

General Certificate of Education
June 2008
Advanced Level Examination



ECONOMICS

ECN6

Unit 6 Government Policy, the National and International Economy

Friday 13 June 2008 9.00 am to 10.30 am

For this paper you must have:

- an 8-page answer book.

You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN6.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information

- The maximum mark for this paper is 100.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to use good English, to organise information clearly and to use specialist vocabulary where appropriate.

Advice

- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

1 INFLATION

Study **Extracts A, B and C**, and then answer **all** parts of Question 1 which follows.

Extract A: The annual % rate of UK inflation: Consumer Price Index (CPI) and Retail Price Index (RPI), 2000 – 2006

	2000	2001	2002	2003	2004	2005	2006
CPI	0.8	1.2	1.3	1.4	1.3	2.1	2.3
RPI	3.0	1.8	1.7	2.9	3.0	2.8	3.2

Source: *www.statistics.gov.uk*, accessed on 21 December 2006

Extract B: Friedman is dead but what about inflation?

Milton Friedman, an American economist who died in 2006, is perhaps best remembered for arguing that inflation is always and everywhere a monetary phenomenon in the sense that it occurs when the quantity of money in the economy grows more rapidly than output. The increase in aggregate demand (AD), which the increase in the money supply causes, can potentially be inflationary unless there is an adequate supply-side response. 1 5

By emphasising the importance of money to inflation, Friedman revived interest in the Quantity Theory of Money. This predicted a direct relationship between changes in the money supply and changes in the price level. Friedman believed that, by changing people's expectations, growth in the money supply led to higher prices. For example, if workers expected inflation to accelerate as money supply grew, they would submit potentially inflationary higher pay claims to try to maintain their real incomes. 10

In common with many other economists, Friedman argued that low inflation is vital for sustained economic success, in that it will help to keep interest rates low, maintain consumer and business confidence, and allow an economy's competitiveness to improve in global markets. In contrast, accelerating inflation can have damaging economic consequences. For example, in the long term, higher unemployment is likely, affecting both the economy and individuals. Unemployment may lower average incomes, and living standards in general can easily deteriorate. On the other hand, higher unemployment may help restore low inflation. 15

Certainly, for Friedman, money never lost its importance. He may be dead but long live the theory. 20

Source: adapted from an article by NIALL FERGUSON, *Sunday Telegraph*, 19 November 2006

Extract C: The failure of monetarism

Extract C has been removed due to third-party copyright constraints.

It was adapted from an article in the Guardian on 20 November 2006.

Source: adapted from an article by LARRY ELLIOTT, *The Guardian*, 20 November 2006

Question 1

- 1 (a) Using **Extract A**, compare the CPI and RPI measures of UK inflation for the period 2000 to 2006. (4 marks)
- (b) **Extract B** (lines 12–13) suggests that ‘low inflation is vital for sustained economic success’. Explain **two** economic benefits of low inflation for an economy. (6 marks)
- (c) **Extract B** (lines 15–17) argues that, with accelerating inflation, ‘higher unemployment is likely, affecting both the economy and individuals’. Analyse **three** possible economic effects of higher unemployment. (10 marks)
- (d) Using the data and your economic knowledge, discuss the extent to which increases in the money supply may increase the rate of inflation in an economy. (30 marks)

Turn over for the next question

Turn over ►

SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

2 (a) Explain the economic reasons for government spending. *(20 marks)*

(b) In 2006, UK government spending accounted for 41% of GDP and was predicted to grow further.

Evaluate the possible consequences for the UK economy if this further growth were to occur. *(30 marks)*

3 (a) Explain the possible costs **and** benefits for an economy arising from its involvement in international trade. *(20 marks)*

(b) The enlargement of the European Union (EU) to include such countries as Poland, Bulgaria and Romania brought the EU population in 2007 to over 450 million and provided new opportunities for growth and jobs for all other member countries.

Assess the possible consequences for UK macroeconomic performance of EU enlargement. *(30 marks)*

4 (a) Explain how a currency's value against other currencies might be determined. *(20 marks)*

(b) Assume that the value of the pound sterling rises significantly against other major currencies.

Evaluate the extent to which this might have an impact on UK economic growth. *(30 marks)*

END OF QUESTIONS

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