Write your name here

Surname	Other names

Centre Number | Candidate Number

Edexcel GCE

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Wednesday 19 January 2011 – Morning
Time: 1 hour 30 minutes

Paper Reference
6EC02/01

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer EITHER Question 1 or Question 2. Write your answer in the spaces provided in this question paper.
- Answer the questions in the spaces provided – *there may be more space than you need.*

Information

- The total mark for this paper is 80.
- The marks for **each** question are shown in brackets – *use this as a guide as to how much time to spend on each question.*
- Questions labelled with an **asterisk** (*) are ones where the quality of your written communication will be assessed – *you should take particular care on these questions with your spelling, punctuation and grammar, as well as the clarity of expression.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Keep an eye on the time.
- Check your answers if you have time at the end.

Turn over ▶

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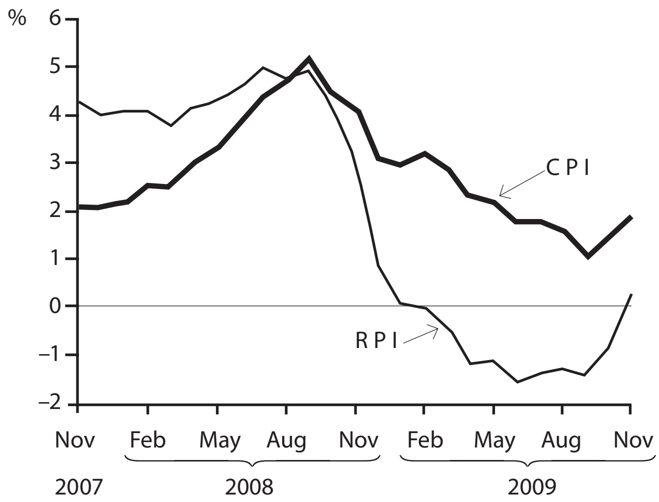
Answer EITHER Question 1 or Question 2.

If you answer Question 1 put a cross in this box ☒ .

1 Inflation and growth

Figure 1 Rates of Inflation in the UK, year on year percentage changes



Source: http://www.statistics.gov.uk/pdfdir/cpi1209.pdf produced on 15th December 2009.

Figure 2 Annual percentage change in Gross Domestic Product (GDP) at constant prices

				Forecast
Country	2007	2008	2009	2010
Germany	2.5	1.2	-5.0	1.2
United Kingdom	2.6	0.5	-4.9	1.3
United States	2.1	0.4	-2.4	3.1
Developing Economies	8.3	6.1	2.4	6.3

Source: www.imf.org (World Economic Outlook Database April 2010).

Extract 1 Recession to cause permanent damage

The effects of the 2008-09 financial crisis and recession (at least two consecutive quarters of negative growth) has similarities to the recessions of the 1920s, 1980s and 1990s: global output is on a persistently lower path than expected before the crisis; public finances are severely weakened; long term unemployment has increased and income inequality has risen.

Research by the International Monetary Fund (IMF) into previous recessions found three major forces which tended to prevent economies rebounding to their pre-crisis trends of output.

First, for a period of time after the recession there is likely to be high unemployment and misallocations of resources in several sectors of the economy. An example is residential construction. If unemployment remains high for some time, former employees may lose skills and the discipline of working.

Second, part of the capital stock is destroyed as some plant and equipment is scrapped prematurely. Other companies struggle to invest in viable and innovative projects because banks restrict credit to protect their finances.

Third, productivity falls because there is 'less innovation, as research and development spending tends to be scaled back in bad times', the IMF says.

Source: adapted from *The Financial Times*, the article 'Recession to leave permanent scars' by Chris Giles, 24th November 2009.

(a) (i) With reference to Figure 1, explain what happened to the price level in the period shown.

(6)

(ii) With reference to Figure 1, and your own knowledge, to what extent has monetary policy, as conducted by the Monetary Policy Committee, been a success?

(12)

(b) With reference to Figure 2,

(i) Explain what is meant by a **fall** in *Gross Domestic Product at constant prices*.

(4)

*(ii) Discuss **two** problems of comparing the economic growth of the UK and developing economies using GDP as a measure.

(12)

(iii) Analyse **two** possible implications for macroeconomic policy of inaccurate forecasts of GDP growth data.

(8)

(c) With reference to Extract 1, analyse the possible impact on the distribution of income of negative economic growth.

(8)

*(d) Assess the effectiveness of supply-side measures that the government could use to deal with the problems outlined in paragraphs 3, 4 and 5 of Extract 1.

(30)

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(Total for Question 1 = 80 marks)

If you answer Question 2 put a cross in this box ☒.

2 Public finances

Extract 1 Some initial reactions to the 2009 Pre-Budget Report

No Chancellor would wish to publish a forecast showing that the government will need to borrow £178 billion in 2009/10. But when you consider that the economy has shrunk more in the last six months than the Chancellor, Alistair Darling, predicted in Spring 2009, an increase of just £3 billion in the forecast deficit from £175 billion actually looks like good news.

Far from reducing the fiscal deficit immediately, the Chancellor has actually announced a modest increase in the fiscal deficit over the next three years. The Chancellor increased planned spending by around £15 billion in total over 2011/12 and 2012/13, while recovering only £9 billion through new tax increases.

The Chancellor said that the extra spending would allow modest real increases in spending on 'frontline' schools and no real cuts in the 'frontline' National Health Service plus no cuts in police numbers. But this will leave remaining public services, such as housing, transport and higher education, facing severe real cuts. By 2015, the planned spending increases become less generous while the planned tax increases continue to bring in more revenue.

Source: adapted from The Institute for Fiscal Studies, the article 'Some initial reactions to the 2009 Pre-Budget Report', 9th December 2009 http://www.ifs.org.uk/pr/pbr09.pdf.

Figure 1 Changes in UK GDP and Components of Aggregate Demand in real terms (£ millions)

	2008	2009	Percentage Change
Consumption	852,918	826,436	–3%
Investment	232,202	199,962	–14%
Government Spending	282,681	288,133	2%
Stocks	866	–15,644	–1906%
Exports	361,535	321,155	–11%
Imports	401,137	349,189	–13%
Exports–Imports	–39,602	–28,034	29%
GDP	1,330,088	1,266,533	–5%

Source: adapted from http://www.bankofengland.co.uk/publications/inflationreport/ir09nov.pdf and data from Daiwa Capital Markets, 6th January 2010.

Figure 2 Value of £1 sterling, expressed in Euros and Dollars, annual averages

	EURO	US$
2004	1.43	1.90
2005	1.46	1.74
2006	1.48	1.95
2007	1.41	2.01
2008	1.15	1.52
2009	1.10	1.62

Source: adapted from Yahoo Finance.

(a) (i) With reference to the information in Extract 1, explain what is meant by 'a modest increase in the fiscal deficit' (line 7).

(6)

(ii) Illustrating your answer with an aggregate demand and aggregate supply diagram, evaluate the likely effect of an increase in the fiscal deficit on the level of real output and on the price level. Refer to the multiplier effect in your answer.

(16)

(b) (i) Explain the impact on aggregate demand of the fall in the size of the current account deficit in 2009, as represented in Figure 1 by 'Exports – Imports'.

(6)

*(ii) With reference to Figure 1, discuss **two** likely reasons for the fall in consumer expenditure in 2009.

(14)

(c) (i) With reference to Figure 2, explain the term *exchange rate*.

(4)

(ii) Using the data in Figure 2, calculate the percentage change in the value of the pound against the Euro between 2004 and 2009.

(4)

*(d) Evaluate the likely effects on the UK's current account of the balance of payments of changes in consumption, investment and the exchange rate of the pound sterling (£), as shown in Figures 1 and 2.

(30)

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(30)

(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

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