Tom Furber - Economics Practice Papers

Practice Paper 2 Blue

Suitable for those revising for or teaching:

- Paper 2 Edexcel A Economics: National and Global Economy

About the test:

- Time available: 2 hours.
- For Section A and Section B, answer all questions.
- For Section C, answer one question only.
- Total marks available: 100.
    - Section A has 25 marks available.
    - Section B has 50 marks available.
    - Section C has 25 marks available.

This paper was written by Tom Furber, an economics tutor.

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

Section A

1. Household consumption was meant to drive an economic recovery after the Covid pandemic restrictions were lifted, with consumers having been unable to spend on some services while staying at home. Instead, the UK economy has experienced a period of slow economic growth and high inflation. The Bank for International Settlements has found that consumption-led expansions tend to be weaker than when other components of aggregate demand, such as investment, drive growth.

Source: Bank for International Settlements (2017)

(a) Draw a diagram to show a situation in which a rise in consumption, ceteris paribus, does not lead to higher real GDP.

(4)

(b) Which **one** of the following is a reason why an increase in investment may have a greater effect on real GDP than an increase in consumption?

A Investment can boost the economy's long-run aggregate supply, while consumption does not.

B Investment boosts aggregate demand while consumption does not.

C Consumption is more stable however investment is more volatile.

D Consumption is a withdrawal from the circular flow of income.

(1 mark)

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2. The value of the pound sterling has changed from 1.66 US dollars per pound in 1999 to 1.27 US dollars per pound at the end of 2023.

(a) The percentage change in the value of the pound against the dollar from 1999 to 2023 is (select **one**):

A - 23.5%

B + 23.5%

C - 30.7%

D + 30.7%

(1 mark)

(b) Explain one possible reason for this change in the value of the pound sterling in the long term.

(2 marks)

(c) Explain how the effect of this change in the value of the pound sterling on net trade may differ in the short run compared with the long run.

(2 marks)

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3. The income share of the top 1% highest earning individuals in the US, before tax, has risen from 10.4% in 1978 to 19% in 2021.

Source: World In Data

(a) Based on the information above, show the likely change in the shape of the Lorenz curve for income inequality for the United States from 1978 to 2021.

(4 marks)

(b) Suppose the area above the Lorenz curve is denoted by the letter A and the area below the Lorenz curve is denoted by the letter B. How is the Gini coefficient calculated? (Select **one**):

(1 mark)

A $\frac{B}{A+B}$

B $\frac{A}{A+B}$

C $\frac{A+B}{A}$

D $\frac{A+B}{B}$

4. International organisations such as the International Monetary Fund have recommended that governments cut government spending or raise taxes. If the budget deficit does not fall, the IMF claims that central banks' attempts to lower inflation may be hindered.

Source: adapted from Financial Times

(a) Using an aggregate supply and aggregate demand diagram, show how a fall in government spending can reduce the size of a positive output gap.

(4 marks)

(b) Which **one** of the following options is the most likely drawback of a fall in government spending?

(1 mark)

A Higher inflation.

B Higher economic growth.

C Higher unemployment.

D An increase in the current account deficit.

5. The Eurozone is a group of countries who use the euro as their currency. The table shows the CPI inflation index for the Eurozone over time.

Time	CPI inflation index for the Eurozone, March 2015 = 100
December 2021	110.37
December 2022	120.52
December 2023	124.05

Source: Eurostat

The CPI rate of inflation is calculated by comparing the current CPI inflation index to the CPI inflation index one year beforehand.

(a) Explain how the rate of CPI inflation has changed for the Eurozone from December 2022 to December 2023.

(4 marks)

(b) Which **one** of the following is the most likely effect of a sharp rise in the price level, other things being equal?

A The real value of debt rises.

B Lower purchasing power for workers whose incomes rise in line with the rise in price level.

C The central bank is more likely to consider reducing its key interest rate.

D The real value of savings falls.

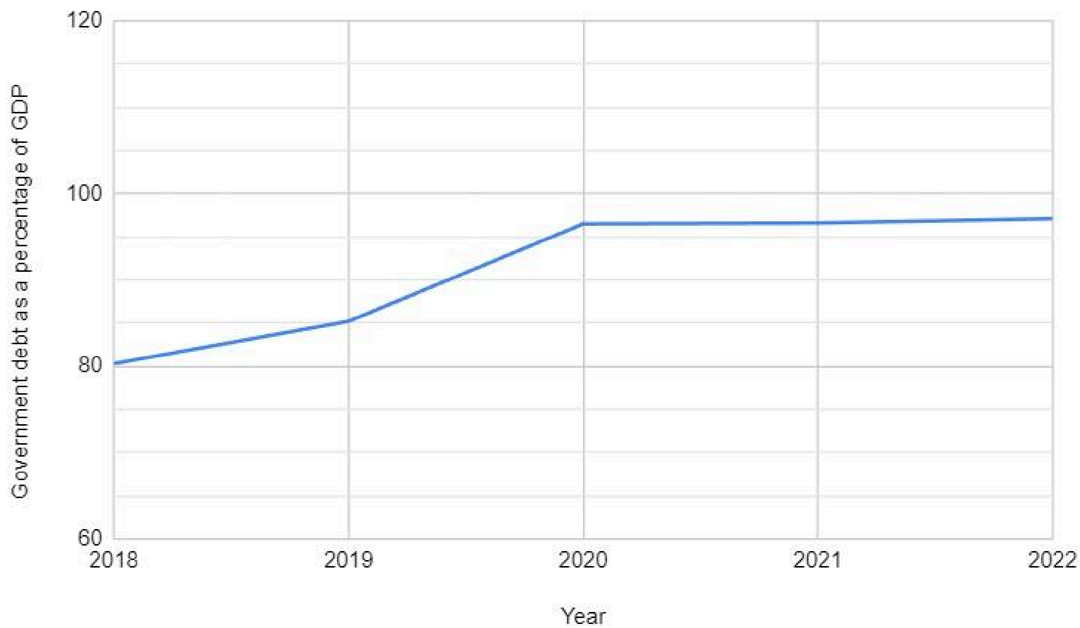
(1 mark)

Section B

Question 6

The UK economy - domestic challenges and global opportunities

Figure 1: UK Government debt as a percentage of GDP, 2018-2022 (annual data)



Source: Office for Budget Responsibility

Figure 2: UK exports to and imports from the European Union and countries in the CPTPP trading agreement, 2022

The CPTPP is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership.

	UK exports to	UK imports from
EU	£340 billion	£432 billion
CPTPP	£64.7 billion	£53.7 billion

Source: Office for National Statistics, UK Parliament

Extract A: Domestic policy challenges

As of 2023, the UK ranked as the lowest ranking country in the G7 group of advanced economies in terms of workforce participation. 500,000 more people were "economically inactive" in 2022 compared to just before the Covid-19 pandemic. The main contributors to this has been older workers exiting the labour market and an increase in those out of work due to long-term illness. Part of the cause of high long-term illness could be long NHS waiting lists. Economic inactivity also includes students, people who look after family, those with disabilities who cannot work and discouraged workers.

To curb high inflation, the Bank of England has raised Bank Rate from 0.1% at the end of 2021 to 5.25% as of August 2023. Changes in interest rates can take up to 18 months to have their full impact on the economy. UK mortgage owners either have variable or fixed rate mortgages. Variable rates are often linked to the Bank of England's Bank Rate. Fixed rate mortgages in the UK most often last for two or five years, before the homeowner chooses a new mortgage deal.

Extract B: UK competitiveness and financial market regulation

Financial market regulators now have to take into account long-term economic growth and international competitiveness, when regulating the financial system. The financial services sector contributed 8.3% of total UK output in 2021 and provides about one-tenth of UK Government tax revenue. Moving away from EU regulations may allow the UK economy to pursue economic growth and competitiveness.

Deregulation can reduce costs but it can also contribute to financial crises. Specifically there is a plan to repeal and replace Solvency II laws from the EU era, which would free up the balance sheets of insurance companies. The separation between retail and investment banking divisions of banks is likely to be loosened, with banks mostly engaging in retail banking no longer subject to "ringfencing rules".

Extract C: New trading arrangements for the UK with other economies

Now that the UK has left the European Union (EU), there is a new Trade and Cooperation Agreement in place between the UK and EU. This means there are no tariffs for UK-EU trade, provided goods meet rules of origin regulations. Yet there are now non-tariff barriers. This includes export declaration forms where exporters need to disclose the country of origin of certain items. There are also checks on livestock. Leaving the EU though has allowed the UK to make its own trade deals.

The UK has joined the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). This is a trade agreement involving countries like Australia, Canada, Chile, Japan, Malaysia, Vietnam and others which together represent 13% of global GDP. The deal removes 95% of import tariffs. In 2017, for every £12 of foreign investment into the UK, £1 came from CPTPP economies.

The UK Government has estimated a benefit of 0.08% of GDP over 10 years from joining the CPTPP, partly because the UK already had separate deals with some CPTPP members. UK farmers may face greater competition as a result of joining. However as these economies grow, the benefits to the UK may rise.

6. (a) Explain the concept of crowding out. Refer to Figure 1 in your answer.

(5 marks)

(b) Referring to Extract A, examine **two** causes of the UK's low labour force participation rate.

(8 marks)

(c) Referring to Extract A, assess how changes in UK interest rates influence aggregate demand through their effect on the housing market.

(10 marks)

(d) Assess the effects of financial market deregulation on financial markets **and** real GDP. Refer to Extract B in your answer.

(12 marks)

(e) Evaluate the consequences of the UK's trading arrangements with the EU **and** CPTPP countries for the UK's balance of payments. Refer to Extract C and Figure 2 in your answer.

(15 marks)

Section C

Choose one of the following two questions:

Either

7. Nigeria hosts several multinational companies, including Coca-Cola, Nestle as well as various oil operations. Starting in 2023, some multinational companies have been leaving Nigeria or downsizing, such as Unilever. Politicians are concerned, as multinationals provide jobs and investment into local communities. Yet some global companies may rely on workers from abroad. Communities have also suffered from oil spills, harming agriculture.

Sources: LSE, The Guardian, miscellaneous others.

Evaluate the impact of global companies on developing countries.

(25 marks)

Or

8. Diamonds are the top export of Botswana, accounting for 90% of export revenues. The rate of economic growth is forecasted to decline from 5.8% in 2022 to 3.8% in 2023, in part because of a fall in diamond production. To reduce risks to the outlook of the economy in Botswana, the International Monetary Fund suggests that Botswana reduce its dependency on diamonds.

Source: International Monetary Fund.

Evaluate the impact of the development of primary industries on developing countries.

(25 marks)

End of the test.