Tom Furber - Economics Practice Papers

Practice Paper 2J Macroeconomics
In the style of Paper 2 Edexcel A Economics: National and Global Economy

Time allowed: 2 hours

For Section A and Section B, answer all questions.
For Section C, answer one question only.

Section A has 25 marks available
Section B has 50 marks available.
Section C has 25 marks available

Total marks available: 100.

This paper was written by Tom Furber.

You can find more economics resources on my website tfurber.com.

SECTION A

Answer ALL questions

1. The table below presents investment data for the UK economy:

Year	Gross fixed capital formation, a measure of investment
Q2 2022	£99,704 million
Q3 2022	£100,838 million

(a) Explain the difference between gross and net investment.

(2)

(b) Calculate the percentage change in gross fixed capital formation in the UK from Q2 2022 to Q3 2022.

(2)

(c) Which **one** of the following is **least** likely to increase investment in the UK?

(1)

A An increase in the rate of UK economic growth.

B Increased demand for UK exports.

C A rise in interest rates.

D Increased business confidence in the UK.

(Total for Question 1 = 5 marks)

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2. The World Trade Organisation (WTO) published a finding that US tariffs on imported steel and aluminium were not consistent with WTO rules. The WTO is also looking into a claim that European Union (EU) tariffs on imports of South African citrus fruits are illegal under WTO rules.

(a) Draw a supply and demand diagram to show the effect of EU tariffs on citrus fruit imports on social welfare in the EU.

(4)

(b) Which **one** of the following is the most likely reason why a trading bloc would implement a tariff on imports?

(1)

A To encourage greater competition from producers outside the bloc.

B To increase the profits of foreign producers.

C To reduce the current account deficit.

D To devalue the currency.

(Total for Question 2 = 5 marks)

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3. The United States has sanctions in place on certain companies and individuals from Venezuela. For example, there are sanctions relating to oil that would reduce revenues to Venezuela from oil sales.

(a) Draw an aggregate supply and aggregate demand diagram to show the likely effect, *ceteris paribus,* of US sanctions on the Venezuelan economy.

(4)

The Venezuelan currency saw devaluation in the later half of 2022 at both the central bank rate and the parallel market rate.

(b) Assume the Marshall-Lerner condition holds true. Which of the following is least likely to occur following a depreciation or devaluation in a currency, *ceteris paribus*?

(1)

An increase in:

A The total value of imports minus the total value of exports.

B The value of the financial account on the balance of payments.

C Employment.

D Foreign direct investment

(Total for Question 3 = 5 marks)

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4. The table shows the CPI and food, energy price indices for an unnamed country. 2019 is the base year for all indices.

Year (2019 = 100)	CPI (consumer price index)	Food price index	Energy price index
2020	99	102	98
2021	107	107	105
2022	118	114	124

(a) Calculate the annual rate of energy price inflation for 2020 to 2021.

(2)

(b) Explain how the changes in the money supply could contribute to inflation.

(2)

(c) **One** drawback of using CPI as a measure of inflation is:

(1)

A in the CPI basket of goods, there are too many goods.

B the basket of goods does not include mortgage interest payments.

C old products are slow to be added to the basket of goods.

D it does not account for income effects, which change the basket of goods.

(Total for Question 4 = 5 marks)

5. The Harrod-Domar model suggests a link between saving rates and growth rates. This table shows saving rates and growth rates for different countries:

Country	Saving rate (2022 estimate)	GDP per capita in December 2021 (in US Dollars)
France	16.6%	38,046
United Kingdom	9.0%	45,102
South Africa	0.5%	5,948

Sources: INSEE, Office for National Statistics, Statistics South Africa.

(a) Explain why increased saving rates may lead to a higher rate of economic growth.

(2)

(b) Explain one reason why it may be difficult for poor countries to increase their rate of saving.

(2)

(c) Which **one** of the following is least likely to be an effect of finding additional natural resources in a developing economy?

(1)

A Reduced consumption.

B Natural resource exports lead to an appreciation of the currency, reducing demand for other exports such as tourism.

C Multinational companies may exploit natural resources and see higher profits as a result.

D An increase in exports of natural resources

(Total for Question 5 = 5 marks)

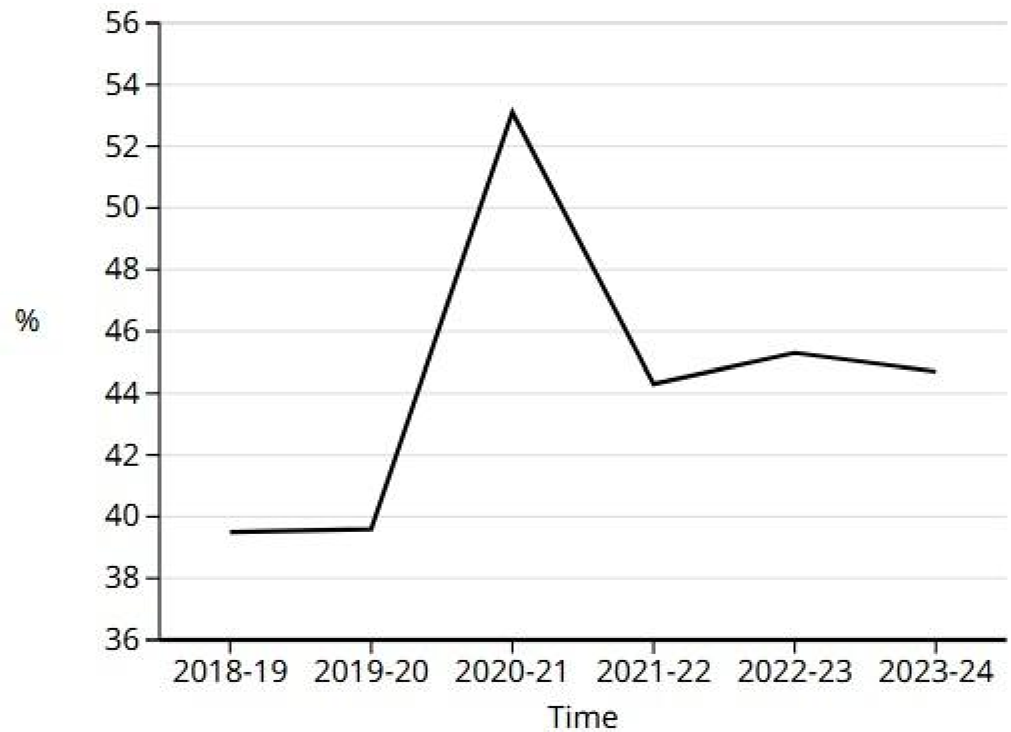
TOTAL FOR SECTION A = 25 MARKS

SECTION B

Question 6

Fiscal and monetary policy in the United Kingdom

Figure 1: UK public sector spending as a percentage of UK GDP over time.



(Source: Office for Budget Responsibility)

Extract A: Inflation and monetary policy

The Bank of England has faced criticism for not acting soon enough to bring down inflation. Could the Monetary Policy Committee (MPC) have acted more quickly and more aggressively to bring down inflation? Higher inflation was largely driven by energy and food prices, largely out of the Bank of England's control. But others have claimed that a decade of expansionary monetary policy is to blame, contributing to inflated asset prices and in the case of quantitative easing, rising inequality.

One of the members of the MPC claimed that if the Bank of England had foreseen gas price rises and raised interest rates enough to keep inflation at 2%, this would have led to a higher unemployment rate of 10%. The Bank of England should also consider the stance of fiscal policy. If fiscal policy is expansionary for example, this may necessitate even higher interest rates to maintain the 2% inflation target.

Another monetary policy tool to reduce inflation is quantitative tightening, that is the opposite of quantitative easing (QE). As of November 2020, there was a total of £895 billion in assets under the QE scheme. Not least because of the high indebtedness of UK households, there are potential financial stability implications of more contractionary monetary policy. The possibility of widespread failures to repay mortgages or other consumer debt, in the context of rising inflation, could create systemic risk.

In September 2022 the Bank of England actually had to buy more bonds, albeit in a temporary and limited way. This was to prevent a so-called "doom-spiral" of ever-rising yields on bonds which, left unattended, would have caused pension firms to fail.

(Sources: The Economist, BBC, miscellaneous others.)

Extract B: Government bonds and taxes

UK Government bond yields rose in September to October 2022, when tax cut promises which included a fall in the marginal income tax rate from 45% to 40% for high earners, were combined with significant spending to support the energy price cap. Altogether, this could have left a significant hole in the government finances. This budget was predicted to increase the UK Government's debt to GDP ratio by 15 percentage points over five years. However significant parts of these policies were later reversed, dampening bond yields.

In September 2022, the value of the pound fell to its lowest value since 1985, of US$1.035 per pound. Rabobank pointed to investors lacking confidence about the government's fiscal plans, while the Government claimed that rising US bond yields were also a contributing factor, as well as expectations about Bank of England monetary policy tightening.

As of writing, bond yields remain higher than before Liz Truss came into office as Prime Minister. Some economists have attributed this to an extra risk premium because of the uncertainty around government policy.

In spite of this policy reversal, the UK's Conservative Party has stated it would still like to cut taxes, once the public finances are in order. Firms and top talent have become more mobile in recent decades. OECD average corporation tax rates have fallen, partly to try to attract these groups, from nearly 50% in the 1980s to just over 30% as of 2016. Corporation tax cuts can increase the rate of return for companies and investors in the UK economy but this effect can be relatively small.

While tax cuts may lead to higher private sector investment, they are likely to mean reduced government spending on long-term investments. This could include government spending on education, training and infrastructure projects which can contribute to productivity growth. Tax cuts also led to markets expecting higher future interest rates from the Bank of England.

(Sources: The Economist, Resolution Foundation, BBC, Oxford University, IFS, Citi, miscellaneous others)

6. (a) With reference to Figure 1, explain **one** possible reason for the trend in public sector spending from 2018-19 to 2023-24.

(5)

(b) Assess the likely effects of contractionary monetary policy to control inflation. Refer to Extract A in your answer.

(12)

(c) With reference to Extract B, examine the impact of fiscal policy announcements made in September to October 2022 on the cost of borrowing.

(8)

(d) Assess the effect of tax cuts on the productive capacity of the UK economy. Refer to Extract B in your answer.

(10)

(e) Using the extracts and your own knowledge, evaluate the reasons why the value of the pound, relative to other currencies, may vary over time.

(15)

(Total for Question 6 = 50 marks)

TOTAL FOR SECTION B = 50 MARKS

SECTION C

Answer ONE question from this section.

EITHER

7. According to the International Monetary Fund, Switzerland has a GDP per capita of $92,434 (US dollars), while Burundi has a GDP per capita of $293 (US dollars).

Discuss the causes of income **and** wealth inequality **between** different countries.

(Total for Question 7 = 25 marks)

OR

8. Germany has consistently run trade surpluses since the mid-2000s, while France and the UK have more or less run trade deficits over that same period. The current account deficit for the UK is 2% of its GDP as last measured in 2021.

(Source: Office for National Statistics)

Discuss the causes of a current account deficit.

(Total for Question 8 = 25 marks)

TOTAL FOR SECTION C = 25 MARKS
TOTAL FOR PAPER = 100 MARKS