Zig Zag Education

Economics AS / A Level | Edexcel | 8EC0/9EC0

Topic Tests for AS / A Level Edexcel A

Theme 2: The UK Economy – Performance and Policies

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Contents

Teacher's Introduction

This resource consists of a set of Topic Tests that have been written to support the teaching of A Level Edexcel A Theme 2. It allows teachers and students to check their understanding and consolidate knowledge of each part of the Edexcel specification. In each Topic Test there is a mixture of numerical, multiple-choice, short-answer and essay-style questions of a variety of different difficulties. There are 12 Topic Tests in this resource, following the topics of the A Level specifications.

Importantly, each Topic Test is accompanied by a set of detailed answers that could be handed out to students as a basis for 'model' answers in the examination. Note that although the Topic Test questions aren't always in exam format, the questions within have been written carefully with the intention of testing the range of Assessment Objectives and often borrow aspects that are similar to those in the exam.

Most of the case studies in the Topic Tests include up-to-date economic data and scenarios that should place economic theory in recent history, enrich students' general knowledge of the subject, and prepare students for the Data Response aspects of the examination. Moreover, the resource also includes plenty of opportunities for students to practise the Quantitative Skills outlined in the Appendix of the Edexcel specification.

Most Topic Tests contain 30–40 marks worth of questions, although some tests are shorter to cover each specification topic appropriately according to its scope. It is intended that the longer Topic Tests will take about one hour to complete and should be presented to students *after* teaching the parts of the specification that are to be tested. However, the Topic Tests could also be given to students as homework in order to consolidate their knowledge outside of the classroom, or certain aspects could be used as a supplement to in-class learning.

It is important to note that this resource should be used as a complement to other resources such as textbooks and practice exam papers, and not in isolation. These Topic Tests include plenty of explanation of the theory in the mark scheme, but students should be encouraged to access information as widely as possible.

Notes on specific tests:

- Note that although the title of this Theme is 'The UK Economy – Performance and Policies', at various points in the resource we use examples from other countries. For these questions students are not expected to have prior knowledge of the economies in question, and it is hoped that they can practise applying the principles of macroeconomic theory without needing to stick solely to the UK context. This will also prepare them well for macroeconomic themes in Theme 4 and in the exam for Paper 3.
- Test 2.1d (Balance of Payments) is very short; however if you are teaching the full A Level you may wish to combine this with the equivalent Theme 4 test which covers 4.1.7 Balance of Payments. Alternatively it could be paired with an earlier or later Theme 2 test, or simply set as a short task.

It is hoped that this resource, as well as offering support for teaching the essential elements of the Edexcel macroeconomics specification, will help students fully prepare for their A Level examinations. The economic environment is constantly in flux, and full of fascinating current issues. This resource attempts to share some of these current issues as a basis for teaching in the most interesting way possible, meanwhile encouraging further study from the next generation of Economists!

Happy teaching!

November 2019

Mark Breakdown Test-by-test

Test	
2.1a	
2.1b	
2.1c	
2.1d	
2.2a	
2.2b	
2.3	
2.4	
2.5	
2.6a	
2.6b	
2.6c	

Topic Test 2.3 Aggregate Supply (AS)

1. What is meant by aggregate supply (AS)?

2. In April 2016, the UK government introduced the 'National Living Wage' whic
wage by 50p. How would the introduction of the National Living Wage affect
supply (SRAS)?

3. Table 1 outlines various factors that might affect macroeconomic equilibrium

Table 1

	Scenario
(i)	Increasing prices for a barrel of crude oil on international markets b
demand from emerging economies such as India and China.
(ii)	Miners find a deposit of rare earth elements that can be used to prod
(iii)	Increasing government expenditure on the NHS to improve the gene
British public.
(iv)	Firms' confidence in the state of the British economy falls following

Using AD/AS diagrams, individually evaluate how these factors can affect ma

4. Explain, using one or more diagrams, the difference between a movement al
shift of the AS curve.

5. Explain, using an appropriate diagram, the difference between Keynesian a
aggregate supply.

Topic Test 2.4 National Income

1. Explain the **three** methods of measuring national income.

2. Which of the following is *not* a form of income?
   A Salaries
   B Bonuses
   C Real estate
   D Wages

3. What is meant by a circular flow of income?

4. Explain the difference between physical and monetary flows in the context of income model.

5. Using an AD/AS diagram, identify macroeconomic equilibrium.

6. Suppose the UK government injected funds into the economy via infrastructu differing effects this policy would have on macroeconomic indicators betwee schools of thought.

7. Imagine a fictional economy in which households spend £80 each day out of £150. If incomes rose to £200, the same households would spend £100 per d

   Calculate the marginal propensity to consume.

8. Table 1 gives information on a country's marginal propensity to save, tax, and

Table 1

	Value
Marginal Propensity to Save	0.1
Marginal Propensity to Tax	0.1
Marginal Propensity to Import	0.05

   Calculate the national income multiplier for this economy.

9. Explain **one** factor that affects the size of the national income multiplier.

10. Explain, using an AD-AS diagram, how the multiplier effect would impact GDP

Topic Test 2.5 Economic Growth

1. Using a PPF, explain the difference between short- and long-run economic gr

2. Explain the difference between *actual* and *trend* rates of economic growth.

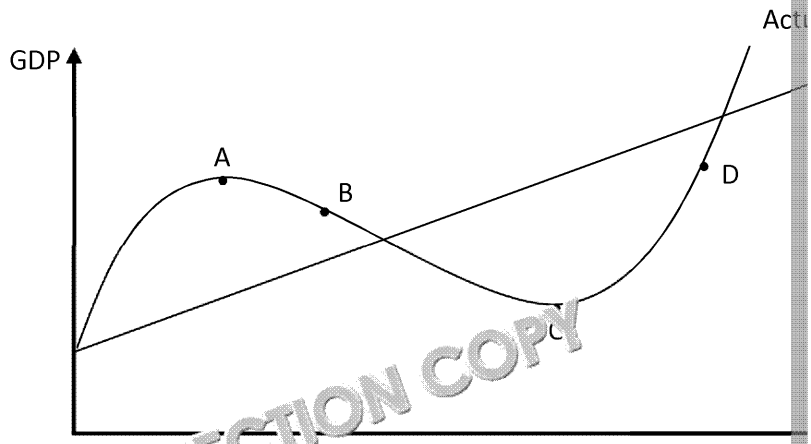
3. Explain how *economies of scale* can be achieved [illegible] gh international trade.

4. Evaluate **two** potential causes of a [illegible] gap.

5. (i) Illustrate, [illegible] AD/AS diagram, both a negative and a positive outpu
   (ii) E[illegible] he reason why it is difficult to measure an economy's output ga

6. Figure 1 displays a diagram of the business cycle.

Figure 1



   (i) In Figure 1, which point (A–D) correlates to the recessionary stage of the
   (ii) In Figure 1, which point (A–D) correlates to a 'boom' in the economic cyc

7. Imagine that you are an economist working for the Office for National Statist England's Monetary Policy Committee and have been asked to monitor the U you would tell whether the UK economy was in a boom or in a recession.

China and India are among the fastest growing economies in the world. China's growth between 2005 and 2015 was 9.76%, and India's 7.59%. GDP growth r astonishing for economies that within the last century were highly underdevelope The World Bank has estimated that more than half a billion people have escape since 1981 as its poverty rate has fallen from 88% to [illegible] of the population. H growth certainly has its benefits, there are asso[illegible]d [illegible]ts as well. Inflationary in the Chinese economy and India is th[illegible]d-[illegible]st unequal economy on Earth, controls 58.4% of the country's [illegible]

8. Refere[illegible]he [illegible]perience of India and China, evaluate the costs and benefi

Topic Test 2.6a Macroeconomic Objectives and Policies

1. Distinguish between *fiscal* and *monetary* policy.

2. It is said that one of the core macroeconomic objectives for most governmen employment'. What is meant by 'full employment'?

3. The Bank of England, the central bank of the UK, has an objective of price sta monetary policy to achieve the government's inflation target of 2.0%. What i macroeconomic policy objective of 'low and stable' inflation?

4. Explain what is meant by the macroeconomic policy objective of reducing inc

5. Explain **two** potential reasons why a government might wish to increase publ

6. Which of the following is an example of *indirect* taxation?
   A Corporation Tax
   B Income Tax
   C Property Tax
   D Value Added Tax (VAT)

7. The United Kingdom's Conservative government budget for 2016 outlined th £716 billion received in revenue, but a projected £772 billion in government

   (i) Calculate the UK government's budget position for 2016.
   (ii) What is meant by a budget deficit?

8. In the UK, the Coalition and Conservative governments from 2010 operated reducing the budget deficit. Explain one reason that some governments have macroeconomic objective of a balanced budget'.

9. 'Quantitative Easing' (QE) refers to which of the following explanations?
   A When an economy's monetary policy authority publishes economic fore future interest rate changes in order to influence market expectations.
   B When an economy's monetary policy authority provides stimulus to the money creation and the purchase of financial assets.
   C When an economy's monetary policy authority conducts monetary polic inflation target.
   D When an economy's monetary policy authority distributes money direct handing out a citizens' dividend.

10. Explain the role of the Bank of England's Monetary Policy Committee (MPC).

On the 4th of August 2016, the Bank of England's Monetary Policy Committee (M historic low of 0.25% from the previous 0.5%. The UK's inflation rate around this which is below the MPC's inflation target of 2.0%. Its predictions of the UK's rate were revised downwards from 2.3% to 0.8% largely because of the uncertainty the UK economy that has resulted from Brexit. The MPC is also considering cutting to 'close to, but above, zero' if the economy performs as poorly as Bank However, the Brexit result has also resulted in a depreciation of the pound sterli of the UK's imported goods.

11. Evaluate the MPCs decision to cut interest rates on the government's macroe

Topic Test 2.6b Conflicts and Applications of Macroeco

1. 'Sustainability', including the protection of the natural environment, is an im many central governments. Explain why this objective might conflict with oth policy objectives.

2. What is meant by the Phillips curve?

3. Explain, using an appropriate di[illegible] potential for a trade-off between growth when using mo[illegible] to stimulate the economy.

4. Explai[illegible] to the effectiveness of monetary policy measures.

In 1929, America was confronted with an economic downturn more severe than by an industrialised nation. It was dubbed the 'Great Depression' by commenta consumption fell dramatically and this had a subsequent impact on the behaviou including their employment and investment decisions. Nearly 20% of the Americ themselves unemployed in the years following the Wall Street crash. John May modern macroeconomics, believed that this phenomenon could have been expla rigidity of wages.

5. Evaluate, using an appropriate diagram(s), whether the Great Depression pro inflexibility of nominal wages.

In the aftermath of the 2007–2008 financial crisis, [illegible] Western central gover spending for causing the crisis and were also c[illegible] about the impact of sub ability for their economies to recover. [illegible] – a policy of decreased governm increased taxation – was rolle[illegible] in order to improve these governments' fina such as Paul Krugman [illegible] concerns about the effect that austerity could depressed [illegible]

6. Evaluate, using an appropriate diagram(s), the effect of austerity on economi onset of the 2007–2008 financial crisis.

Topic Test 2.6c Supply-Side Politics

1. Explain, using one or more examples, the difference between market-based a supply-side policies.

2. Explain the difference between supply-side polices and s pply-side improven

3. Which of the following is *not* an examp[illegible] f a su[illegible]-side policy?
   A Reforming the social secur[illegible] st[illegible]
   B Immigration
   C Quantitati[illegible]
   D D[illegible]tio[illegible]

4 Assess **one** policy that a government could employ in order to improve labou

In London, Crossrail 1's 'Elizabeth' line is set to open in 2021. Crossrail 1 is set to economic benefits in London and the South East by bringing in an additional 1.5 minutes travel time of the City. Crossrail 2, which will travel from London's North similar benefits and should be completed in the not-so-distant future.

5. Explain, using one or more diagrams, how investing in Crossrail 1 and 2 will i of the economy.

6. Evaluate the capacity of supply-side policies to achie[illegible]e government's ma full employment.

Answers

Topic Test 2.1a Measure of Economic Performance: Eco

1. Economic growth refers to increases in the real GDP of an economy over time. Im
between short- and long-run economic growth, wh[ere] long-run growth refers t
output and long-run growth refers to changes in the *potential* output of an econo
between short- and long-run economic growth when looking at rates of change i

*[2 marks for a clear explanation of the concept of economic growth; 1 mark for an
conveys the general meaning]*

2. Gross national income (GNI) measures the total income generated by a country's
borders. Note that GNI is equivalent to gross national product (GNP) because of t
output and expenditure calculations of national GNI/GNP.

*[2 marks for a clear explanation of what is measure by gross national income (GNI)
less clear but which conveys the general meaning]*

3 Nominal GNI is the value of an economy's total income. Real GNI is an economy's
effect of inflation.

*[2 marks for a clear distinction between nominal and real GNI; 1 mark for a distinc
conveys the general meaning]*

4. **A** – If an economy's growth rate falls but is still *positive* (e.g. a change from 10% t
increasing. If an economy's output was £100 million at the beginning of 2016, th
would be £108 million – hence output has increased.

[1 mark for correct response]

5. (i) *Nominal* GDP Growth = % change in Nominal GDP $= \frac{1,940,000-1,873,000}{1,873,000} \times 1$

[1 mark for correct answer; 1 mark for showing working]

(ii) $Real\ GDP\ (2016) = 1.8\%\ increase\ in\ Real\ GDP\ (2015) = 1,832,000 \times 1.$

[1 mark for correct answer; 1 mark for showing working]

(iii) $Nominal\ GDP\ per\ capita = \frac{Nominal\ GDP}{Population} = \frac{1,940,000}{65} = £29,846$

*[1 mark for correct answer; 1 mark for showing working. Note that a commo
not converting each figure into the same units]*

6. Between 2007 and 2010 the UK economy was experiencing a recessionary phas
has been a sustained period of negative economic growth (and, hence, declining
Recessions have the consequence of increasing unemployment because firms are
commercial activity. If workers are unemployed for long periods of time they mig
depressed, which would constitute a decrease in the productive capacity of an ec
face declines in tax receipts and increased government expenditure if there has b
has the potential to cause a budget deficit, increasing the national debt, and limiti
conduct expansionary fiscal policy. If recessions are prolonged there might be long-te
of investment during this period, this could lower an economy's trend rate of GDP

*[3–4 marks for a clear discussion of the consequences of a recession, expanding effe
offering counterarguments where applicable; 1–2 marks for a discussion that is ap
engagement and analysis; 0 marks for answers that are off-topic]*

7. The Easterlin Paradox is an economic theory that suggests that there is no correl
prosperity and levels of self-reported happiness *between* countries, while *within*
a correlation between happiness and higher income, creating a paradox betwee
measurements. Income, therefore, is only one factor that determines our happin

*[2 marks for a clear explanation of the Easterlin Paradox; 1 mark for an explanatio
conveys the general meaning]*

8. (i) Nominal GDP measures income, output, or expenditure at *current* prices. It
monetary value of all the output produced within an economy during a spec
capita is simply nominal GDP divided by the country's total population, whe
Nominal GDP per capita tells us a little about a country's standard of living.

*[2 marks for a clear explanation of the difference between nominal GDP and n
an explanation that is less clear but which conveys the general meaning]*

(ii) Nominal GDP and real GDP differ because real GDP is corrected for changes
It is, therefore, useful in helping us understand whether an increase in GDP
effect. If prices doubled, nominal GDP would double because it measures the
transactions. However, the *volume* of output has remained the same and so
real GDP increases, we know that the volume of output has risen, which mea
experiencing economic growth.

*[2 marks for a clear explanation of how nominal and real GDP can be used to hi
in national accounting; 1 mark for an explanation that is less clear but which co*

9. (i) Issues:
- *International Price Differentials:* GDP figures don't take into account dif
countries. Therefore, it could be possible that two countries have exact
country's citizens have greater purchasing power as prices are lower.
then not equal, even if the value of GDP is exactly the same.
- *National Price Differentials:* It is argued that changes in a country's pric
misleading statistic in comparing standard of living over time. Nominal
economic transactions and so reflects changes in the price level. The
over time it's important for real GDP to be used.
- *Hidden Economies:* GDP figures don't include hidden economies, which
difficult. Many LDCs have informal economies that are exclu
nevertheless have an important impact on a citizen's standard of living
- *Inequality:* GDP per capita allows us to compare the 'average' standard
obscures the distribution of income. Inequality is an important conside
standard of living between countries.
- *'Bads':* GDP figures include public and private spending on 'bads' as we
countries have similar levels of GDP, but one country invests in welfare
in 'bads' such as warfare. It would not be correct to say that these coun
standard of living and the quality of life.
- *Exchange Rate:* If we are to compare GDP between countries, we need t
a common currency (e.g. US$). However, the exchange rate might not b
consistently, or might be manipulated by the country, and so it can be
living standards.
- *Externalities:* GDP is useful in measuring overall living standards, but it
economic growth – e.g. pollution. It is likely that pollution and other fa
life of a country's citizens, and using GDP does not measure these effects.

*[2 marks each for a clear explanation of a limitation of using GDP to compare
countries or over time; 1 mark for an explanation that is less clear but w*

(ii) Purchasing power parity (PPP) can be used to overcome some of the limitat
co PPP corrects the exchange rate between countries for the relative
co currency. If we used a nominal exchange rate to compare the GDP
halving of the value of the euro relative to the pound would halve the value
unlikely that France's output has actually halved. Therefore, using PPP avoi
compare GDP between countries.

*[2 marks for a clear explanation of how PPP facilitates international comparis
explanation that is less clear but which conveys the general meaning]*

Topic Test 2.1b Measure of Economic Performance: Infl

1. **C –** Inflation refers to sustained, or persistent, increases in the aggregate price le period of time. Importantly, the focus is on the price increase being *sustained*. If t fluctuation then Economists wouldn't usually consider the movement to be inflat according to this definition.

   [1 mark for correct response]

2. The Consumer Price Index (CPI) is a *weighted* price index of a representative bu ONS collects data on the prices of individual price quotes of the sample of repres time frame. Next, the price level of the individual items in the sample are weight import households in the UK by using information from the *Household Fin Expend* survey – e.g. if petrol is a more important expense than, say, tinned f weight in the index. Note that these weights will change over time according to th Inflation can then be calculated by working out the rate of change in the level of p

   [3–4 marks for a clear explanation of CPI and its use in calculating inflation; 1–2 mar clear but conveys the general meaning; 0 marks for content that is unrelated to the q

3. (i) $Inflation_{2011-2013} = \frac{110.117-104.484}{104.484} * 100 = 5.39\%$

   [Maximum 2 marks. 1 mark for correct answer. 1 mark for showing calculatio

   (ii) $Inflation_{2014-2015} = \frac{111.842-111.786}{111.786} * 100 = 0.05\%$

   [Maximum 2 marks. 1 mark for correct answer. 1 mark for showing calculatio

4.

Advantages	Di
Indices are an established way of calculating inflation, and having a clear method allows governments to produce statistics that are comparable over time – that is, certain items are included in CPI and these are measured continuously, rather than choosing the basket of goods on a case-by-case basis.	Indices such as CPI are the *quality* of products relation to increases i rising because of new just inflation.
Indices such as CPI are useful because they've been adopted as measures of inflation by numerous economies, which facilitates the international comparisons of inflation.	Indices such as CPI als effect of consumption. alternatives, and price consumption to the ch index's weight isn't alt overstated. (Note that an annual basis in orde
Indices help governments forecast and this analysis can help determine fiscal or monetary policy.	If the weights of indivi index are calculated fr statistical errors that c weight the importance
Indices make it easy for consumers and businesses to plan their behaviour – e.g. workers might be able to demand *fair* salary increases by comparing movements in the price	It is important to cons 'base' year – if the base economic situation tha way) then future calcu might engender a misl economy's health.

[Maximum 6 marks. 5–6 marks for a careful and balanced evaluation of the relativ using an index to measure inflation, specifically referencing CPI. 3–4 marks for a lim missing sufficient reasoning and evidence. 1–3 marks for identifying a few concepts absence of thought behind the advantages and disadvantages of using an index to m

5. Inflation can be caused by demand-side factors, supply-side factors, or changes i
brought about by demand-side factors it is called *demand-pull inflation*. Increase
and this effect is more marked when the economy is operating close to full capac
increase in demand can allow producers to charge higher prices for their produc
potential buyers. If inflation is brought about by supply-side factors. Economists
inflation as *cost-push inflation*. Whenever a firm's costs increase, these costs will
form of higher prices in order for the firm to maintain profitability – costs for fir
say, if there was a natural disaster, an increase in the w s price of oil, or work
However, the important evaluative point here i t w le both of these factors
price level, inflation is a *sustained* increas th rice level. It is suggested that
when there are increases in the s pply. If too much money is chasing too
these goods is increased s ns r spond to excesses in demand brought about
increasing purch r

*[Maxim arks. 5–6 marks for accurate and balanced evaluative comments of
supporting a rounded conclusion that pertains directly to the question. 3–4 marks
inflation, partially linked to the question but displays incomplete or basic reasonin
few causes, but inconsistently, and with inaccurate or absence of thought behind th*

6.

Inflation	
Inflation has menu costs – this is the cost of firms having to update their price lists. However, these are insignificant when inflation is stable. Therefore, we would expect this to be a problem in the Venezuelan economy but not in the UK.	In Japan's experience it has been *wholly* bad. P causes the price of goo these items appear mo international markets Japan has benefited fro the periods that it has trade surplus). Moreover, if deflation and productivity gains goods and services, the positive and an indicat
Inflation also involves 'shoe leather costs' – this is the time and effort and wasted resources spent by people trying to counteract the effects of inflation (e.g. making continuous trips to the bank to reduce cash holdings). Again, this is more of problem when inflation is high!	Deflation can be consid discourages consumer consumers tend to del can purchase the prod Deflation, therefore, ca consumer expenditure However, an evaluatio direction of causality is falling AD that brings a
Inflation redistributes income from lender to borrowers by reducing the *real* value of one's borrowings – e.g. if you borrowed £100, but the price level doubled, you would be able to pay this back by giving up half as much income as before.	Deflation can increase increasing real interest proportion of their inc while firms find it diffi e effect is to decrease
Inflation when it is high tends to also be volat e – hi is problematic because it creates un y and makes financial planning and c n decision-making difficult. Firm to invest as they will be unsu bo evenue streams. Consumers tend t ba on consumption. However, this is less lik be a problem for the UK who anchor inflation around the 2.0% target – when inflation is targeted people can make decision based on expectations that the target will be achieved.	If the interest rate is c the case of Japan, then rate positive. Ultimatel bank's monetary policy the economy in a defla

Knowledge (2), application (2) and analysis (2)		
	0	No relevant answer given.
Level 1	**1–2**	A few concepts may be identified correctly, but inconsistently, and with inaccu thought behind the causes and effects.
Level 2	**3–4**	Some knowledge of economic concepts is shown, partially linked to the questi reasoning skills, but may focus too much on one side of an argument.
Level 3	**5–6**	Knowledge of the economic concepts is very accurate. Links to the question a examples. Analysis is well reasoned and logical, and appropriate for the quest
Evaluation (4)		
	0	No evaluation.
Level 1	**1–2**	Limited attempt at evaluation – may contain comments closely related to the question, o sufficient reasoning.
Level 2	**3–4**	Accurate, balanced and relevant comments are made, supporting a rounded con direct to the question.

1. **A –** Unemployment refers to the situation in which people are *willing* and *able* to employment, but are unable to find work. **B** is incorrect because not being part o you are unemployed – some people don't participate in the labour force because retirement, or people on paternity or maternity leave). **C** is incorrect even thoug redundant can constitute part of unemployment. Impor[illegible]y, the focus is on peo people aren't they are considered to be *inactive* [illegible] constitute part of the l incorrect because even those that are abl[illegible] aren't unemployed unless the

[1 mark for correct respo[illegible]

2. Emplo[illegible]ally, is the opposite of unemployment. It is all those people th and are[illegible]tly employed. It includes all those who are employed by firms and those that declare themselves self-employed.

[2 marks for clear explanation of the meaning of employment; 1 mark for an explan the general meaning]

3 (i) The claimant count measure of unemployment is a measurement that uses t unemployment-related benefits (i.e. Job Seeker's Allowance and National In the calculation of the unemployment rate. Unemployment is, therefore, calc of claimants as a percentage of the total labour force.

[2 marks for a clear explanation of the claimant count measure of unemploym that is less clear but conveys the general meaning]

(ii) Difficulties (claimant count):
- The UK government has changed the conditions regarding eligibility fo benefits a number of times since their int[illegible]duction, making it difficult unemployment over time using this measure;
- People might be claiming unemployment-related benefits without truly they wouldn't be considered unemployed by conventional definitions;
- The claimant count excludes a number of people that aren't eligible to [illegible] that are under the age of 18, anybody seeking part-time or v [illegible]men that are looking to return to work, women looking to return to have too-high a level of savings to apply for JSA, etc.);
- The claimant count might include those that are fraudulently claiming 'black market' or undeclared employment;
- Sometimes it is possible to have part-time work and also claim unempl people would be counted twice).

[1 mark each for identifying a suitable difficulty associated with the claimant mark each for an explanation about how this difficulty will affect the measure

4. (i) The ILO measure of unemployment is an alternative to the claimant count m from the *Labour Force Survey* in order to determine the unemployment rate private residences and asks questions relating to employment activity. It th unemployment according to the ILO's definition of unemployment and expr people according to this definition as a percentage [illegible]e total labour force.

[2 marks for a clear explanation of th[illegible]O measure of unemployment; 1 mark clear but conveys the general m[illegible]

(ii) The ILO's definition of unemployment are those people 'without a job, want in the last four weeks and are available to start work in the next two weeks' ha[illegible]nd a job, and are waiting to start it in the next two weeks'.

[2 marks for the correct ILO's definition of unemployment; 1 mark if only a pa

5. $\text{Unemployment Rate} = \frac{\text{Unemployed}}{\text{Labour Force}} \times 100 = \frac{\text{Unemployed}}{\text{Full-time+Part-time+Unemployed}} \times 100 =$

[1 mark for correct answer; 1 mark for showing working]

6. Difficulties (ILO):
   - ILO measure of unemployment is based on the evidence from the *Labour Fo*
     are many statistical issues that can arise from choosing an incorrect sample
     ILO measure of unemployment is rarely likely to be the *true* unemployment
   - It can be hard to distinguish if somebody is actively seeking work via a surv
     better measure in this regard because Job Seeker's Allowance requires clai

   [1 mark each for identifying a suitable difficulty associat[illegible]th the claimant coun
   mark each for an explanation about how this diff[illegible] affect the measure]

7. **B –** 'Frictional' unemployment i[illegible]pent *searching* for employment, or the
   people have between le[illegible] and starting a new one. **A** is referring to the co
   C 'structural', an[illegible]onal'.

   [1 mark[illegible]rect response]

8. 'Structural' unemployment is unemployment that exists because of the changing
   activity. It occurs because of changes in industrial organisation (e.g. the decline o
   because of foreign competition and shifts towards the tertiary sector) or because
   automation of labour).

   [2 marks for clear explanation of 'structural' unemployment; 1 mark for an explan
   the general meaning]

9. **C –** Paul's situation is a classic example of 'seasonal' unemployment. Since the de
   demand, there is no need for Santa Claus impersonators in any other period of th
   tempting choice because seasons could be thought of as cyclical, but cyclical une
   business cycle and deficiencies in demand. There is nothing to suggest that Paul's
   voluntary (**D**).

   [1 mark for correct response]

10. In this question students should [illegible]pl[illegible]evaluate the differing types of unem
    Students should use theor[illegible]d ev[illegible]nce to support their decision.

    e.g. Stu[illegible]mi[illegible]gue that *structural* unemployment is the most concerning f
    presen[illegible]uggests there is a serious mismatch between skills that are suppli
    in the la[illegible]r market – this is something that is likely to be incredibly difficult to
    Furthermore, technological change that brings about the automation of work is a
    that must plan-ahead for periods in which machines will replace much labour. Fr
    comparison, is totally unavoidable, and would exist even if skills were perfectly
    Frictional unemployment, therefore, is likely to be less of a concern for Economis

    [Maximum of 6 marks. 5–6 marks for accurately evaluating each cause of unemplo
    understanding of the economic ideas. 3–4 marks for adequate analysis, might be u
    1–3 marks for unsupported or irrelevant evaluation]

11. 'Underemployment' refers to a situation in which a worker is employed but is be
    Underemployment is characterised by situations in which highly skilled workers
    opportunities that they are overqualified for (e.g. a physician working as an Uber
    workers are involuntary employed in part-time work w[illegible]n their preference is f
    (this is the ONS's definition of underemployme[illegible]).

    [2 marks for a clear explanation[illegible]t is meant by underemployment; 1 mark for
    but which conveys the ge[illegible]ning]

12. Immig[illegible]an be a useful tool in the macroeconomy because inward migratio
    gaps in [illegible]t economy. In the UK, for instance, cuts to bursaries for trainee nu
    future deficit of nurses in the UK. However, inward migration, from, say, the EU,
    be plugged by hiring pre-trained European nurses. Immigration can boost emplo

    [2 marks for a clear explanation of how immigration can be used to correct an eco
    for an explanation that is less clear but which conveys the general concept]

1. **A –** International aid is the only item that would appear on the current account fr that the current account includes a country's balance of trade, net factor income, constitute an entry in the *net cash transfer* part of the current account section.

   [1 mark for correct response]

2. **C –** FDI into the UK would be considered a positive entry on the UK's financial account includes FDI, portfolio investment, other investments, and FOREX reserv of the current account.

   [1 mark for correct response]

3. Current Account = Net Trade + Net Factor Income + Net Transfer Payments
   Current Account = (-4,845) + (-1,035) + (-6,208) = £-12,088 million

   [*1 mark for correct answer; 1 mark for showing working]*

4. **B** – The BoP is said to be in imbalance when one or more of its components does imbalances on the BoP occur when there is a deficit or surplus on one or more of the BoP *must* sum to zero by the nature of accounting.

   [1 mark for correct response]

5. Fundamentally, the structure of the UK's economy has changed much since 1983 restructuring of the UK economy from manufacturing and primary resource expo led to a persistent deficit in the UK's trade in goods balance. The UK doesn't expo (mainly insurance and financial) in order to counteract the deficit in the trade in imports so many goods from the rest of the world because many economies are i competitive for their manufacture – e.g. the Asian economies.

   However, another contributing factor to the imbalance is that the UK's economy during the 2008 financial crisis. The UK, on average, has more disposable income highly correlated to consumption and so this increase in income has been associa UK produce but also the produce of the rest of the world. Hence, this could also h the UK's current account in recent times.

   [Maximum 4 marks. 3–4 marks for accurately assessing the causes of the UK's imba 1–2 marks for a limited attempt at assessing the causes and may be only loosely rel sufficient reasoning and evidence]

6. It is important to have a 'sustainable' BoP position because while the BoP sums t components can have important macroeconomic effects. If, for instance, there is this implies that there must be a surplus on the financial and capital accounts. Es economy spends more on foreign produce than foreigners spend on domestically means that foreigners are investing more capital into the domestic economy thar a surplus on the financial account because of the BoP accounting principle). Fore investments into the domestic economy because we're supplying more of the do imports than we are taking in from our exports. However, this implies that the co rest of the world, and these liabilities will eventually need to be repaid. Therefor run a current account deficit if the country will eventually reach a position where

   Note that eventually, if a country runs a current account deficit for a prolonged domestic economy feel that there is a risk of default and so funds can 'dry itself up' to borrow to finance its current account deficit, it must attempt to re can do is *depreciating* the exchange rate, but this can have an impact on peop domestic economy (e.g. by reducing their options for consumption).

   It is also worth considering that a consistent current account deficit might imply uncompetitive on international markets. Therefore, a deficit can be an indicator economy, and so it is a key macroeconomic indicator to assess an economy's hea

Importantly, the current account deficit can be thought of positively too. Primarily, economy because of the surplus in the financial account can be thought of as benef improves the long-run potential of the economy – this could even enable the econo

However, current account deficits are only problems if they are *sustained* and *la* current account deficit is not so much of a problem because it grows at a similar economy has sufficient funds to repay its liabilities. If, however, the deficit was a there might be serious issues. Moreover, if the deficit t[illegible]nto a surplus, and vi will be less concerning.

Finally, it's worth considering th[illegible]g a persistent current account surplus current account surplus i[illegible]s that the economy is diverting goods that could b economy – this c[illegible]ct people's standard of living and the public could bene curren[illegible]nt [illegible]pluses can cause political friction between countries – e.g. Ch could c[illegible]taliatory protectionist measures.

[Maximum 6 marks. 5–6 marks for providing a clear assessment on the consequenc marks for providing a limited attempt at evaluation. 1–2 marks for identifying a fe inconsistent or inaccurate.]

Topic Test 2.2a Aggregate Demand (Part 1)

1. (i) Aggregate Demand (AD) = Consumption (C) + Investment (I) + Governme
(Exports (X) − Imports (M))

*[2 marks for stating the correct components of AD; 1 mark if a mistake is mad
generally correct]*

(ii) Now, the aggregate demand (AD) cu[illegible] sh[illegible] the relationship between an
total demand in all of its ma[illegible] F[illegible] the AD curve we are able to calculat
given price level. Im[illegible]ntly just as there is an *inverse* relationship betwee
market (micro[illegible]m[illegible]), there is an inverse relationship between the gen
ag[illegible]e e[illegible]y. From microeconomics we know that when price decrea
in[illegible] which tends to stimulate consumption. In macroeconomics, the i
lev[illegible] that assets in *real* terms tend to be higher, and so there is a wealth e
Next, there is the effect of prices on interest rates, when the price level is fal
which can provide a stimulus to both consumption and investment. Finally,
an economy's exports appear more cost-effective than the competition, and
increase in foreign demand for exports and a rise in spending. Consumers i
less because products appear cheaper at home and so there is an improvem
prices are low. Hence, AD is downward sloping.

*[3–4 marks for a clear explanation of the relationship between AD and the pri
avenues through which prices can stimulate demand; 1–2 marks for an explan
the general concept; 0 marks for responses that are off-topic]*

(iii) Income is said to be the most important determinant of consumption – afte
difficult to consume anything without the financial resources necessary to d
income which determines consumption because consumers must consider t
been deducted and transfer payments added. If di[illegible]sable incomes rise, we
– this is because most goods tend to be 'n[illegible]', however, an important det
people's marginal propensity to c[illegible]e (MPC). If the MPC is low, consume
consumption very much [illegible] incomes increase. Conversely, if the MP
would spend the [illegible] their additional income on consumption rather
imp[illegible]nt [illegible] of this relationship between consumption and income
E[illegible]st Milton Friedman. Friedman suggests that people's consumption
inc[illegible]ut instead consumers make expenditure decisions based on their '
income they expect to receive in normal circumstances. Moreover, it's also s
smooth their consumption over a lifetime and so consumption tends to vary
which changes a lot according to one's age.

*[3–4 marks for a clear explanation of the relationship between income and co
conventional relationship with alternative theories; 1–2 marks for an explana
the general concept; 0 marks for responses that are off-topic]*

(iv) Firms operating in the post-2008 period are likely to have received lower pr
general economic activity. With less retained earnings it is natural that ther
because firms have less financial resources to invest. Firms might also have
future income streams in the post-2008 economy and so would delay their i
certain and the risk of investing lower.

[1 mark for identifying a potential factor]

(v) Noting that the trade bal[illegible]nce [illegible]atutes part of AS (X – M) reversing this ba
a surplus (X – M[illegible]s] have a positive effect on AD, therefore shifting i

[1 [illegible]or correctly identifying the movement in AD in response to this shock

(vi) US government's response to the financial crisis was to reduce government
effect of decreasing AD and shifting the curve inwards.

[1 mark for correctly identifying the movement in AD in response to this shock

2. (i) $26\%\ of\ 65.2\% = \left(\frac{26}{100} \times 65.2\%\right) = 16.952\% = 17\%$

[1 mark for correct answer; 1 mark for showing working]

(ii) *65.2% + 16,9% +19.4% +x% = 100%*
x% = -1.5%

[1 mark for correct answer; 1 mark for showing working]

(iii) *Consumption:* an increase in the consumption component of the UK's AD would have a positive impact on aggregate demand because consumption is the largest component.

[1 mark for correct response]

3. (i) Net Investment = Gross Investment - Depreciation = £1,550,000 - £780,000

[1 mark for correct answer; 1 mark for showing working]

(ii) Net investment is a better measurement of a change in an economy's stock of productive assets because it takes into account the effect of depreciation, or the consumption of capital. Capital goods do not have an infinite lifetime – otherwise buildings and machines would last forever – and so some capital goods are consumed in the production process. Therefore, some portion of firms' investment is simply to replace capital that has become obsolete (e.g. because of technological change) or worn down through use. Net investment is only the *excess* of investment above what is needed to cover depreciated capital, and so it is the change in the stock of productive assets, and this is why net investment is the better measurement.

[2 marks for a clear explanation of the reason that net investment is a better measurement of an economy's stock of productive assets than gross investment; 1 mark for an explanation that is less clear but which conveys the general meaning]

4. Factors:
- *Income:* Income is an important influence on the level of consumption because it determines our ability to consume. It is almost impossible for consumption to occur without financial resources. Note that it is a person's 'disposable income' that matters, so the economy's tax system also has an indirect influence on consumption.
- *Interest Rates (and Savings):* Interest rates influence consumption by affecting incentives to save. When interest rate increases, consumers have an incentive to save their income because they can substitute consumption for saving. Moreover, this effect is exaggerated because higher interest makes borrowing more expensive, and so consumption through borrowing falls. Note that a higher rate of interest will also tend to reduce the discretionary income of households with mortgages because it increases the value of interest repayments, thus reducing disposable income.
- *Consumer Confidence:* If consumers are confident about the trajectory of the economy, they increase their consumption – e.g. if consumers expect that their current income will increase indefinitely, there is likely to be an increase in consumption because such consumers have healthy finances. If, however, consumers are worried about losing their employment, they will save more.
- *Wealth Effect:* Consumers' wealth has an effect on consumption – that is, the more wealthy consumers become richer, or perceive themselves to be richer, there is an increase in consumption because they can afford more expensive items, or because they feel secure enough to purchase an increased number of items

[2 marks each for a clear explanation of a factor that influences consumer expenditure; 1 mark for an explanation that is less clear but which conveys the general meaning]

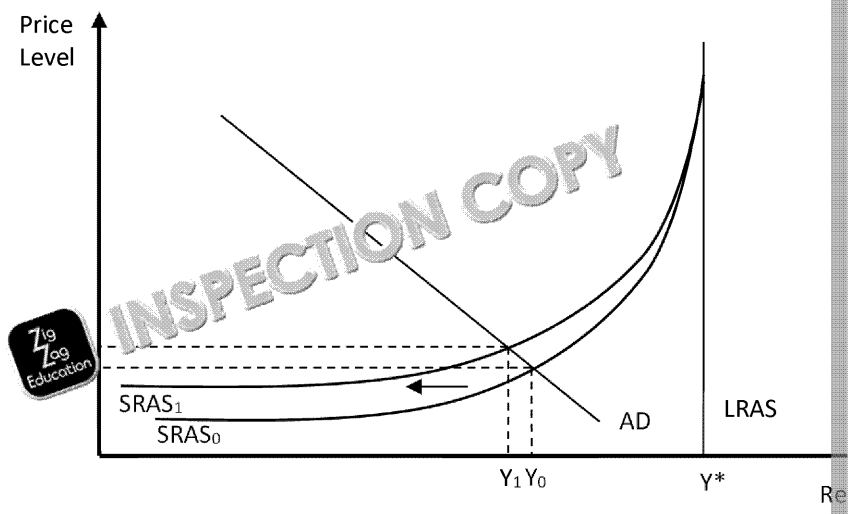
5. For:
- *Credit Crunch:* Typically, when interest rates are reduced there is an increase in investment because the cost of financing investment has decreased. Moreover, when the interest rate is low the opportunity cost of investing is also low – this is because purchasing a government bond, for example, will only yield a low return, e.g. 0.5% interest per annum, whereas the potential return of some other investment is much higher. Therefore, from this perspective, the dearth of business investment in recent years can be blamed on firms not being able to access credit from commercial banks. It is also possible that firms would be uneasy about lending during a financial crisis because the stability of the economy is ambiguous. Businesses that would usually invest at interest rates of 0.5% would be unwilling to do so and could have only financed investment through retained profit.

Against:

- *Business Confidence:* However, although the inaccessibility of credit is an im
  explaining why investment fell during the 2008 financial crisis, it is debatab
  invested anyway. Therefore, a lack of business confidence – or uncertainty –
  investment. It is thought that a business is unlikely to make investments wh
  because there could be future shocks to the economy. Businesses tend to de
  there is a lack of business confidence and, therefore, this could explain the f
  financial crisis.
- *Negative Accelerator:* The *accelerator* theory of investment suggests that the
  economy will primarily depend upon changes in real national income (GDP)
  firms' products. If GDP is decreasing, firms will expect to make less profit as
  demand for their products and thus will decrease their capital investment.
  investment has a 'multiplier' effect if it further reduces GDP, further re
- *Low Exports:* The 2008 financial crisis was an *international* crisis, meanin
  did not make up for a reduction in domestic demand with external dema
  for a loss of revenue by exporting, they will reduce their investment through

*[Maximum 8 marks. 6–8 marks for a strong, well-supported evaluation of whether t
important factor in the reduction of investment during the 2008 financial crisis. An
appropriate for the question. 4–5 marks for a limited evaluation, though it may be u
argument. Reasoning / supporting evidence is provided but may be incomplete. 1–3
however, answer is largely inconsistent or inaccurate.]*

1. (i)



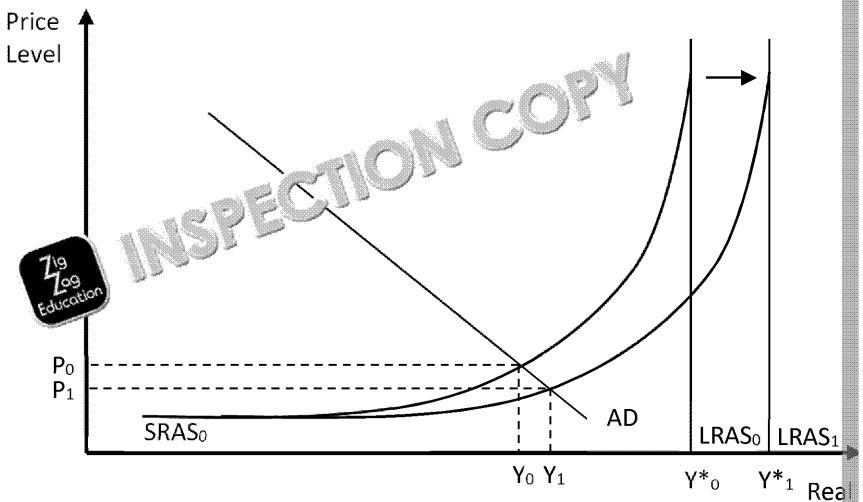
Analysis:
If the price per barrel of crude oil increases, firms' short-run costs of produc
curve shifts inward. Note that this is unavoidable because there are few alte
production inputs, and firms are also unable to change their production pro
there are fixed factors of production. Naturally then, the economy's macroec
in response to such a supply-side shock.

Equilibrium starts at the intersection of AD and $SRAS_0$ where real output is Y
Then, SRAS shifts *inward* as firms respond to the increase in their costs of pr
amount of output they are willing to supply at the prevailing price level. At F
the aggregate price level is bid-up as consumers c[illegible]te to purchase outpu
will be reached at price level P_1 and real o[illegible] Y

Therefore, the macroeconom[illegible] this shock is a one-off increase in th
into an inflationary e[illegible] cost increases of crude oil are maintained.
increase in the [illegible] a supply-side shock because firms are producing
he[illegible]ee[illegible]our input. Finally, real GDP decreases because of the dec
he[illegible]re is negative economic growth – note that this doesn't constitute
ecc[illegible]y's growth rate, but a short-run increase in the economy's level of sp

Evaluation:
- Effect depends upon the *magnitude* of the price increase of crude oil – c
will have a substantially different effect to a £100 increase.
- Effect depends upon the significance of oil as part of firms' production
assume that oil is an important part of firms' production processes in t
be operating using strictly renewable resources, which would alter the
- Effect depends on whether the price increase is temporary or permane
temporary, firms may absorb the increased cost of oil.

(ii)



Analysis:
If UK miners found deposits of rare earth elements, this would constitute an
resources available that can be used as inputs in the production process. In
productive potential of the economy and so the LRAS curve shifts to the righ
shifts to reflect this change. Naturally the UK's macroeconomic equilibrium
increase in productive potential.

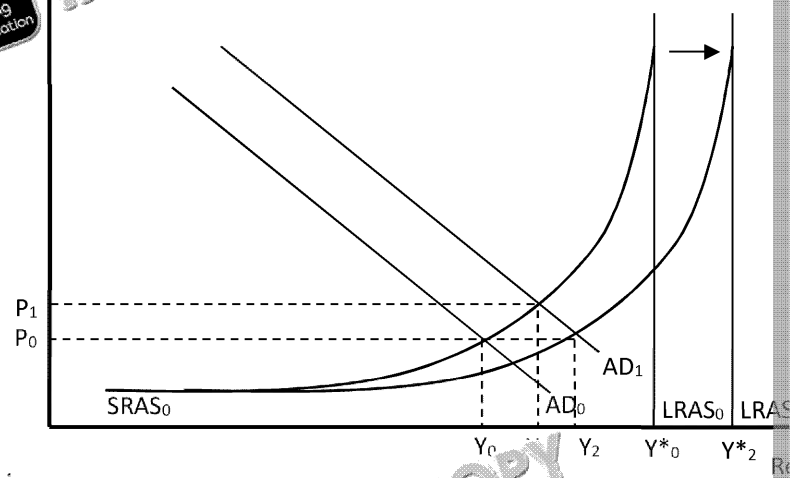
Equilibrium starts at the intersection of AD and SRAS where real output is Y
Then, LRAS shifts *outward* as the productive capacity of the economy increa
of factor inputs. The SRAS curve also shifts *outward* because the new-found
implies that firms' short-run costs fall – anything that is in abundance t
that are scarce. At P_0, SRAS will outstrip AD and so the aggregate price level
consumers to absorb the glut of supply and restore macroeconomic equili
equilibrium is reached at price level P_1 and real output Y_1.

The macroeconomic effect of this shock is a one-off decrease in the price lev
deflationary episode if firms' costs continue to fall – note that this type of de
because it arises from improvements in the supply-side of the economy and
should fall because firms are expanding their output in response to their de
hire more workers in order to achieve this expansion. Finally, real GDP incr
economic activity and hence economic growth is achieved– note that there
economic growth in this scenario.

Evaluation:

- Effect will depend on the *magnitude* of the rare earth deposit that is fo
all, they are *rare*) then the increase in productive potential and, hence,
likely to be minimal.
- While this scenario has good implications for the key macroeconomic v
that other things such as inequality and the environment might worse
rare earth elements are concentrated to wealthy owners of industry, o
damages the environment.
- Since the UK is structured more so as a tertiary economy the effect of fi
have demand-side implications as opposed to possessing a larger numbe
export these factors of production to manufacturing economies, and so
LRAS will be less significant.

(iii)



Analysis:
If the UK government invested in improving the NHS, the immediate effect o
the government expenditure component of AD – recall that AD is given by A
the effect of this is to increase AD and the AD curve will shift to the right, ce
macroeconomic equilibrium will change in response to this demand-side sh

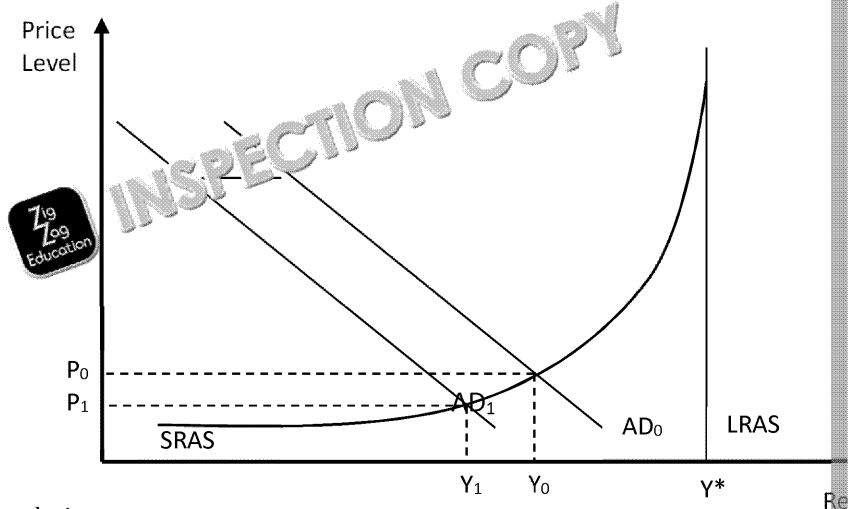
Equilibrium starts at the intersection of AD and SRAS where real output is Y
Then, AD shifts *outward* as the government stimulates demand through gov
increase in government expenditure causes AD to outstrip AS and so firms h
prices in order to improve their profitability. Eventually, the excess of dema
general price level increases and macroeconomic equilibrium is restored. Eq
level P_1 and real output Y_1.

The macroeconomic effect of this shock is a one-off increase in the price lev
inflationary episode if AD continues to increase over time. Unemployment,
government's investments in the NHS will require additional labour in vari
Finally, real GDP increases because government expenditure constitutes an
income – thus, economic growth of the short-run kind is achieved when gov
(note that is the basis for the Keynesian policy of deficit spending in a reces

Evaluation:

- Primarily, the most interesting aspect to analyse about the governmen
it has the potential to improve the long-run capacity of the economy. If
general health of the population, it can be considered that human ca
will be more efficient as a resource. LRAS would, thus, shift to the right
dependent on the effectiveness of the NHS improvements. Note, however,
the link between the investment in the NHS and improvements in heal
- The impact will depend on *how much* is invested in the NHS – the larger the
on the macroeconomy.
- Effect will also depend on the starting position of AS – if the economy
part of SRAS) then the increase in AD will tend to increase output with
Conversely, if the economy is already at full employment, the effect of
inflationary – only a supply-side improvement will boost growth at thi
- Effect will also depend on the size of the multiplier. Note that the diagr
simple initial reaction of AD to an investment in the NHS. If the multipl
investment will have far reaching and positive effects across the entire
would represent this as a second positive shock to AD.
- Finally, it's important to consider how the increase in government exp
through taxation? Is it financed through debt? If financed through taxat
expenditure will be offset by the tax. If financed through debt there wil
term economic growth.

(iv)



Analysis:

If there was a decrease in firms' confidence in the post-Brexit economy, the
withdraw or reduce their investments until confidence is restored – this is k
Investment is a key component of AD, and so if this is reduced in any way th
output will be lower for any given price level. Naturally, the UK's macroecon
response to this demand-side shock.

Equilibrium starts at the intersection of AD and SRAS where real output is Y
Then, AD shifts *inward* as firms begin to retract investment in the post-Brex
investment causes AS to outstrip AD and so firms that produce capital good
output. Eventually, the excess of AD over AS is reduced as the general price l
movement to the equilibrium is restored. Equilibrium will be reached at pric

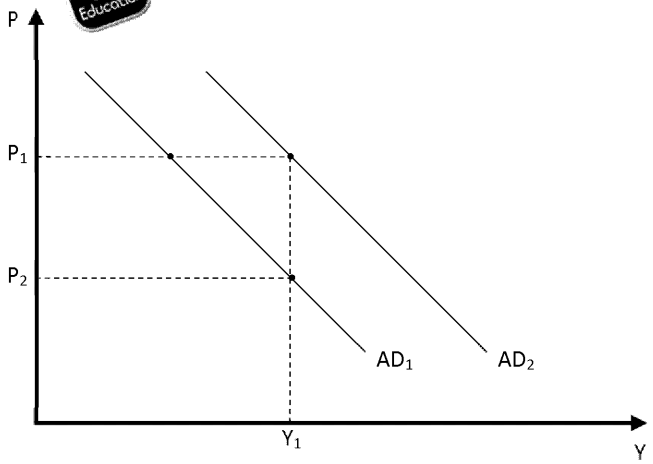
The macroeconomic effect of this shock is a one-off decrease in the price lev
deflationary episode if AD continues to shrink over time. Unemployment sh
decrease in investment implies there is less need for labour inputs. Real GDI
investment, and hence more saving, constitutes a withdrawal from the circu
negative economic growth when investment falls.

Evaluation:

- Effect will depend on the *magnitude* of the fall in investment – the less … post-Brexit economy, the more they will disinvest. In reality we know t… leave the UK, and so the fall in investment is likely to be large in reality…
- Effect will also depend on the multiplier – the multiplier effect works f… demand-side shocks, so the fall in investment could have far-reaching … decreases in labour demand might imply falling wages, and so consum… invest less, etc.)
- If the economy is close to full capacity th… ease in the price level w… contribute further to unemploym… nt if w…s are 'sticky'.

[Maximum 24 marks. 5–6 … for a strong analysis of these shocks on … performance – ang… out the impact of the shocks using economic th… students sh… …ate the extent to which the shocks will effect macroecon…

2.



Movements *along* the AD curve are referred to as ext… …s of aggregate demand… changes in the economy's price level. The AD cu…ve … …s an *inverse* relationshi… 'total' amount of goods and services de… …d w…hin an economy in a given perio… *microeconomic* demand curve d… …a relationship between price and quan… falls from P_1 to P_2, there i… …te…on of demand since a greater quantity of outp…

A shift … AD … is referred to as an increase in aggregate demand. A shift … increas… …r of the components of AD (C + I + G + X – M). It captures changes i… is repre…ed as an outward shift of AD from AD_1 to AD_2.

[Up to 2 marks for an accurately drawn diagram, including correct labelling of the … a clear distinction between movements along the AD curve and shifts of the AD cur… less clear but which conveys the general meaning]