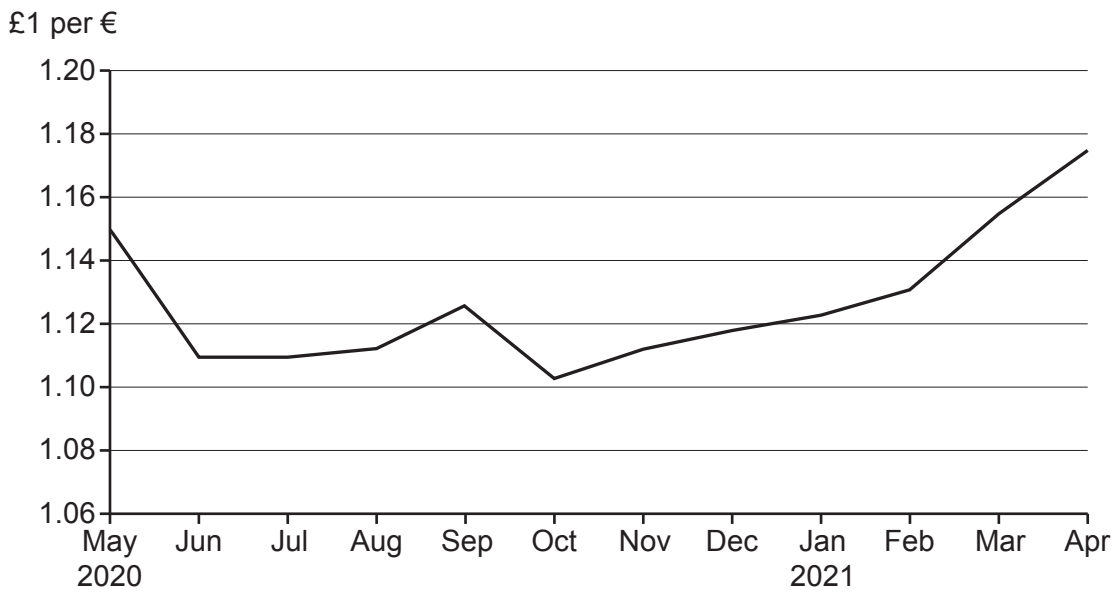
20

Manufacturing also saw its first decline since April 2020, with car production falling significantly. However, increases in health services, from vaccine production and increased testing, partially offset the declines in other industries.

25

Following a trade deal announced in September 2020, nearly all exports to Japan will be tariff free, increasing the demand for UK goods in Japan. UK tariffs on imported Japanese cars will be removed by 2026. The deal is expected to boost trade between the UK and Japan by about £15 billion. Critics of the trade deal said it will boost UK GDP by only 0.07%, a fraction of the trade that could be lost with the EU.

30

Fig. 1**UK trade in goods with the EU 2019–2021 (seasonally adjusted)****Fig. 2****Sterling to euro exchange rate 2020–2021**

16

- (a) Using **Fig. 1**, describe the UK's balance of trade in goods in January 2021.

The UK had a deficit on its balance of trade in goods with the EU in January 2021.
Imports were about £16bn and exports about £8bn, so the balance was £8bn – £16bn
= –£8bn, a deficit of about £8bn.

[2]

(b)

- (i) Using **Fig. 2**, explain what happened to the Sterling to euro exchange rate from May 2020 to October 2020.

Sterling depreciated against the euro (the euro appreciated). In May 2020 £1 bought
€1.15, but by October 2020 it bought only €1.10, so each pound buys fewer euros.
Percentage change = $(1.10 - 1.15) / 1.15 \times 100 = -0.05 / 1.15 \times 100 = -4.3\%$
So Sterling depreciated by about 4.3% against the euro over the period.

[3]

- (ii) **Lines 28–29** refer to an expected increase in international trade with Japan.

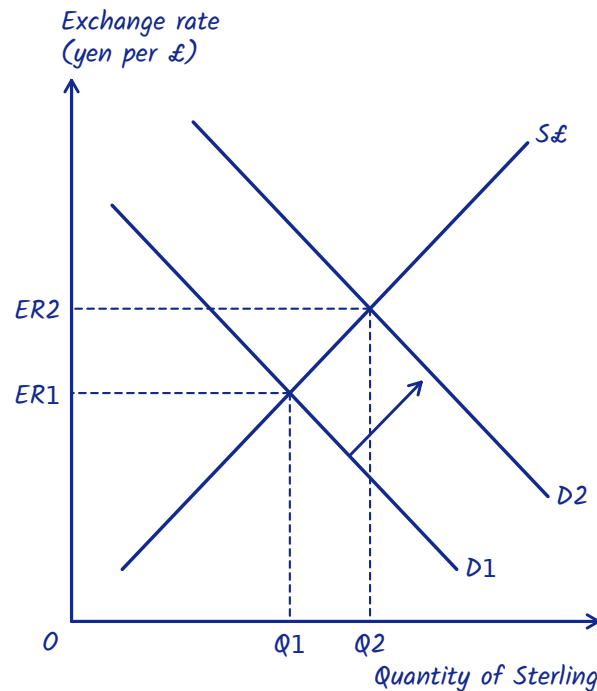
Explain **one** advantage of international trade for developed countries.

Trade gives producers access to larger markets, e.g. UK firms selling tariff free to Japan.
They can sell more output and so benefit from economies of scale, lowering unit costs
and raising profits.

[2]

- (c) The trade deal with Japan (**lines 26–30**) may have an impact on the exchange rate between Sterling and the Japanese Yen.

Using a diagram, explain the possible impact on the Sterling to Yen exchange rate of an increase in demand from Japan for UK goods.



Japanese consumers must buy pounds (selling yen) to pay for UK goods, so demand for Sterling shifts right from $D1$ to $D2$. With supply $S_{£}$ unchanged there is excess demand for £ at $ER1$, so the Sterling to Yen exchange rate rises (appreciates) from $ER1$ to $ER2$ and the quantity of £ traded rises from $Q1$ to $Q2$. [4]

- (d) Using information from the **Extract**, explain how the UK's circular flow of income would have been affected during 2020 and 2021.

Exports to the EU fell by 40.7% in January 2021. Exports are an injection, so less income flowed into UK firms and households, reducing the circular flow of income. Savings, a withdrawal, rose to £92bn in the second quarter of 2020 from £33bn, so less was spent on non-essentials (retail output fell 9%), further reducing the flow. Imports fell by 28.8%, and as imports are a withdrawal this partly increased the flow, but overall the circular flow shrank: GDP fell 2.9% in January 2021 and was 9% below its pre-pandemic level. [4]

- (e)* Evaluate the effect the increase in unemployment in November 2020 to January 2021 from the same period the year before, is likely to have had on the UK economy. [10]

Unemployment rose by 1.1% over the year to a near five-year high, with 1.7 million people (about 5.1% of the workforce) unemployed in November 2020 to January 2021. Much of this was cyclical (demand-deficient) unemployment caused by lockdowns and falling exports to the EU.

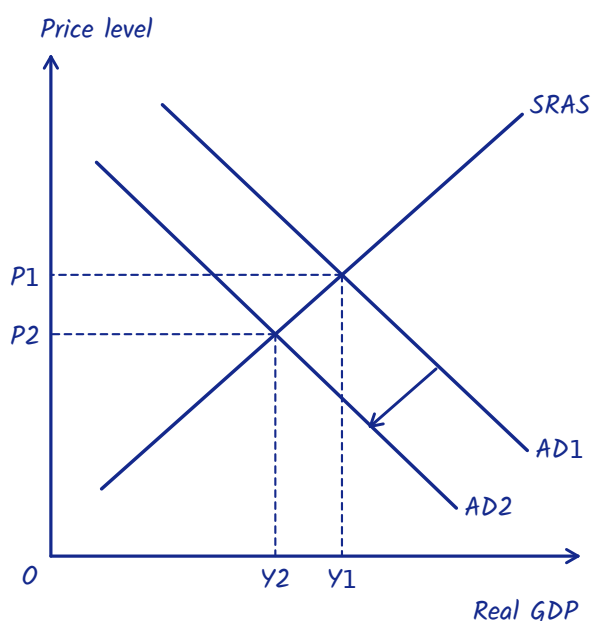
Unemployed workers lose income, so disposable income and consumption fall, especially on non-essential goods, where retail and wholesale output already fell by 9%. Lower demand reduces firms' revenue and profits, so they may cut their workforce further, a negative multiplier effect. Low confidence also makes households save more (savings peaked at £92bn) and firms cut investment. As consumption and investment are components of AD, AD shifts left from AD1 to AD2 (diagram below), so real GDP falls from Y1 to Y2, consistent with GDP falling 2.9% in January 2021.

Unemployment also means resources are used inefficiently, so the economy produces inside its PPF and output is lost for ever, lowering growth. The government pays more in benefits and receives less income tax and VAT, widening the fiscal deficit and national debt, with an opportunity cost such as less spending on health or education. Workers in food services and accommodation, where output fell by 28%, may struggle to find new jobs and lose skills; if lost exports to the EU never recover, unemployment may become structural and long-term, reducing LRAS. There are also social costs, e.g. poverty and poor mental health, especially if concentrated in certain regions or among young people.

However, the impact may be smaller. Consumption may not fall much because many households built up savings in lockdown which they are willing to spend. A rate of 5.1% is still fairly low, and cyclical unemployment should fall as the economy recovers when lockdowns end. The excess supply of labour puts downward pressure on wages and prices, improving competitiveness. Some workers may find jobs in growing sectors such as health services, or in firms able to trade with Japan.

Overall, the effect depends on the time period. In the short term the rise in unemployment

..probably caused only a modest fall in AD, as it was temporary and savings were high. But if.....
 ..it persists, long-term unemployment could make the impact more severe, reducing potential.....
 ..growth and worsening the public finances.....



TURN OVER FOR SECTION C

SECTION C

Answer Question 17 or Question 18.

- 17*** Germany's public sector spending increased annually by 12.1% in 2020, to €1700 billion. Some of this extra spending was used to offer subsidies to firms to help them keep workers employed.

Evaluate, using an appropriate diagram(s), whether government spending to keep unemployment low will conflict with objectives a government may have for inflation. [20]

OR

- 18*** Qatar's GDP in 2020 was \$146.4 billion and its Human Development Index (HDI) was 0.86. Over the same period, Slovenia's GDP was \$52.9 billion and its HDI was 0.90. Both countries had similar populations of approximately two million people.

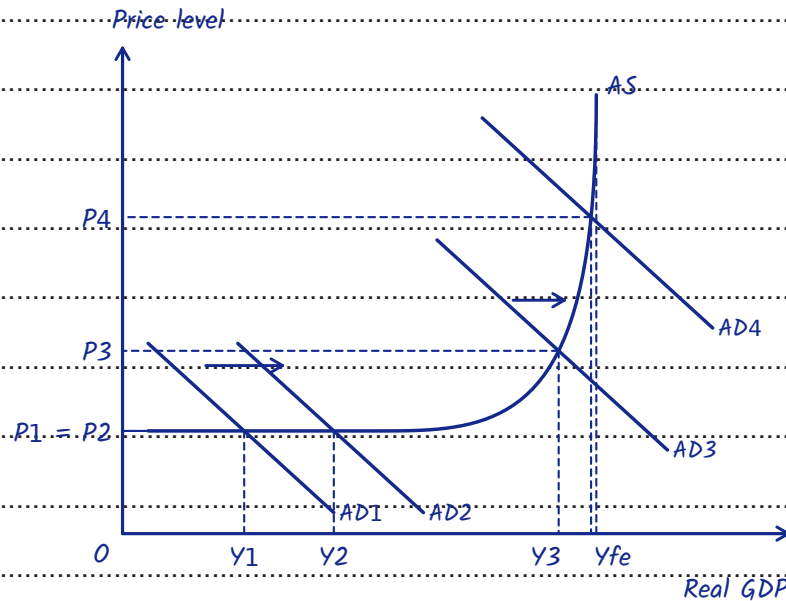
Evaluate, using an appropriate diagram(s), the usefulness of GDP as an indicator of development. [20]

Question No. 17.....

Fiscal policy is the use of government expenditure and taxation to achieve the government's macroeconomic objectives, such as low unemployment and low, stable inflation (e.g. a 2% target). Germany's public sector spending rose by 12.1% in 2020 to €1700 billion. This is expansionary fiscal policy, and with lower tax revenue in a recession it increases the fiscal (budget) deficit.

Some of the extra spending was subsidies to firms to keep workers employed. Firms use the subsidies to keep paying wages and perhaps to invest, so workers keep their incomes and consumption is maintained; the government may also give money to consumers as unemployment benefits or other welfare payments to spend in shops. Government spending is a component of aggregate demand ($AD = C + I + G + X - M$), so AD shifts right, and through the multiplier the final rise in national income is larger than the initial injection. This raises the derived demand for labour and keeps unemployment low.

However, this creates demand-pull inflation. In the diagram, as AD shifts from AD3 to AD4 close to full employment (Y_{fe}), firms face capacity constraints and compete for scarce labour and materials, so the price level rises sharply from P_3 to P_4 with only a



small rise in real output. Low unemployment also strengthens workers' bargaining power, so wages rise, increasing firms' costs and causing cost-push inflation and possibly a wage-price spiral, the trade-off shown by the Phillips curve. So keeping unemployment low can conflict with an objective of low and stable inflation, and the extra spending also worsens the budget deficit and national debt.

However, whether there is a conflict depends on how close the economy is to full employment. In 2020 Germany was in a Covid recession with a large negative output gap and lots of spare capacity. In the diagram, AD shifts from AD1 to AD2 on the horizontal section of AS, so real output rises from Y1 to Y2 with no rise in the price level ($P1 = P2$). If there is deflationary pressure, the spending may even help keep inflation up to its target. Also, subsidies to keep workers employed largely replace lost income, so they stop AD falling rather than adding new demand.

The size of the effect depends on the multiplier. If the marginal rate of withdrawals (saving, taxation and imports) is high, the multiplier is small: Germany is very open to trade and confidence was low, so households may save the extra income and firms may use the subsidies to pay off bank loans or save, limiting inflationary pressure. If the spending is on infrastructure, business investment grants or training, it increases productive capacity, so LRAS shifts right and in the long run output can grow faster.

without inflation, which may even be lower in future years. Keeping workers in jobs also stops them losing skills, protecting LRAS.

Finally, it depends on the inflation objective. A low inflation target (e.g. 2%, set for the eurozone by the ECB) is more likely to be breached than an objective of a manageable level of inflation, and the ECB could raise interest rates to offset any demand-pull pressure.

Overall, government spending to keep unemployment low is unlikely to conflict with inflation objectives in the short run when the economy is in recession, as Germany was in 2020, because there is spare capacity. The conflict becomes significant as the economy recovers towards full employment if the spending is not withdrawn. So it depends on where Germany is in the economic cycle, what firms spend the money on, the level of taxation and withdrawals, and the inflation objective; temporary spending that also boosts LRAS is least likely to conflict.

END OF QUESTION PAPER

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Gross domestic product (GDP) is the total value of goods and services (output) produced in a country in a year, and it is equal to national income. Economic growth is an increase in real GDP: in the short run a rise in output, and in the long run an increase in productive potential, shown by LRAS shifting right from LRAS1 to LRAS2 (output Y1 to Y2, Diagram 1 overleaf) or the PPF shifting out from A to B (Diagram 2). Development is a wider concept than growth, as it considers quality of life indicators such as health, education and freedom, measured for example by the Human Development Index (HDI), which combines life expectancy, years of schooling and GNI per capita.

Qatar's GDP in 2020 was \$146.4bn, nearly three times Slovenia's \$52.9bn; Slovenia's GDP is only about a third of Qatar's. As both have populations of about two million, Qatar's GDP per capita (about \$73 000) is far higher than Slovenia's (about \$26 000). Yet Slovenia has a slightly higher HDI of 0.90 compared with Qatar's 0.86, which suggests GDP alone is not a perfect indicator of development.

GDP is useful because economic growth means more output and more money flowing around the circular flow, so there are more resources available to everyone, higher incomes and higher material living standards. Higher incomes generate more tax revenue, which allows additional resources to be invested in schools and healthcare. This raises education and skills levels, increases the opportunities available to citizens and increases life expectancy, two of the components of HDI. Growth also creates more employment, so more households can afford to buy education and healthcare themselves. Since GNI per capita is one of the three components of HDI, improved growth directly contributes to a rising HDI. GDP data is also regularly collected and calculated in a standard way, so it is easy to compare over time and between countries.

However, GDP has important limitations. An increase in GDP with high inflation may

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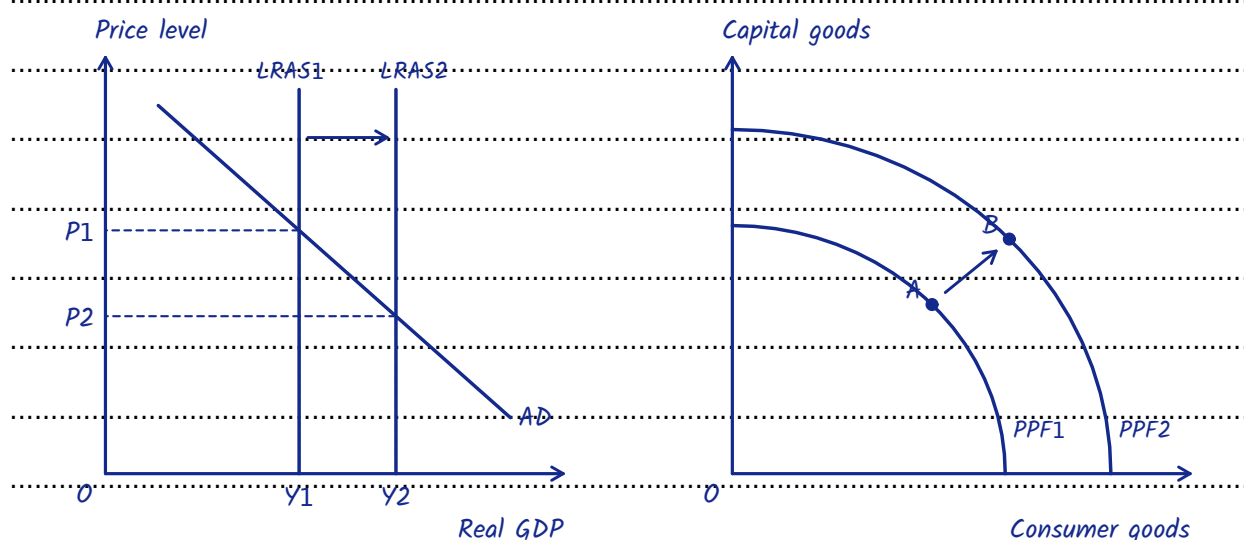


Diagram 1

Diagram 2

not improve living standards, so real GDP must be used, and if the population grows by more than GDP, GDP per capita falls. GDP says nothing about distribution: a highly unequal country with a large percentage of people in absolute poverty may have high average income but find it harder to increase development. Qatar's income from oil and gas may be concentrated among a small number of people while many migrant workers earn low wages. Corruption, or a reluctance to invest in those in absolute poverty, may also limit improvements in development. Slovenia's government spends money on development such as healthcare and schooling, whereas Qatar may spend more on other things such as weapons, which may explain its lower HDI despite its higher GDP.

In many less developed countries there is a large informal economy, so GDP underestimates the level of economic activity and therefore development. Growth may also be accompanied by more pollution, stress and crime, which lower living standards now and in the future, and GDP ignores leisure time and the quality of the environment. Growth generated from more capital goods (a movement towards capital goods on the PPF in Diagram 2) may reduce living standards and development in the short run but increase both in the long run, as the PPF shifts

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18

out. HDI tends to give a better long-term picture, as recent improvements in healthcare and schooling take time to come through.

Overall, GDP is a useful starting point, especially as real GDP per capita at purchasing power parity. For developed countries it is probably a good indicator of development, as governments often invest more in services that increase the wellbeing of citizens, and it is useful for comparing over time or between countries. However, as Qatar and Slovenia show, it is less useful for countries with large income inequalities or where income comes from a few natural resources, where an HDI measure is more useful. GNI may be a better measure than GDP because it includes income from abroad, and other indicators such as the inequality-adjusted HDI, HDI calculated separately for females and males, the percentage working in agriculture, and access to clean water, electricity, mobile phones and the internet give a fuller picture. Even these ignore gender inequality, environmental quality such as clean air, and happiness, so a range of indicators should be used alongside GDP rather than GDP alone.