



GCE AS/A level

1132/01

ECONOMICS – EC2

A.M. FRIDAY, 27 May 2011

2 hours

ADDITIONAL MATERIALS

In addition to this examination paper, you will need:

- a calculator;
- a 12 page answer book.

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Answer **all** the questions in Section A.

Answer **one** question from Section B.

Answer **one** question from Section C.

You are advised to spend no more than 55 minutes on Section A.

Insert the numbers of the questions you have answered in Sections B and C on the front of your answer book.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question.

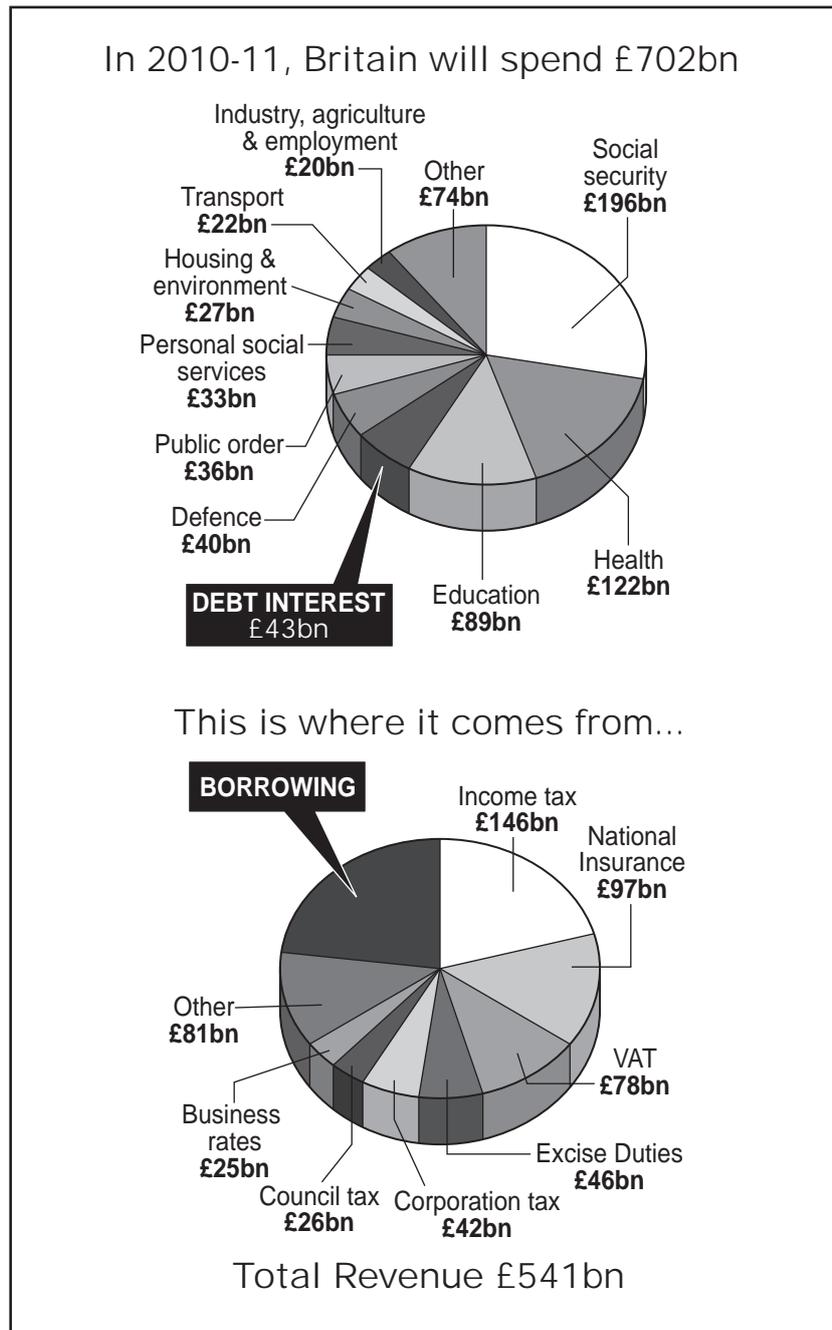
You are reminded that assessment will take into account the quality of written communication used in answers that involve extended writing in Section B part *(b)* and Section C part *(b)*.

SECTION A

Answer all the questions in this section.

1. Study the information and then answer the questions that follow.

**DARLING'S LAST STAND?
BUDGET AT A GLANCE**



Source: HM Treasury.

On 24 March 2010 Alistair Darling announced his last Budget before the General Election. The economy had spent the previous year in recession despite the **fiscal stimulus** given to it by the Government: a temporary cut in VAT to 15%; subsidies for scrapping old cars for new cars and bringing forward some capital expenditure projects. Without such measures the recession could quite possibly have been even deeper.

By Spring 2010 the recovery was by no means certain and a further stimulus might have seemed a good idea. However, with a massive budget deficit, interest rates at 0.5% and a **very low exchange rate for the pound** (a pound buying 1.11 euros, compared with 1.45 euros a few years ago) the cupboard looked bare as far as policy options went. The eurozone buys 55% of UK exports but there was little sign of economic recovery among euro member states – a blow to British exporters.

Consequently there was little room for manoeuvre in the Chancellor's Budget, but a £2.5bn package to help boost labour market skills and innovation in small businesses was some recognition of the supply-side problems facing the economy. However, the labour market remains a problem and it is not just recession-related unemployment either. There are 8.16 million adults of working age who are **economically inactive** (i.e. have chosen not to work or given up looking for work), and yet the UK continues to be a country with **net inward migration of labour**. Immigrants, mainly from the European Union, increase the supply of labour and perform jobs which British workers cannot do or choose not to do. Whoever occupies Number 11 Downing Street as Chancellor after the election faces an uphill struggle.

- (a) Calculate the budget deficit for 2010-11. [1]
- (b) With the aid of a diagram, explain how the **net inward migration of labour** might affect wage rates. [4]
- (c) (i) Using examples, distinguish between the Government's current expenditure and capital expenditure. [4]
- (ii) Explain how the Government uses its expenditure to correct market failure. [7]
- (d) With the aid of an aggregate demand and aggregate supply diagram, explain how a **fiscal stimulus** might help an economy in a recession. [6]
- (e) Evaluate the supply side reforms that could be introduced to reduce the number of **economically inactive** adults in the UK. [8]
- (f) Discuss the view that the **very low exchange rate of the pound** will help the UK out of recession. [10]

SECTION B

Answer one question from this section.

2. OIL PRICES RISE AS GLOBAL ECONOMY GROWS

- (a) Explain what is meant by the term equilibrium price and explain with examples how in a free market the equilibrium price might rise or fall. [8]
- (b) Discuss how useful the concept of price elasticity of demand is to decision makers such as firms and governments. [12]

3. MOTORISTS FACE TOLLS TO PAY FOR NEW ROADS

- (a) Using motoring as an example, distinguish between private costs, external costs, and social costs. [8]
- (b) Evaluate the view that road congestion in the UK can be best solved by allowing private firms to build new motorways for profit. [12]

4. GOVERNMENT COMMITTED TO REDUCING POVERTY

- (a) Explain the ways in which governments can attempt to reduce income inequality. [8]
- (b) Using a diagram evaluate the effects of an increase in the UK's national minimum wage. [12]

SECTION C

Answer one question from this section.

5. UK INTEREST RATES STAY AT HISTORICALLY LOW LEVEL

- (a) Using a diagram, outline the basic circular flow of income and explain the effects of injections into and withdrawals from the circular flow. [8]
- (b) Discuss the view that the Bank of England must set a low interest rate if it wants to increase consumption and investment in the UK economy. [12]

6. NEW 50% INCOME TAX RATE INTRODUCED AND GOVERNMENT EXPENDITURE CUT

- (a) Using a diagram and appropriate examples, explain how a significant reduction in government spending could affect aggregate demand and aggregate supply in the economy. [8]
- (b) Evaluate the effects on the economy of a rise in income tax rates. [12]

7. UNEMPLOYMENT RISES BUT TRADE DEFICIT IMPROVES

- (a) Explain the Government's main macroeconomic objectives and why there may be policy conflicts when attempting to achieve them. [8]
- (b) Discuss the view that free trade between countries is the best way for a government to achieve its macro economic objectives. [12]

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