Past-paper walk-through

The circular flow of income ▪ 9.1

eXercise

Questions in this set

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Question 20

9708/31 N25 ▪ Q20 ▪ 1 mark

20 What may prevent a government achieving a faster rate of growth of real GDP?

A The multiplier has a small value.

B The consumer price index is below its target set by the central bank.

C The economy is operating on the vertical section of the long-run aggregate supply curve.

D There is a large negative output gap in the economy.

Solution 20

Answer: **C**

Why

- Growth needs an injection to work its way through the economy.
- A *small* multiplier means each injection has little total effect on national income.
- So a weak multiplier limits how much faster real GDP can grow from any given stimulus.

Question 22

9708/31 N25 ▪ Q22 ▪ 1 mark

22 To overcome deflation in an economy the government increases the size of its budget deficit and funds this by increasing the money supply.

What is most likely to reduce the effectiveness of these measures?

A a high marginal propensity to save

B a rise in business confidence

C an inelastic demand for money

D low cash deposit ratios for commercial banks

Solution 22

Answer: **A**

Why

- Deflation is tackled by raising aggregate demand, and a monetised deficit does that strongly.
- The policy's effect is weakened if the extra money is not spent.
- So it works least well when households save the extra income or confidence stays low.

Question 17

9708/32 N25 ▪ Q17 ▪ 1 mark

17 What is most likely to increase if an economy enters a negative output gap?

A business confidence

B economic growth rate

C inflation rate

D unemployment rate

Solution 17

Answer: **D**

Why

- A negative output gap means actual output is below potential output.
- That means spare capacity and demand-deficient unemployment.
- So the unemployment rate rises, while growth, confidence and inflation all fall.

Question 15

9708/33 N25 ▪ Q15 ▪ 1 mark

15 Which policy is most likely to lead to a reduction in the natural rate of unemployment?

A an increase in government expenditure on goods and services

B an increase in government expenditure on training schemes to address skill shortages

C an increase in the period when the unemployed are eligible for welfare benefits

D an increase in the minimum wage

Solution 15

Answer: **B**

Why

- The natural rate of unemployment is the frictional and structural unemployment left at full employment.
- It falls when the labour market works better – more training, better job information, more mobility.
- Raising aggregate demand only reduces *cyclical* unemployment, so it leaves the natural rate untouched.

Question 16

9708/34 N25 ▪ Q16 ▪ 1 mark

16 An open economy has a positive output gap.

What is likely to be decreasing?

A expenditure on imports

B leisure time of workers

Question 16

C nominal wage rates

D the general price level

Solution 16

Answer: **B**

Why

- A positive output gap means the economy is producing above its sustainable capacity.
- Labour is scarce, so wages and prices are bid up and workers work longer hours.
- So leisure time falls, while wages, prices and imports all rise.

Question 19

9708/34 N25 ▪ Q19 ▪ 1 mark

19 What is an example of a demand-side macroeconomic policy that would reduce cyclical unemployment?

A an increase in government spending on new infrastructure such as roads

B an increase in government spending on retraining workers

C a reduction in the rate of tax on imports

D an increase in the rate of tax on goods and services

Solution 19

Answer: **A**

Why

- Cyclical unemployment comes from too little aggregate demand.
- A demand-side remedy raises spending directly.
- Government spending on infrastructure is exactly that – an injection that raises aggregate demand.