Edexcel AS/A-level Year 1 Economics A exam practice answers

5 Measures of economic performance

**1** The basket has to reflect patterns of spending so the correct weights are applied in the basket of goods to form the CPI, so that inflation or an increase in the cost of living is recorded in a representative way. [5]

**2** If items form a larger percentage of our spending then it is important that price changes of these items feature more significantly in the measure of inflation. For example, if your family spends a lot of money on petrol and petrol prices rise significantly, then your family will feel the squeeze. When it comes to negotiating wage rises the increase in petrol costs will be a bargaining factor.

The basket is changed every year and many types and outlets are tested for each of the 650 items, so overall we would expect the figure over time to be fairly accurate. We can also use more specific measures, such as the pensioners’ price index to have a basket geared more specifically to the demands of older people. Sometimes we use RPI ‘headline’ measures to give a more accurate reflection of living costs. Pension and other adjustments rarely use CPI changes. [10]

**3** The 650 items in the basket of goods used to measure inflation in the UK is supposed to represent typical spending patterns. Tablet devices such as iPads can form a large part of many people’s expenditure, especially if they like to upgrade to the latest models. Price changes in devices will be reflected significantly in the retail price index and, as prices come down, this will lower the inflation figure. However, pensioners use these items less than other people and their pensions are often index-linked to the retail price index. This means that the rate of increase in their pension will not go up as fast as their cost of living, if non-tablet items are becoming relatively more expensive on average. This will mean their real incomes are falling and pensioners might become relatively less well off. The government aims to reduce income inequalities, but errors like this worsen them. [6]