

FORM TP 2015176



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CARIBBEAN EXAMINATIONS COUNCIL

CARIBBEAN ADVANCED PROFICIENCY EXAMINATION®

ECONOMICS

UNIT 2 – Paper 02

2 hours 30 minutes

01 JUNE 2015 (p.m.)

READ THE FOLLOWING INSTRUCTIONS CAREFULLY.

1. This paper consists of **THREE** sections: I, II and III.
2. There are **TWO** questions in each section. Candidates **MUST** answer **THREE** questions, **ONE** from **EACH** section.
3. Answers for **ALL** questions must be written in the answer booklet provided.
4. Begin **EACH** question on a separate page.
5. You may use a silent, non-programmable calculator to answer questions.

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SECTION I

MODULE 1: MODELS OF THE MACROECONOMY

Answer ONE question.

1. (a) (i) Define the term 'gross domestic product (GDP)'. **[2 marks]**
- (ii) Explain why certain **final** goods and services are NOT included in the measurement of GDP. **[3 marks]**
- (iii) Explain why economists use 'real GDP' rather than 'nominal GDP' to gauge economic wellbeing. **[3 marks]**
- (b) Consider the data on GDP presented in Table 1.

TABLE 1

Year	Nominal GDP (millions)	Real Potential GDP (2005 dollars)	GDP Deflator (base year = 2005)
2013	9 269	7 730	113
2014	9 873	10 145	118

N.B. For this question, round all numerical answers to one decimal place.

- (i) Calculate real GDP in 2013 and 2014, respectively. **[4 marks]**
- (ii) Calculate the growth (in percentage terms) of nominal GDP between 2013 and 2014. **[2 marks]**
- (iii) Calculate the growth (in percentage terms) of the real GDP between 2013 and 2014. **[2 marks]**
- (iv) Explain the difference between 'the growth of nominal GDP' and 'the growth of real GDP'. **[3 marks]**
- (v) Calculate the output gap (in percentage terms) in 2013 and in 2014, respectively. **[4 marks]**
- (vi) State whether the output gap was recessionary or inflationary in 2013 and 2014, respectively. **[2 marks]**

Total 25 marks

2. (a) (i) Identify the **most** important determinant of consumer spending and personal saving. **[1 mark]**
- (ii) Define EACH of the following terms:
- a) Marginal propensity to consume (MPC) **[2 marks]**
- b) Marginal propensity to save (MPS) **[2 marks]**
- (iii) Describe the relationship between MPC and MPS. **[2 marks]**
- (b) Use the following information to answer Parts (i) and (ii).

Consider the Keynesian consumption function:

$$C = 2000 + 0.8 (Y - T)$$

where C = personal consumption

Y = personal income

T = income taxes

Also, suppose $Y = 40\,000$ and $T = 0.25Y$.

- (i) Calculate
- a) the average propensity to consume (APC) **[2 marks]**
- b) the average propensity to save (APS). **[3 marks]**
- (ii) Calculate the multiplier and interpret its value. **[4 marks]**
- (c) Distinguish between the 'investment demand curve' and the 'investment curve'. **[4 marks]**
- (d) (i) Using the accelerator model of investment, calculate the change in investment if firms desire to hold 25% of output as inventory and output falls by \$500 million. **[3 marks]**
- (ii) Calculate the change in investment if firms' desire to hold inventories rise to 30%, with all else remaining constant. **[2 marks]**

Total 25 marks

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SECTION II

MODULE 2: MACROECONOMIC PROBLEMS AND POLICIES

Answer ONE question.

3. (a) (i) Define EACH of the following terms:
- a) National budget deficit [2 marks]
 - b) National debt [2 marks]
- (ii) State FOUR causes of national debt. [4 marks]
- (b) (i) Explain why the size of national debt is commonly expressed as a ratio to GDP. [3 marks]
- (ii) Evaluate the statement “public debt is a burden on future generations”. [4 marks]
- (c) Table 2 shows government spending and tax revenue for a hypothetical economy over a four-year period. All figures are in millions.

TABLE 2

Year	Government Spending	Tax Revenue	Budget Balance	Deficit/Surplus/Neither
1	\$800	\$825		
2	\$850	\$850		
3	\$900	\$875		
4	\$950	\$900		

- (i) Copy Table 2 into your answer booklet and complete it to show the budget balance indicating whether it is a deficit, surplus or neither. [8 marks]
- (ii) Calculate the public debt in this economy over the four-year period. [2 marks]

Total 25 marks

4. (a) (i) Define the term 'fiscal policy'. [2 marks]
- (ii) Explain, using TWO examples, the term 'automatic stabilizers'. [5 marks]
- (iii) Distinguish between 'discretionary fiscal policy' and 'non-discretionary fiscal policy'. [4 marks]
- (b) Analyse how monetary policy can be used to address
- (i) the problem of recession or slow growth [4 marks]
- (ii) inflation. [4 marks]
- (c) (i) Define the term 'stagflation'. [2 marks]
- (ii) With the use of a labelled Phillips curve, explain how the use of fiscal and monetary policies to solve problems of inflation and unemployment can further compound the problems. [4 marks]

Total 25 marks

SECTION III

**MODULE 3: GROWTH, SUSTAINABLE DEVELOPMENT
AND GLOBAL RELATIONS**

Answer ONE question.

5. (a) Table 3 shows data on income and population differences among groups of countries for 2013. Use this information to answer the following questions.

TABLE 3

1	2	3	4
Income Groups by GDP per capita (2013)	GDP (US \$ million)	World GDP (%)	World Population (%)
Low (\$1 350 or less)	2 278 000		60
Lower-Middle (\$1 351–\$5 390)	3 228 000		17
Upper-Middle (\$5 391–\$16 710)	3 674 000		8
High (\$16 711 or more)	36 594 000		15
World	45 774 000	100	100

- (i) Copy Table 3 into your answer booklet and complete it by calculating the percentage of World GDP earned by EACH income group. **Round your answers to one decimal place.** [4 marks]
- (ii) List FOUR factors which could explain the inequality in income amongst all groups in the table. [4 marks]
- (iii) Identify the income group in which the majority of CARICOM countries fall and state TWO structural peculiarities of CARICOM countries which might justify them being in that group. [3 marks]
- (iv) Outline THREE implications for CARICOM economies that might result from the structural peculiarities identified in (a) (iii) above. [6 marks]
- (b) Discuss ONE benefit of economic growth and ONE cost of economic growth. [8 marks]

Total 25 marks

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6. (a) (i) Identify THREE factors which may affect the levels of imports and exports of a country. [3 marks]
- (ii) Explain EACH of the following concepts:
- a) Comparative advantage [3 marks]
- b) The effects of foreign exchange earnings on small open economies [3 marks]
- (b) (i) Define the term 'protectionism'. [2 marks]
- (ii) Discuss the infant industry's argument for protection. [4 marks]
- (c) (i) Define 'trade liberalization'. [2 marks]
- (ii) Discuss TWO benefits of trade liberalization. [8 marks]

Total 25 marks

END OF TEST

IF YOU FINISH BEFORE TIME IS CALLED, CHECK YOUR WORK ON THIS TEST.