

# Tricky Questions with Explanations for AS and A Level Edexcel A

Theme 2: UK Economy: Performance and Policies

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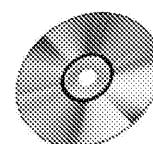
# Teacher's Introduction

Multiple-choice questions are an integral part of 2015 AS/A Level Economics specifications, and to score highly in this section of the examination the candidate needs knowledge and technique acquired by practice! The aim of this collection of original questions with supported answers is not simply to replicate the style and content of exam questions by thorough coverage of the specification – and thus improve examination technique – but also to provide many 'trickier' questions which should stretch the student, enhance understanding and build competence and confidence.

## Format

This resource consists of:

- Write-on **worksheets** with space for the answer and explanation for each question. The explanation is a useful way of indicating understanding and should help reduce guessing.
- **Answers:** Each question is supported with the correct answer with detailed discussion of why it is correct. Many of the answers contain advice about technique – how drawing diagrams can help to process the data within the question, how to avoid typical errors, how to apply formulae, and how to remove 'red herrings' from your decision-making.
- The CD includes the same questions in **PowerPoint** format, presented one by one. This format is ideal for starters/plenaries or for a timed test (simply add timings to the slides so they progress at the same speed students would be advised to spend on them in the exam). Each slide has the option to reveal the answer and explanation (this will only reveal if clicked on specifically, not as the slideshow progresses).



## Valuable Exam Preparation

The resource will supply a valuable bank of questions both to the busy teacher wishing to test a given topic, as material for a 'mock' or for end-of-module revision, and to the student seeking to improve their performance on specific topics or preparing for their AS Paper 1. The teacher will find thorough coverage of the specification and the student will find that the 'question and supported answer' format is complementary to their other resources, whether it be their course notes, online facility or textbook.

I personally have used multiple-choice questions for over 30 years in teaching Economics, whether or not they form part of formal assessment. Past papers have been one reliable source; so too are original questions such as these, especially for a new specification.

## Topic Coverage

Topic	AS Spec. ref.
1. Economic Growth: Basics	(2.1.1)
2. Inflation	(2.1.2)
3. Employment and Unemployment	(2.1.3)
4. Aggregate Demand	(2.2)

Topic	AS Spec. ref.
5. Aggregate Supply	(2.3)
6. National Income	(2.4)
7. Economic Growth	(2.5)
8. Macroeconomic Objectives and Policies	(2.6)

April 2016

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\* resulting from minor specification changes, suggestions from teachers and peer reviews, or occasional errors reported by customers

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## Topic 2.1.1: Economic Growth: Basics

No.

- 1) Which of the following is not an example of underemployment?
- a) A graduate working full time as a waiter
  - b) A zero-hours contracted worker in KFC averages 10 hours paid work per week but wants more
  - c) A Business graduate doing clerical work for a recruitment agency
  - d) A footballer released by his club circulates his CV to clubs
- Answer: ☐
- 2) Which one of these statements about key UK economic indicators is incorrect?
- a) GDP is the value of output produced within the UK per period.
  - b) GNP adds net factor income from abroad to GDP.
  - c) GDP per capita measures output per worker.
  - d) GVA is the value of unpaid work such as DIY.
- Answer: ☐
- 3) Economic activity within a country is not fully reflected in its GDP figures for each of the following reasons except:
- a) some transactions are illegal
  - b) some legal output is subject to tax evasion
  - c) some legal output is subject to tax avoidance
  - d) transactions may be undertaken using barter
- Answer: ☐
- 4) The purchasing power parity exchange rate between the pound and the euro is where:
- a) £1 exchanges for 1 euro
  - b) valid international comparisons of per capita incomes between the UK and the Eurozone can be made
  - c) the pound is 'strong'
  - d) the trade deficit on goods should disappear
- 5) *Other things being equal* if a Big Mac is priced at 3 euros in the Eurozone and £2 in the UK:
- a) Big Macs are larger in the Eurozone than in the UK
  - b) an exchange rate of £1 to 1.5 euros would reflect purchasing power parity
  - c) Big Macs in the UK would outsell those in the Eurozone
  - d) there would be a trade balance in the goods and services category of Big Macs
- Answer: ☐

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- 6) Consider the prices index figures for these years:

Year	1	2	3	4
Price Index	100	110	121	133.2

Which of these statements is *incorrect*?

- a) Inflation was highest from year 3 to year 4.
- b) Prices were highest in year 4.
- c) The rate of inflation was constant over the period.
- d) The purchasing power of the average citizen fell over the period.

Answer: ☐

- 7) To calculate the average material standard of living in a country we need knowledge of:

- a) the rate of inflation
- b) per capita income at base prices
- c) the value of leisure time
- d) the value of unpaid work

Answer: ☐

- 8) Which of the following statistics help provide a more complete calculation of living standards of a country?

- a) Life expectancy
- b) The distribution of income
- c) Doctors per 1,000 of the population
- d) Options a) to c) inclusive

Answer: ☐

- 9) and 10) make use of the following table:

Year	1	5	9	13
Money GDP (£bn)	1000	1500	1750	2000
Price Index	90	100	125	150
Population (m)	50	60	55	55

- 9) In which year was real national income highest?

- a) 1
- b) 5
- c) 9
- d) 13

Answer: ☐

- 10) Which of these statements is *incorrect*?

- a) The average person's standard of living increased from year 1 to year 5.
- b) The average person's standard of living increased between year 9 and year 13.
- c) Between year 1 and year 5 real GDP grew more slowly than population.
- d) The base year for all prices of comparison is year 5.

Answer: ☐

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11) Which one of these phrases refers to GDP figures adjusted for the impact of inflation?

- a) At nominal prices
- b) At current prices
- c) At constant prices
- d) Per capita

Answer:

☐

12) Study the table, which shows an index of real GDP for three countries (A, B and C) across a three-year time span starting from a base year.

Years	1	2	3
Country A	100	105	110
Country B	100	120	110
Country C	100	120	115

All of the statements which follow are correct *except*:

- a) 'A' grew faster between year 1 and 2 than between year 2 and year 3.
- b) All three countries had identical GDPs in year 1.
- c) 'C' grew at more than 10% between year 2 and year 3.
- d) 'B' grew faster than 'A' between years 2 and 3 but their growth rate was equal over the two years.

Answer:

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## Topic 2.1.2: Inflation

No.

1) With inflation at 3% which of the following statements is *false*?

- a) A 1% interest rate on savings is a negative real rate.
- b) Pay rises of less than 3% are effectively a cut in real wages.
- c) The real value of debt falls, other things being equal.
- d) The Governor of the Bank of England must write to the Chancellor and explain why the inflation rate is so high.

Answer:

☐

2) Which of these statements regarding inflation is *incorrect*?

- a) An increase in interest rates would cause the rate to increase in the short run.
- b) Inflation rates may be overestimated if price rises reflect an improvement in the quality of goods.
- c) The weight assigned to goods in a prices index should fall in a period of economic growth.
- d) A negative rate of inflation means that deflation is occurring.

Answer:

☐

3) Study the table which shows changes in the average price of beer per pint and the CPI over a period of years:

Year	Beer price (per pint)	CPI
1	£2.50	100
N	£3.00	110

Which of these statements is *correct*?

- a) The standard of living has increased by 10% over the period.
- b) The nominal price of beer is constant.
- c) The tax on beer must have increased.
- d) The real price of beer has increased.

Answer:

☐

4) Consider the prices index data for a country for several years:

Year	1	2	3	4
CPI	100	120	122	121

Which of these statements most accurately describes price changes over the period?

- a) Inflation was higher between year 1 and year 2 than between year 1 and year 4.
- b) Between years 2 and 4, deflation followed inflation.
- c) Inflation was 20% between year 1 and year 2 and 2% between year 2 and 3.
- d) Inflation was higher between year 1 and year 3 than between year 2 and 3.

Answer:

☐

5) Two ways of measuring inflation are the CPI and the RPI. Only one of these statements regarding the measurement of inflation is correct. Which one?

- a) CPI is a superior method for measuring inflation.
- b) RPI monitors housing costs such as mortgages, CPI does not.
- c) If interest rates rise, RPI tends to fall sooner than CPI.
- d) When prices rise on RPI the weights are immediately reduced.

Answer:

☐

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6) to 8) are based on these four items and their weights (totalling 1,000) which comprise a simple price index:

Category	Weight (1,000)	Price relative (yr 1)
Food	400	100
Clothing	250	100
Entertainment	200	100
Gadgets	150	100

6) In the base year the value of the index would be:

- a) 250
- b) 400
- c) 150
- d) 100

Answer: ☐

7) Which of the following would have the biggest impact on the rate of inflation in year 2?

- a) Each category going up in price by 2%
- b) Food prices rising by 9%
- c) Entertainment prices rising by 8%
- d) Clothing prices rising by 10%

Answer: ☐

8) By year 2, with inflation at 100% and unchanged weights and money incomes, which of the following is/are true?

- a) Real incomes have fallen by 50%
- b) The prices index has doubled
- c) The proportion of income spent on food is unchanged
- d) Each of the three previous options is correct

Answer: ☐

9) Based on the table below, in which year were real wages highest?

Year	1	2	3	4
Wage p/w (£s)	400	450	550	600
CPI	100	125	125	150

- a) 1
- b) 2
- c) 3
- d) 4

Answer: ☐

10) Each of the following could cause cost-push inflation EXCEPT:

- a) a 10% rise in the NMW
- b) an increase in the world price of oil
- c) new investment spending induced by growing business confidence
- d) an increase in the standard rate of VAT from 20% to 25%

Answer: ☐

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- 11) All of these statements regarding the price level are incorrect, except one. Which one?
- If the inflation rate falls from 5% to 0.1% prices are still rising and this represents deflation.
  - Deflation can mean that consumers postpone their spending as much as possible.
  - Rising Aggregate Demand (AD) is always associated with demand-pull inflation.
  - An inflation rate of zero is the main macro-objective for UK government.
- Answer: ☐
- 12) Cost-push inflation can be caused by each of the following, except:
- rising oil prices
  - a weaker currency
  - wages rising faster than productivity
  - the existence of structural unemployment
- Answer: ☐
- 13) The phrase 'too much money chasing too few goods' is associated with:
- stagflation
  - demand-pull inflation
  - monetarism
  - import cost-push inflation
- Answer: ☐
- 14) The reaction of workers to rising prices by seeking higher wages which in turn lead to higher production costs and further price rises is an example of:
- expansionary fiscal policy
  - a positive output gap
  - a wage-price spiral
  - imported inflation
- Answer: ☐
- 15) Deflation refers to a fall in the general price level. Which of these statements concerning deflation is incorrect?
- Benign deflation is associated with a growing economy.
  - 'Bad' deflation can be caused when output falls due to reduced AD.
  - Deflation in goods prices does not guarantee deflation overall.
  - The value of money falls.
- Answer: ☐
- 16) Consider the table below, which shows the UK's CPI inflation rate over several months in a given year:

Month	%
January	3.2
February	2.8
March	2.1
April	0.95
May	-0.22

Which of these statements is correct?

- Prices were higher in February than January so real wages fell.
  - Prices were lowest in May.
  - From given nominal wages, purchasing power was greater in May than April.
  - The Governor of the Bank of England would need to write to the Chancellor in both January and February to explain the inflation rate.
- Answer: ☐

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## Topic 2.1.3: Employment and Unemployment

No.

- 1) The Labour Force Survey (LFS) measure of unemployment includes all the following categories of people except:
- a) 'Returners' – often women seeking work after a period out of the workforce.
  - b) 'Discouraged workers' – former workers no longer involved in job search.
  - c) Retired people actively seeking employment.
  - d) IT workers with contracts due to begin in a fortnight.

Answer: ☐

- 2) Only one of the following groups can claim Jobseeker's Allowance: Which one?

- a) People whose redundancy payment is less than 16 weeks' pay
- b) Students looking for part-time work or vacation work
- c) People who have left their job voluntarily
- d) Redundant shop assistants

Answer: ☐

- 3) The preferred measures of inflation and unemployment rates in the UK economy are, respectively:

- a) RPI and the Claimant Count
- b) CPI and the Claimant Count
- c) CPI and the LFS method
- d) RPI and the LFS method

Answer: ☐

- 4) Each of the options 1 to 4 is a reason why a person is unemployed. All except one is matched up to the correct type of unemployment. Which one?

- [1] A person has concluded one contract and will start another in six weeks.
- [2] A shop assistant in Tesco has been made redundant due to investment in self-checkout technology.
- [3] An assembly-line worker in the car industry loses her job in a recession.
- [4] A temp with Argos concludes a seven-week contract on Christmas Eve.

- a) 1 is frictional
- b) 2 is structural
- c) 3 is voluntary
- d) 4 is seasonal

Answer: ☐

- 5) The economic effects of rising unemployment in a recession include which of the following combinations?

- a) Low output but pressure for higher wages
- b) Reduced income tax revenues but higher VAT receipts
- c) Increased welfare payments and more applicants per job vacancy
- d) A reduction in consumer confidence and reduced spending on inferior goods

Answer: ☐

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- 6) Which of the following is *not* a likely consequence of rising unemployment in the UK?
- A decrease in income tax revenue
  - A rise in government welfare expenditure
  - Government increases the real value of the national minimum wage
  - A decrease in demand for imported goods
- Answer: ☐
- 7) Despite many local vacancies being available, unemployment remains high in a northern city. This is *unlikely* to be caused by:
- occupational immobility of labour
  - geographical immobility of labour
  - high wages in the unfilled market
  - penalties for benefit claimants who refuse suitable interview
- Answer: ☐
- 8) Which of the following is likely to cause **demand-deficient** unemployment in the UK?
- A reduction in savings
  - An increase in the proportion of income spent on imports
  - Tax breaks for business investment
  - Global warming
- Answer: ☐
- 9) Each of the following is an example of structural unemployment *except*:
- Tesco investment in 'shop-assistant free' stores
  - Falling demand persuades some public schools to make their Latin teachers redundant
  - Competition with cheap imports leads to the closure of textiles factories in Manchester
  - Restaurants lay off waiting staff as business falls in a downturn
- Answer: ☐
- 10) Only one of the statements about seasonal unemployment is *false*. Which one?
- The retail trade recruits thousands of temporary workers every November.
  - The unemployment figures rise at the end of the Christmas period.
  - Redundant deckchair attendants can claim unemployment benefit.
  - Seasonal workers are entitled to the minimum wage.
- Answer: ☐
- 11) Which combination of policies listed below would be most appropriate for a government dealing with an economy facing both high structural unemployment and a negative output gap?
- Interest rate increase and a cap on unemployment benefit
  - Central bank selling of the pound and cuts in income tax
  - Increase in state pensions and a cut in excise duties
  - Spending on training schemes and a cut in the cost of borrowing
- Answer: ☐

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## Topic 2.2: Aggregate Demand

No

- 1) Savings would be expected to rise following all of the following changes *except*:
- an increase in the rate of interest
  - a fall in the rate of inflation to zero
  - an increase in disposable incomes
  - an increase in the supply of credit.
- Answer: ☐
- 2) Which one of the following would be expected to cause a movement along rather than a shift of the UK AD curve?
- A cut in the basic UK rate of income tax
  - A rise in GDP in Germany
  - A 10% increase in the price of UK houses
  - A fall in the UK price of petrol of 20%
- Answer: ☐
- 3) Which of the statements about macroeconomics is **correct**?
- Higher exports boost AD and GDP.
  - Wage rises always raise living standards.
  - Living standards can be measured using a prices index.
  - An output gap is always negative.
- Answer: ☐
- 4) Aggregate demand (AD) is a measure of total planned expenditure on a country's output worldwide. All of the following statements regarding AD are true *except*:
- In a closed economy without a public sector AD is  $C + I$ .
  - In an open economy with a public sector AD is  $C + I + G + X - M$ .
  - With a public sector but an economy closed to trade, AD is  $C + I + G$ .
  - In an open economy with a government sector AD can be expressed as  $C + X + G + I$ .
- Answer: ☐

- 5) Consider the table, which shows how Consumption (C) varies with GDP (£bn) over several years:

Year	1	2	3
GDP (£bn)	1000	1200	1400
C (£bn)	800	950	1000

Which of these statements is *incorrect*?

- Between years 2 and 3 the marginal propensity to consume is 0.25.
  - In year 1 the average propensity to consume is 0.8.
  - The highest average propensity to consume is in year 2.
  - In year three the average propensity to consume is 0.71.
- Answer: ☐
- 6) Investment by private sector firms is likely to rise for which *one* of the following reasons?
- A rise in interest rates
  - A rise in profits taxes
  - Rising demand for consumer goods
  - An increase in the negative output gap
- Answer: ☐

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- 7) Investment is defined in economics as:
- that part of disposable income not spent
  - the purchase of new vehicles by a car hire company
  - the creation of capital goods
  - 'investment' accounts from high-street banks
- Answer: ☐

- 8) The accelerator effect explains:
- how lower interest rates stimulate investment
  - that as demand or income increases in an economy, so does the investment made by firms
  - that changes in AD cause GDP to change by a larger amount
  - that demand for labour can fall in a period of growth
- Answer: ☐

- 9) The table below shows the composition of GDP (£bn) for an economy:

Economy Component	GDP (£00bn)
C	600
I	150
G	300
X	100
M	150

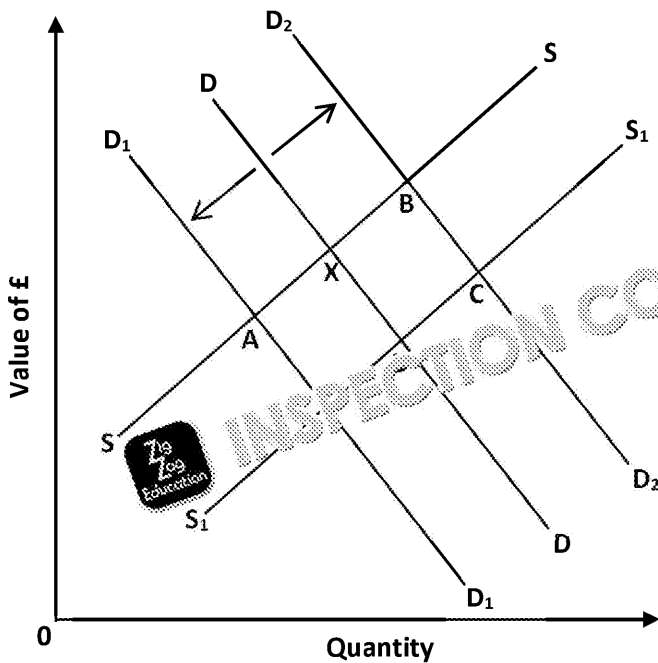
Based on the table, which of these statements is correct?

- The economy is at full employment output and is suffering from inflation.
  - The current account is in deficit by £50bn which is 5% of GDP.
  - Consumption is 45% of GDP.
  - Government has a budget deficit.
- Answer: ☐
- 10) An appreciation of the pound against the euro would have all of the following economic effects on the UK economy except:
- cheaper raw materials from the Eurozone
  - a reduction in import-cost push pressures
  - pressure on exporters to the Eurozone to control their costs
  - fewer UK citizens taking holidays in Spain
- Answer: ☐
- 11) If the £ is 'strong' on the foreign exchange rate market then which of these statements is valid?
- Exporters may face reduced orders and imported materials will cost more.
  - Aggregate demand will fall and demand-pull inflationary pressures will be reduced.
  - At a fixed exchange rate it is appropriate to compare living standards between countries.
  - All firms will face more difficult trading conditions.
- Answer: ☐

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12) to 14) make use of this supply and demand diagram, which shows the exchange rate for the pound against the euro, currently in equilibrium at point X. For each question, assume that X is the starting point.



- 12) What letter represents the new equilibrium if demand for UK exports falls? Answer: ☐
- 13) What letter represents the new equilibrium if UK demand for imports rises? Answer: ☐
- 14) What letter represents the new equilibrium if the Bank of England starts buying £s on the foreign exchange market? Answer: ☐
- 15) Domestic interest rate cuts may not lead to a depreciation of a country's currency if:
- a) rates are still lower in other economies
  - b) export demand is falling
  - c) import penetration is rising
  - d) speculators are selling the currency
- Answer: ☐

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16) If the 'USA sneezes the UK catches a cold'. This example of economic interconnectedness would suggest that:

- a) tax cuts in the USA may stimulate the UK economy as its imports from the UK rise
- b) tax cuts in the UK may stimulate the US economy as UK domestic consumption rises
- c) recession in the USA could cause recession in the UK as demand for UK exports falls
- d) growth in the UK is entirely dependent on conditions in the USA

Answer: ☐

17) If government simultaneously raises the main rate of VAT and uses the expected proceeds to reduce the top rate of income tax this example of fiscal policy would cause each of the following except:

- a) higher prices for many goods
- b) increased disposable income for some earners
- c) a less equitable distribution of income
- d) a reduction in the Budget deficit

Answer: ☐

18) If a government increases its expenditure by £100bn and pays for it by raising income taxes by the same amount then:

- a) there will be no change in GDP because the positive multiplier effects are cancelled out by negative ones
- b) any change in GDP depends on the size of the marginal propensity to consume (MPC)
- c) GDP will increase by £100bn
- d) government spending departments will be unaffected

Answer: ☐

19) Investment is defined in Economics as:

- a) that part of disposable income not spent
- b) the purchase of new vehicles by a car hire company
- c) the creation of capital goods
- d) 'investment' accounts from high-street banks

20) If an economy has a negative output gap of £62.5b, which of the following injections into the circular flow would close the output gap?

- a) £50bn
- b) £25bn if the mpc is 0.6
- c) £40bn if the mpc is 0.2
- d) £25bn if the mpc equals the marginal propensity to withdraw (the sum of the mps + mpm + mrt)

(\*the marginal propensities to save, buy imports and pay income taxes respectively)

Answer: ☐

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## Topic 2.3: Aggregate Supply

No.

1) Which of the following would cause a movement along the LRAS curve rather than a shift of the curve?

- a) Net immigration of people of working age
- b) An increase in government current spending
- c) Falling oil prices
- d) Breaking up of monopolies

Answer:

☐

2) Assuming a Keynesian LRAS curve, which of the following will inevitably happen if there is a fall in AD?

- a) Lower output
- b) Lower inflation
- c) Lower output and higher inflation
- d) None of the above as the shape of LRAS makes none of a) to c) inevitable

Answer:

☐

3) An outward shift in the long-run aggregate supply (LRAS) curve for a country can be caused by each of the following except:

- a) an increase in the official retirement age
- b) an increase in the basic rate of income tax
- c) a liberal policy on migration
- d) private sector investment

Answer:

☐

4) Only one of the following would cause a shift to the right of the LRAS curve. Which one?

- a) An increase in the state pension
- b) Raising of the official retirement age to 66
- c) A reduction in VAT
- d) A fall in imports

Answer:

☐

5) Keynesian and neoclassical economists disagree about the nature of LRAS in the economy. Based on this disagreement, which of these statements is false?

- a) In the neoclassical version, during a recession wage rates will fall, creating jobs and restoring the economy to the natural rate of unemployment.
- b) In Keynesian analysis there is an inverse, non-constant trade-off between inflation and unemployment.
- c) Demand-pull inflation can only occur in the Keynesian model.
- d) According to neoclassical theory a price spiral will result from expansionary monetary policy.

Answer:

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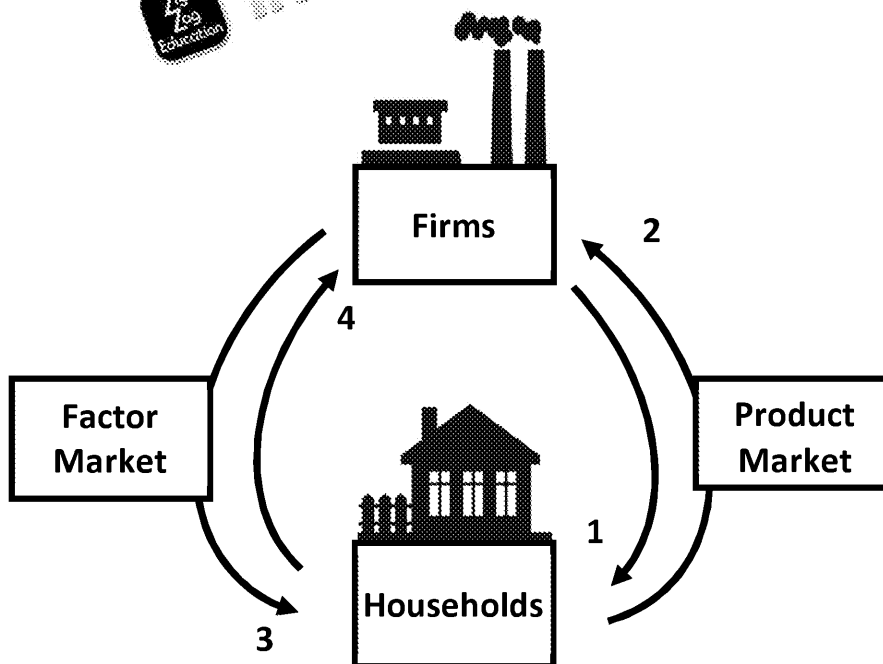




## Topic 2.4: National Income

No.

- 1) Which of the following combinations are both **leakages** from the circular flow of income?
  - a) VAT receipts and child benefit payments
  - b) Savings and investment
  - c) Imports and Individual Savings Accounts (ISAs)
  - d) Exports and tariffs
 Answer: ☐
- 2) There is only one **withdrawal** from the circular flow of income in this list. Which one?
  - a) Tariff-free imports
  - b) Credit card purchases of UK-made goods
  - c) Government subsidy to public transport
  - d) Road building
 Answer: ☐
- 3) Consider the diagram of the basic circular flow of income below:



Which of the arrows represents the flow of factor services from households to firms?

- a) 1
- b) 2
- c) 3
- d) 4

Answer: ☐

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4) Each of the following may be expected to increase both AD and LRAS *except*:

- a) an increase in government capital expenditure
- b) a reduction in the cost of borrowing
- c) a reduction in the top rate of income tax
- d) an increase in the Jobseeker's Allowance

Answer:

☐

5) If an increase in government spending of £150m causes GDP to eventually rise by more than £150m this can be explained by:

- a) the multiplier process
- b) economic interdependence
- c) induced investment
- d) rising wages

Answer:

☐

6) If 'poor' people have a marginal propensity to consume of 1 and 'rich' people have a marginal propensity to consume of 0.2 then a fiscal policy decision which redistributes £100m from 'rich' to 'poor' would, *initially*:

- a) leave AD unchanged
- b) cause 'rich' people to emigrate
- c) increase consumer spending by £100m
- d) increase consumer spending by £80m

Answer:

☐

7) An Economics student normally spends every penny of her £100 weekly income. Offered overtime hours in her part-time job, she decides to save half of the extra £50 and spend the rest.

Based on this information, which one of these statements is *false*? Her:

- a) average propensity to consume falls from 1 to 0.83
- b) marginal propensity to consume is 0.5
- c) average propensity to save rises from zero to 0.17
- d) wealth will decline

Answer:

☐

8) A woman's gross income is £20,000. If the first £10,000 of that income is free from income tax and the rest is taxed at 20%, it follows that (other things being equal):

- a) her average propensity to consume is 0.9
- b) her marginal propensity to consume is 0.2
- c) her disposable income is £1,500 per month
- d) her savings are zero

Answer:

☐

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- 9) The value of the multiplier is:
- smaller, the greater the propensity to consume
  - larger, the greater the propensities to save, tax and import
  - worth 1 if the marginal propensity to consume is 1
  - 2.5 if the marginal propensity to consume is 0.6
- Answer: ☐
- 10) The value of the multiplier is 1.25 if the mpc is:
- 0.9
  - 0.1
  - 0.2
  - 0.25
- Answer: ☐
- 11) In an open economy with government, a reduction in AD of £100m leads to an eventual fall in GDP of £200m, which of the following statements is correct?
- The value of the multiplier is 2.
  - The marginal propensity to import and the marginal propensity to consume must be equal.
  - The marginal propensity to save must be 0.5.
  - There is insufficient information to calculate the multiplier.
- Answer: ☐
- 12) The average worker in an economy receives a gross pay rise of £20 per week. She pays 20% of the £20 in income tax, spends 10% on imports and saves £4. Across the whole economy what is the value of the multiplier process?
- 1
  - 1.5
  - 2
  - 2.5
- Answer: ☐
- 13) In an open economy with government, if AD rises by £100m and the marginal propensity to consume is 0.2, which of the following is true?
- Consumer spending will eventually increase by £20m.
  - GDP will eventually rise by £125m.
  - The marginal propensity to save must be 0.8.
  - The inflation rate will rise.
- Answer: ☐
- 14) If an economy has a £200bn negative output gap, full employment output/income of £1,200bn and its marginal propensity to consume is 0.6, we can deduce that:
- there is both structural and frictional unemployment in the economy
  - a total of £200bn would close the output gap without causing inflation
  - increased government spending and earnings from exports of £80bn would be multiplied by 2.5 to achieve the maximum GDP
  - a reduction in income tax rates would lead to reduced demand for imports
- Answer: ☐

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## Topic 2.5: Economic Growth

No.

1) Economic growth is likely to cause all but one of these outcomes. Which one?

- a) A rising standard of living
- b) A reduced budget deficit
- c) Reduced congestion
- d) Higher income tax revenues

Answer:

☐

2) Of the following four options which best reflects an 'economic slowdown'?

- a) A period of consecutive quarters of negative growth
- b) An annual fall in GDP of at least 1%
- c) A period of zero economic growth
- d) A reduction in the annual growth rate from 3% to 0.5%

Answer:

☐

3) Other things being equal, an increase in exports from the UK will cause all of the following except:

- a) Economic growth
- b) Depreciation of the pound
- c) A positive multiplier effect
- d) Job creation

Answer:

☐

4) If 'full employment output' for an economy is £1,000bn and the *current* equilibrium output is £950bn then:

- a) there is zero demand-deficient unemployment
- b) there is an output gap of -5%
- c) there is a positive output gap
- d) there is a budget deficit

Answer:

☐

5) If the level of AD in an economy is sufficient to buy £1,200bn of output but full employment GDP is £1,000bn which of the following pairs of outcomes is most likely?

- a) A positive output gap with rising unemployment
- b) Deflation and a balance of trade deficit
- c) Demand-pull inflation and a trade deficit
- d) Fewer applicants per job vacancy and falling wages

Answer:

☐

6) A positive output gap would normally be associated with *each* of the following except:

- a) an increase in demand-pull inflation
- b) increased expenditure on imports
- c) workers doing overtime
- d) unemployment caused by insufficient demand in the economy

Answer:

☐

7) A recession is correctly defined as:

- a) a fall in GDP during any two quarters in a year
- b) a year during which GDP falls
- c) at least consecutive quarters of negative growth
- d) a period during which demand for normal goods falls

Answer:

☐

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- 8) A recession would normally feature which *one* of these pairs of outcomes?
- A growing negative output gap and fewer applicants per job vacancy
  - A fall in demand for inferior goods and rising demand for goods with income inelastic demand
  - A reduction in income tax revenues and an increase in welfare spending
  - An increase in unemployment and a reduced but still positive rate of economic growth

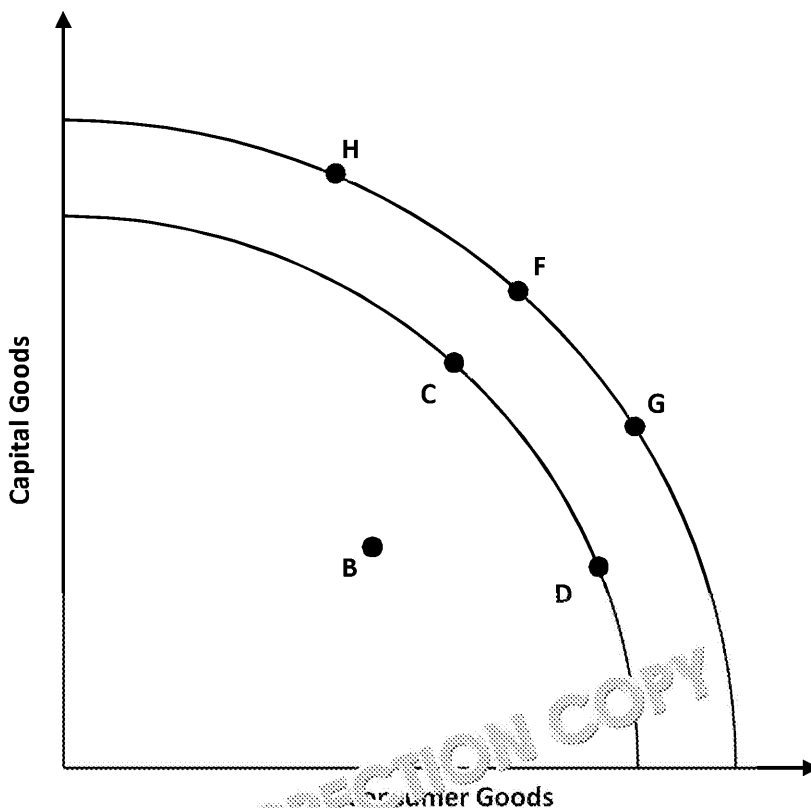
Answer: ☐

- 9) A UK 'economic boom' typically includes *each* of the following *except*:

- asset price inflation
- a worsening trade deficit
- inflation rising above the long-run trend
- excess supply of skilled labour

Answer: ☐

- 10) On the production possibility frontier (PPF) diagram below, which of the following two-part statements is correct?



- Short-run growth is shown by movement from C to D, long-run growth is shown by F to H.
- Short-run growth is shown by movement from B to C, long-run growth from F to G.
- Short-run growth is shown by movement from B to C, long-run from C to F.
- Short-run growth is shown by movement from B to D, long-run from D to C.

Answer: ☐

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11) The trend growth rate for an advanced economy is 2.5%. If it grows at 4% during a given year it follows that:

- a) the trend growth rate has increased
- b) productivity must have increased
- c) its AD curve only has shifted to the right
- d) its current growth rate could be unsustainable

Answer:

☐

12) Economic growth is likely to lead to all of the following except:

- a) increased producer surplus for sellers of normal goods
- b) rising demand for houses
- c) increased consumer surplus from inferior goods
- d) rising real incomes

Answer:

☐

13) and 14) use this explanation and table of data: Countries Nod and Utopia can produce two goods, X and Y. The opportunity cost of using one worker in either of the two goods is shown below in the table:

Country:	Nod	Utopia
Good X	8	1
	Or	Or
Good Y	2	1

13) Which of these statements is correct?

- a) Utopia is equally productive in both goods so cannot specialise
- b) Nod is better at producing both goods, making trade uneconomic
- c) Utopia should specialise in X, importing Y from Nod
- d) Nod has a comparative advantage in X as its X production involves a smaller sacrifice than Utopia's would

Answer:

☐

14) At which rate of exchange would both countries benefit?

- a) One X for one Y
- b) One Y for 2.5X
- c) Trade is uneconomic and would not occur
- d) One X for 0.25Y

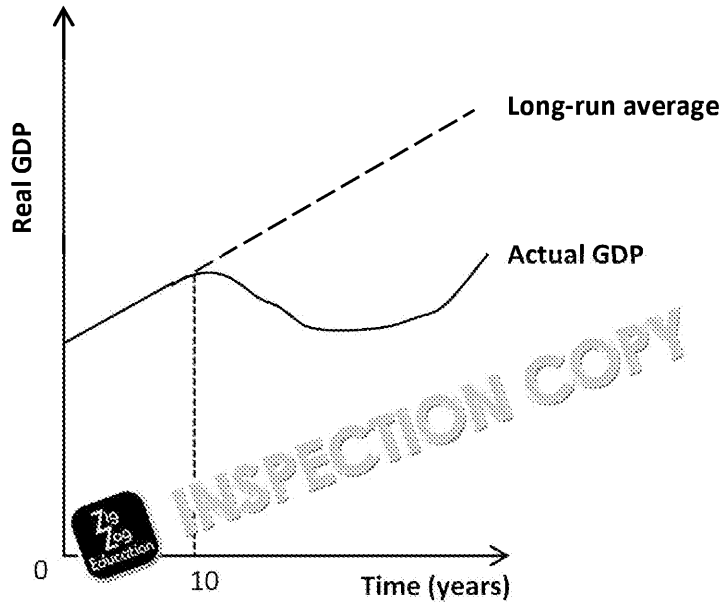
Answer:

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- 15) Consider the diagram which plots the actual trend of real GDP for an advanced economy against its long-run average.

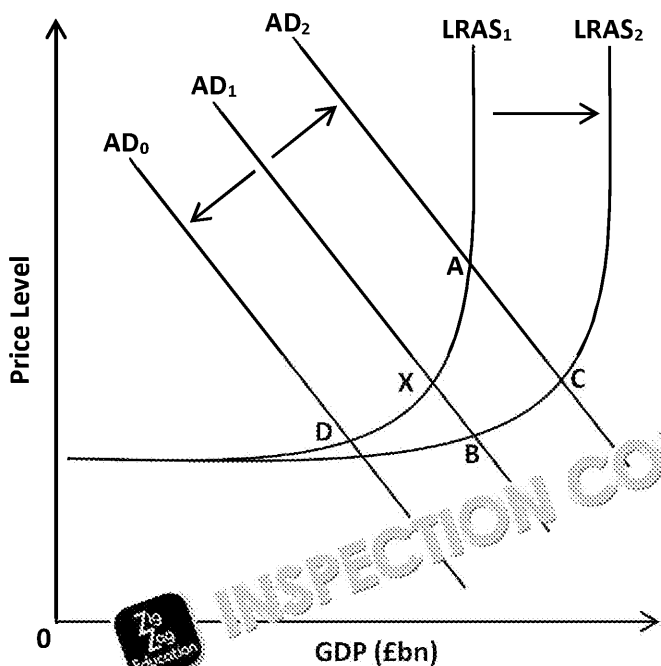


Based on the diagram it can be deduced that:

- up to year 10 there was zero unemployment in the economy
- there must have been deflation after year 10
- there was a recession after year 10
- after the recession the trend rate fell

Answer: ☐

- 16) to 18) inclusive make use of the following diagram, which shows the intersection of two LRAS curves and three AD curves. Assume that the economy begins at point X, where AD<sub>1</sub> meets LRAS<sub>1</sub> in each case.



To which equilibrium point would the economy move if:

- there is net immigration of 0.5m people of working age
- cuts in income tax boost both consumer spending and incentives to work and start businesses
- rising unemployment depresses consumer confidence

Answer: ☐

Answer: ☐

Answer: ☐

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## Topic 2.6: Macroeconomic Objectives and Policies

No.

- 1) A deficit on the current account of the balance of payments is least likely to be reduced by:

- a) a weakening of the exchange rate
- b) increases in income tax
- c) reduced government spending
- d) a rise in house prices

Answer:

☐

- 2) The UK trade deficit should fall for all but one of the following reasons. Which one?

A rise in:

- a) GDP in the Eurozone
- b) EU-wide tariffs on food imports
- c) tax-free income allowances
- d) interest rates in the UK

Answer:

☐

- 3) A weakening of the exchange rate for the pound sterling may actually not help reduce the trade deficit for all of the following reasons except:

- a) Exporters leave their foreign currency prices unchanged in order to raise their sterling prices and profit margins.
- b) Recession in our main markets leads to lower demand for exports whatever their price.
- c) Imported raw materials become costlier, cancelling out the opportunity to reduce export prices.
- d) Price elasticity of demand for both our exports and imports is elastic.

Answer:

☐

- 4) Assuming a Keynesian LRAS, if there is a rise in AD in an economy that is close to full employment output, each of the following can be expected except:

- a) rising inflation with some economic growth
- b) worsening of both the trade and budget deficits
- c) fewer applicants per job vacancy
- d) tightening of monetary policy

Answer:

☐

- 5) With a Keynesian LRAS curve, we can expect what kind of trade-off between inflation and unemployment as AD shifts?

- a) Positive
- b) Inverse and constant
- c) Inverse and non-linear
- d) None

Answer:

☐

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- 6) The Phillips curve indicates a:
- positive linear trade-off between inflation and unemployment
  - negative linear trade-off between inflation and unemployment
  - positive non-linear trade-off between inflation and unemployment
  - negative non-linear trade-off between inflation and unemployment
- Answer: ☐
- 7) An increase in the propensity/tendency to save in the UK would lead (other things being equal) to which combination of outcomes?
- Higher GDP and higher consumer spending
  - Lower employment and less output
  - Increased exports and imports
  - Higher interest rates and increased investment
- Answer: ☐
- 8) An increase in interest rates is likely to cause all of the following paired economic effects *except*:
- a reduction in credit card borrowing and an increased propensity to save
  - an appreciation of the pound and reduced sales of exports
  - a fall in new mortgage applications and an increase in monthly repayments on existing fixed-rate mortgages
  - an increase in income for 'saver' households and a lower inflation rate
- Answer: ☐
- 9) Only one of the following policies is fiscal rather than monetary. Which one?
- Reducing the base rate of interest to stimulate consumer spending
  - Buying of bonds from high-street banks by the central bank to help boost their liquidity
  - Reducing the income tax paid on savings interest
  - Raising interest rates to bolster the exchange rate for £
- Answer: ☐
- 10) An increase in the base rate of interest may have all of the following combinations of economic effects *except*:
- reduced credit card purchases and greater incentive to save
  - increased mortgage repayments and decreased demand for 'big ticket' items
  - falling demand for rented property and lower CPI inflation
  - a strengthening of the pound and reduced import cost-push inflation
- Answer: ☐
- 11) Fiscal and monetary policy are two ways the government has of managing the economy. One of the policies in the options a) to d) has been *incorrectly* categorised. Which one?
- Cutting VAT: *fiscal*; printing money: *monetary*
  - Removing child benefit from 'richer' households: *fiscal*; lowering interest rates: *monetary*
  - Reducing the tax paid on savings interest: *monetary*; raising pay rates to GPs: *fiscal*
  - Quantitative easing: *monetary*; raising the income tax-free allowance: *fiscal*
- Answer: ☐

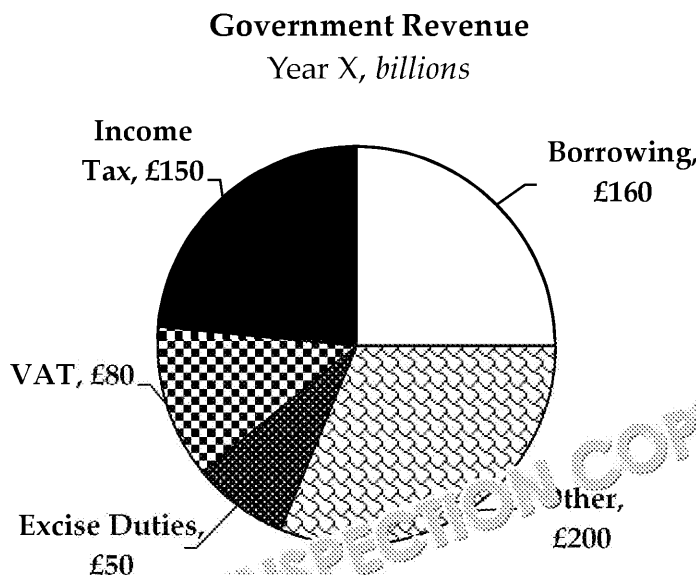
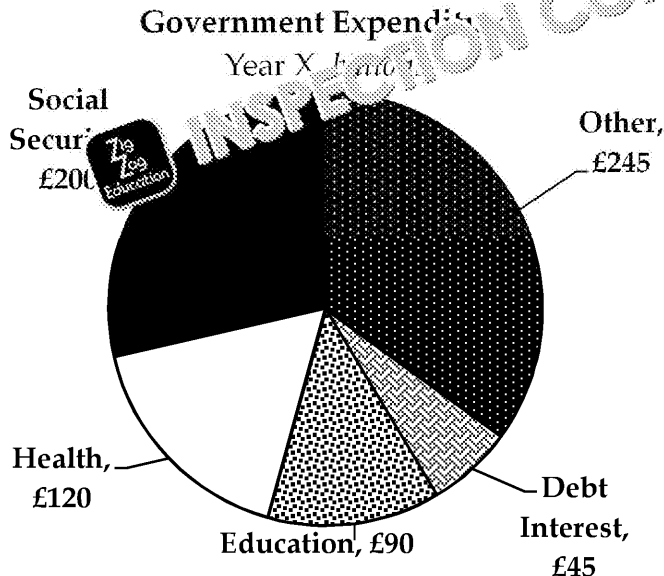
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12) A cut in income tax will have a smaller multiplier effect than an increase in government expenditure to the same value if:

- there is a Budget deficit
- there is reduced tax evasion
- income-tax-paying households decide to save much of any extra disposable income
- the marginal propensity to consume and the marginal propensity to withdraw are equal

Answer: ☐

13) Consider the pie charts which respectively show (for year 'X') what a government plans to spend and what its projected revenue is.



Based on each chart, we can deduce each of the following except:

- In Year X, the government is borrowing at an interest rate in excess of 25%.
- Health expenditure consumes the equivalent of 80% of income tax revenue.
- Excise duties generate one-third as much revenue as income tax.
- The budget for education could spend all the VAT revenues and more besides.

Answer: ☐

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14) All of the following taxes are *direct* except:

- a) tariffs
- b) income
- c) council
- d) corporation

Answer: ☐

15) Consider tax A which works according to the table:

Tax Paid (£s)	1000	2000	2400
Income (£000s)	10	20	30

It is:

- a) progressive at all income levels shown
- b) proportional at all income levels
- c) proportional between £0,000 and £20,000 then regressive
- d) regressive at all income levels

Answer: ☐

16) Arguments in favour of a reduction in the top rate of income tax in the UK include only one of the following. Which one?

- a) A less unequal distribution of income would result.
- b) Guaranteed extra income tax revenue.
- c) A possible shift in LRAS to the right.
- d) Reduced demand for imports should reduce the trade deficit.

Answer: ☐

17) Low productivity as measured by output per worker per hour could be caused by each of the following except:

- a) excessive manning levels
- b) low investment spending
- c) a fall in wage levels
- d) performance-related pay

Answer: ☐

18) Real-wage unemployment is associated with each of these except:

- a) the impact of minimum wages
- b) the power of trades unions to influence wage rates
- c) wages being 'sticky' in a downturn
- d) reduced levels of welfare payment for job seekers

Answer: ☐

19) Supply-side policies to reduce unemployment include each of the following pairs. Which is the exception?

- a) Making it easier for employers to hire and fire workers; increases in the personal tax-free allowance
- b) Reduction in unemployment benefit entitlement for job seekers; subsidising child care costs
- c) A reduction in the main rate of VAT; a liberal stance on immigration
- d) Grants for business start-ups; vacancy information to be emailed to job seekers

Answer: ☐

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## Topic 2.1.1: Economic Growth: Basics

Q	A	Explanation
1	d)	Underemployment refers to workers who want more paid hours than they can supply or to workers who are 'overqualified' for their current job. Of the options, only d) is underemployment, the other options are unemployment.
2	c)	Option c) is right – GDP per capita refers to output per head of population. Options a) and b) are basic definitions, d) would not be counted.
3	c)	Options a), b) and d) would not be counted in GDP but c) would be counted as it is tax avoidance.
4	b)	An exchange rate is at PPP if a unit of the currency can buy the same basket of goods and services at home and abroad – this rate would satisfy a key condition for option b) valid for PPP. Option a) is not valid as it is not a key condition for PPP. Option c) is not valid as it is not a key condition for PPP. Option d) is not valid as it is not a key condition for PPP.
5	b)	The Big Mac index is a simple way of determining whether exchange rates are at PPP or not – based on a single, homogeneous good (the Big Mac) which is sold in all countries. Therefore, option b) would reflect PPP.
6	a)	The Big Mac index works like compound interest, price rises on top of price rises. As shown, prices have risen by 33.2%, but year by year at a steady rate. Option a) is the correct option, and thus the right answer, is option a). We cannot determine whether the average citizen is better or worse off as no information is given.
7	b)	A concept such as the standard of living could include many variables. Option b) is the only material measurement demands the data from option b). Option a) and d) are adjustments that could be made to the key statistic offered.
8	d)	Option d) comprises three additional indicators which provide a more comprehensive view of the standard of living.
9	b)	To calculate real income in a given year we need to adjust the figure for inflation; to compare with the base year, figures for year 1 need to be deflated, to year 5 prices. Year 5 produced the highest real income (option b) at £1,500bn At year 5 prices, year 1 GDP is worth $100/90 \times £1,000\text{bn}$ (£1,111.1bn) Year 9 deflates to: $100/125 \times £1,750\text{bn}$ (£1,400bn); year 13 is $100/150 \times £2,250\text{bn}$ (£1,500bn)
10	b)	Option a) is right since $£1500\text{bn}/60\text{m}$ (income per head at year 5 prices). Option b) is incorrect, and, therefore, the right answer. Real GDP fell as population increased, leading to lower per capita incomes. Option c) is correct – prices rose by 11.1% whereas population increased by 11.1%. Option d) is correct too – with a price index of 100, year 5 is the base year.
11	c)	For valid analysis of figures, they need to be 'real' – therefore, c) at constant prices. Nominal/current mean unadjusted for inflation.
12	b)	The three countries do not have equal GDP values in year 1 – the base year. Option b) is the correct option to originate: option b).

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## Topic 2.1.2: Inflation

Q	A	Explanation
1	c)	Option c) is right; inflation erodes the real value of debt. If the inflation rate had exceeded 3% then a letter (d) would have been correct. The other options are correct.
2	d)	Option d) is incorrect, and, therefore, the right answer – deflation means a general price level not a reduction in the rate of inflation, which means prices are rising at a lower rate. a) is correct, because RPI includes mortgage costs (unlike CPI); so is YED so as demand for inferior goods falls so will their weighting in the index.
3	d)	Option d) is right – the price of beer has increased by 20% whereas other prices have increased by 10% – it has increased faster than prices in general. The real price would be higher by year N. Each of the other options is incorrect or unverifiable.
4	b)	Option b) is right. Disinflation marks a reduction in the positive rate of inflation. It is a fall in the price level.
5	b)	Neither measure is superior, each measures inflation in a different way. RPI is that increases in interest rates raise its measure of inflation in the short run. Aggregate demand falls. This is because mortgage repayments are on a variable rate. Option b) is right then.
6	d)	It is conventional to begin a price index in a year of low inflation, called the base year. Option d) is right.
7	c)	The contributions of each category to the rate of inflation can be calculated by multiplying (its weighting) of 9% thus 3.6%; entertainment is 20% of 8%: 1.6%; clothing is 10% of 5%: 0.5% and, therefore, 2.5% and thus the right option, c), a higher rate than 2.5%.
8	d)	With the assumptions made, each of a, b, and c, is right (option d) the purchasing power has halved but unchanged weights of income spent are unchanged.
9	c)	The money wages need to be corrected for inflation, expressed in base year prices. Here is the method: Wage rate in current year $\times$ Base year CPI Index / Current year CPI Index e.g. year 4: $\text{£}600 \times 100/150 = \text{£}400$ at year one prices. The right answer is option c) $\text{£}550 \times 100/124 = \text{£}440$ : a 10% increase in real wages.
10	c)	Increased investment would raise both AD and LRAS, the other options would raise costs – so option c) is right.
11	b)	Option b) is right: deflation means falling prices so postponing purchases and rational consumer behaviour. The other options are false – a positive inflation rate increases the price level (a); rising Aggregate Demand may not cause inflation if Aggregate Supply is perfectly elastic, say; government has never targeted inflation (c); the risk of deflation would be too great (d).
12	d)	Option d): frictional unemployment is a short-term and an inevitable feature of free markets. It is not associated with stagflation, unlike the other options.
13	c)	Forever associated with Milton Friedman and the monetarist school.
14	c)	Option c): a wage-price spiral is what is being described.
15	d)	Option d) refers to an increase in the value of money, just as inflation refers to a fall in the value of money.
16	c)	Option c) is right. Deflation fell in May so the deflation would have given a marginal increase in the purchasing power to workers – option c) is right.

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## Topic 2.1.3: Employment and Unemployment

Q	A	Explanation
1	b)	Option b) the 'discouraged workers' – typically long-term unemployed as they are not actively seeking work and able to start. The other categories are not unemployed by this measure.
2	d)	Jobseeker's allowance would only be available to those in option d) – long-term unemployed. The other groups would not qualify.
3	c)	Option c) offers the correct pair and is thus right.
4	c)	Option c) is incorrect, and, therefore, the right answer. The cause of unemployment during a recession so it is cyclical, not voluntary.
5	c)	Option c) is right – welfare payments will rise as jobs are lost and there are more applicants per vacancy.
6	c)	It is unlikely that recession which leads to excess labour supply, would cause the real value of the minimum wage to rise.
7	c)	Frictional unemployment is a typical feature of a shrinking economy.
8	b)	Geographical labour immobility is unlikely to be a cause of unfilled vacancies – option c).
9	d)	Demand-deficient unemployment is caused by a fall in AD, so if an increase in income is spent on imports AD must necessarily fall (negative multiplier effect) and unemployment would rise: b).
10	b)	The only instance of unemployment here not caused by a fall in demand for specific types of labour offer is d) which is caused by recession so is demand-deficient in nature.
11	d)	The unemployment figures are 'seasonally adjusted' so spikes in the data are omitted – so b) is the right answer.
12	d)	Structural unemployed workers need to become occupationally mobile to effect this. Cheaper money can stimulate activity – option d).

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## Topic 2.2: Aggregate Demand

Q	A	Explanation
1	d)	An increase in the supply of credit may discourage saving whereas to increase savings – option d).
2	d)	The first three options should all result in a rightward shift of AD – rising expenditure (a), rising X demand (b), ‘wealth effects’ (c) but cheaper prices to benign deflation, lower general prices giving households greater real income – option d).
3	a)	Option a) is right – rising X leads to rising AD. Wage rises could be lower than inflation, reducing living standards; insufficient to measure living standards. An output gap can be positive for an economy’s current potential output.
4	d)	Options b) and d) are virtually the same – public and government sector, but d) excludes the private sector so is incorrect.
5	c)	The marginal propensity to consume/save refers to the proportion of the change in income that is spent/saved. Average propensities refer to spending/saving as a proportion of total income. Option c) is incorrect – the average propensity to consume falls from 0.75 to 0.6, thus the right answer.
6	c)	Investment demand can be induced by rising demand for consumer goods if businesses do not have unused capacity: option c). More costly borrowing and increased tax on profit would deter investment – option b).
7	c)	Option c) is the definition of ‘investment’, b) is an example. a) is savings, d) is expenditure.
8	b)	The accelerator effect refers to the process in which additional investment leads to rising demand in the economy – option b). Option c) refers to the multiplier process, with which the accelerator effect works.
9	b)	AD equals £1,000bn so this is the equilibrium output; the trade deficit is £100bn so GDP = £1,100bn – this is the only calculable option: option b).
10	d)	A ‘stronger’ pound makes imports cheaper but can make it more difficult to sell, but would not reduce visits to Spain from UK citizens (option d) is correct).
11	b)	Aggregate demand may fall and hence demand-pull pressure – if expenditure falls, so option b) is right.
12	a)	A fall in demand for UK goods signals a fall in demand for the £, and hence a fall in the value of the £. The new equilibrium is where D1D1 cuts SS: option a).
13	d)	An increase in demand for imported goods requires an additional supply of goods: option d).
14	b)	Such intervention by the Bank of England would cause a shift to the right for £s, a movement to B.
15	a)	If domestic interest rates are still relatively high then the currency may be ‘hot’ money, keeping demand high, so option a) is right. Options b), c) and d) would all lead to a weaker currency.
16	c)	Option c) – recession in the USA (a cold) causes sniffles in the UK as demand for goods falls.
17	d)	The fiscal policy measures described would leave the budget unchanged (a) but would have the other effects – option d) is right.
18	c)	A balanced Budget Multiplier sees increases in government spending and increases in taxation. They do not cancel each other out because the multiplier effects of the direct injection into the economy are greater than those of a cut in tax. Households are unlikely to spend every extra penny of their increased disposable income – option c) is correct.
19	c)	Option c) is the definition of ‘investment’; b) is an example. Option a) is savings.
20	b)	The multiplier is 2.5 so an injection of £62.5b ÷ 2.5 will secure full employment.

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## Topic 2.3: Aggregate Supply

Q	A	Explanation
1	b)	Movement along a LRAS curve is induced by a change in AD. The only option among the options is option b), the increase in government current spending.
2	d)	Option d) – the impact of a fall in AD on the price and output levels is the same as the original position on LRAS – if in the vertical section, prices only may fall.
3	b)	An increase in the basic rate of tax (option b) may reduce AD but it may also give incentives to work, to set up businesses, so would not cause an increase in the potential of the economy.
4	b)	Raising the official retirement age (option b)) would increase the supply of labour, hence shift LRAS to the right.
5	c)	Option c) – demand-pull inflation can occur under both perspectives. Classical economists believe that the economy tends towards full employment and market forces will correct any imbalance. Keynesians believe government intervention is needed to correct a slump.



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## Topic 2.4: National Income

Q	A	Explanation									
1	c)	Option c) is right – leakages are monies leaving the circular flow, as savings. Each of the other options comprises both a leakage and an injection.									
2	a)	Tariff-free imports (option a) are a leakage, the other three options are injections.									
3	d)	Arrow 4 (option d) represents the flow of factors/services by households to firms via the factor market. (3 is payment to factors, 2 is output of goods/services, 1 is household expenditure on goods/services)									
4	d)	An increase in JSA should boost AD as recipients are likely to spend; however, higher welfare payments may deter labour market participation – so option d) is correct. The other options should influence long-run growth, e.g. a reduced top marginal rate may have an impact on AD but does not stimulate wealth creation.									
5	a)	The multiplier process is being described – a change in AD causes the multiplier effect, i.e. a change in spending.									
6	d)	Option d) is right – ‘rich’ folk would reduce spending by £20m, ‘poor’ folk would increase spending by £80m, so the redistribution would increase consumption by £60m.									
7	d)	Statements a), b) and c) are each correct – consider the table: <table border="1"> <thead> <tr> <th>Spending (£)</th><th>Income (£)</th><th>Savings (£)</th></tr> </thead> <tbody> <tr> <td>100</td><td>100</td><td>0</td></tr> <tr> <td>125</td><td>150</td><td>25</td></tr> </tbody> </table> <p>She now spends 5/6 of her income, down from all of it; she saves 1/6 of her income but 0.5 of the extra. Therefore her ‘wealth’ (savings) rises, not falls, so d) is false and hence option a) is correct.</p>	Spending (£)	Income (£)	Savings (£)	100	100	0	125	150	25
Spending (£)	Income (£)	Savings (£)									
100	100	0									
125	150	25									
8	c)	She pays £2,000 in income tax (20% of her taxable income of £10,000), so her disposable income is £18,000, £1,500 per month (£18,000/12) – option c). As to how she spends/saves this disposable income, we are not told.									
9	d)	The greater the proportion of any extra income that is spent, the greater the multiplier effect – so the first two statements are wrong. If the marginal propensity to consume (mpc) is 1 (c), then every extra pound spent – the multiplier is without limit. The formula for the multiplier is $1 / (1 - \text{mpc})$ , so option d) equals 1/0.									
10	c)	The lower the marginal propensity to consume, the lower the multiplier effect. Where $x = (1 - \text{mpc})$ , so $1/1.25 = x$ , so $x$ is 0.8 and the mpc is 0.2 – option c).									
11	a)	The multiplier can be calculated by dividing the final change in GDP by the initial injection which initiated it – here £200m/£100m means that the multiplier is 2, option a). If the mpc and the mpw had been equal, the multiplier would have been 1/0.5 since any extra income must be spent on imports or paid in taxes.									
12	c)	50% of the extra income is withdrawn/leaked (20% plus 10% plus 20% for savings), so the multiplier is 2: $1 / (1 - 0.5) = 2$ .									
13	b)	The multiplier here is quite low, since $1/0.8$ is 1.25. GDP will rise by £125bn. Consumer expenditure would rise by 0.25 of the total GDP growth (since the marginal propensity to withdraw is 0.8; there is no data to gauge any increase in investment or government spending).									
14	c)	The multiplier is 2.5 since the mpc is 0.6 ( $1 / (1 - 0.6) = 2.5$ ). Thus an injection of £80bn would be multiplied by 2.5, raising GDP by £200bn – securing full employment – option c). An injection of £200bn would cause inflation.									

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## Topic 2.5: Economic Growth

Q	A	Explanation
1	d)	Economic growth is unlikely to lead to reduced congestion, if private good and some forms of public transport are inferior – option d).
2	d)	Option d) – growth is still positive, but at a slower rate.
3	b)	Option b): increased demand for our exports would cause the £ to appreciate it would be in greater demand. The other three would occur.
4	b)	The economy here could produce an extra £50bn output if there was a negative output gap is £50bn – option b) – we cannot speculate on the balance of payments and there must be some demand-deficient unemployment on account of the multiplier.
5	c)	An injection of £50bn would ‘overheat’ the economy, creating a positive output gap. Policy c) would close the gap – £40bn injected with a multiplier of 1.
6	c)	Option c) is correct as this economy is being overworked so we can expect some of the frustrated domestic demand being satisfied by imports, increasing trade deficit; the relatively high domestic inflation rate will make the deficit worse again.
7	c)	The correct definition is c) – output must fall for at least six consecutive quarters.
8	c)	Option c) would be likely – it is automatic for tax revenues to fall and expenditure on welfare to rise when an economy shrinks.
9	d)	Skilled labour is often in short supply during a period of rapid growth such scarce resources is unlikely – option d) is correct, therefore.
10	c)	Short-run growth reflects movement from inside a PPC to a point on the curve, to the right of the original one – hence option c).
11	d)	Years with above average growth rates may be unsustainable as they are ‘booms’ and tend to bring problems of inflation and a deteriorating current account – option d).
12	c)	Inferior goods would be in lower demand so with leftward shifts in demand curves, contractions of supply there would be reduced consumer surplus: option c).
13	d)	According to international trade theory, specialisation should be based on comparative advantage – Nod does have a comparative advantage in good X as it produces more of it, whereas with Utopia it would be 1 for 1: option d). Nod being more productive in both goods does not make trade unnecessary.
14	c)	Trade is possible between two countries if their opportunity cost ratios are different. A mutually beneficial exchange rate will lie between these ratios. Utopia has a comparative advantage in good Y as it makes a smaller sacrifice (1X per Y produced) than the 4X that Nod has to sacrifice per Y. Option c): one Y for 2.5X would lie between the two ratios and benefit both countries.
15	c)	The economy grew ‘on trend’ from year 0 to year 40 but there was a sharp decline in growth resumed – option c).
16	b)	Option b) where the short-run aggregate supply curve crosses AD1.
17	c)	Option c) where the short-run aggregate supply curve crosses AD and AS rise.
18	d)	Option d) where the short-run aggregate supply curve crosses AD falls.

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## Topic 2.6: Macroeconomic Objectives and Policies

Q	A	Explanation
1	d)	Rising house prices tend to make existing homeowners feel wealthier to import tends to rise – making the trade deficit bigger: option d). The other options could improve the trade position.
2	c)	A rise in income tax-free allowances in the UK would stimulate spending on imports, so would not be expected to help reduce the trade deficit. Higher interest rates depress import demand; rising incomes in the UK increase demand for UK exports.
3	d)	A weaker currency should help reduce the trade deficit ('WPIDEC') issues – such as in options a) to c). However, elastic demand for exports and imports should lead to raised export earnings, reduced import expenditure – option d) is right.
4	b)	A worsening trade deficit is a common feature of UK economic growth. The budget – should improve as unemployment falls and tax revenue rises (option b). Higher interest rates and labour shortages would be expected.
5	c)	The Keynesian LRAS is in three sections so we would expect inflation and unemployment fall but for the relationship to be non-linear : option c).
6	d)	Option d) – inverse but non-constant trade-off. The opportunity cost of unemployment tends to rise in terms of inflation.
7	b)	Increased willingness to save means reduced willingness to spend so sometimes referred to as 'the paradox of thrift'. Option b) is right the other three are wrong.
8	c)	Fixed interest mortgage repayments would not rise although mortgage interest rates are likely to fall, so c) is the correct pairing – option c). The other combinations are likely.
9	c)	Fiscal policy concerns government expenditure and taxes so c) is an example of fiscal policy; the other three are monetary.
10	c)	Higher interest rates aim to reduce inflation by encouraging savings and reducing the effective disposable income, including 'big ticket' items, and reducing the effective disposable income with mortgages. However, demand for rented property may rise if mortgages become more expensive so only the latter part of option c) is correct and thus the right answer.
11	c)	Reducing the tax paid on savings is fiscal not monetary: option c).
12	c)	Any income tax multiplier tends to be weaker than an equivalent increase in expenditure as households may only spend a proportion of their extra income: option c).
13	a)	Debt interest includes payments on all outstanding government debt in the current year – so a) is incorrect and thus the right answer.
14	a)	Direct taxes are put on income, profits, value added, indirect (such as option a) tax on goods and services.
15	c)	The tax shown is not directly proportional – same % taken at both income levels but tax payments continue to rise they rise at a slower rate making it regressive: option c).
16	c)	Option c): extra tax revenue is not guaranteed but there would be increased savings in the economy which could lead to an increase in productive potential, an increase in employment and a reduction in unemployment.
17	d)	It is unlikely that option d), performance-related pay, would not lead to an increase in output per worker per period.
18	d)	Real-wage unemployment is caused by wages being above their free market level. Option d) would drive wages downwards if the supply of labour increased and the demand of being unemployed having increased.
19	c)	Option c) a reduction in the base rate of interest is principally a demand-side policy to stimulate spending; liberal immigration may lead to unemployment if the supply price of their labour is higher than the new equilibrium wage.

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