Write your name here

Surname	Other names

Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Wednesday 18 January 2012 – 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 ▶

Answer EITHER Question 1 or Question 2.

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

1 Productivity, Investment, Trade and Employment

Figure 1 Annual average international labour productivity growth, %

	1995 – 2007	2007 – 2009
United States of America (US)	2.1	2.1
United Kingdom (UK)	2.2	-0.7
European Union (EU)	1.5	-0.5

(Source: http://www.mckinsey.com/mgi/publications/UK_report/pdfs/MGI_UK_growth_and_renewal_full_report.pdf)

Figure 2 UK Gross Investment and GDP Growth (percentage change over previous year), 2001–2009

Year	Gross investment	GDP Growth
2001	2.6	2.5
2002	3.6	2.1
2003	1.1	2.8
2004	5.1	3.0
2005	2.4	2.2
2006	6.4	2.8
2007	7.8	2.7
2008	–5.0	–0.1
2009	–15.0	–4.9

(Source: © Crown Copyright 2010/HMSO)

Extract 1   Trade risks are main threat to UK Economy, says Bank

According to the Governor of the Bank of England, Mervyn King, the biggest risk to growth in the UK is that if the economies of its trading partners suffer badly, demand for UK exports will slow and will make it difficult for the nation to undertake a rebalancing of its economy. Mr King said "the biggest risk that we face is bad news on the world economy and in particular in the euro area". He noted that more than 60% of UK exports were to the eurozone - including 7% to Ireland alone.

Mr King went on to say that the central issue facing the UK economy is to reduce its dependence on credit-fuelled household consumption and on the public sector, replacing it with demand for exported goods and services and increased investment.

Nearly three years after a 25% drop in the value of sterling, there has been little improvement in Britain's trade balance.

(Source: adapted from the Financial Times © The Financial Times Limited 2010
"Trade risks are main threat to UK, says Bank" By Norma Cohen and Daniel Pimlott
November 10 2010 http://www.ft.com/cms/s/0/e6a628a8-ecbf-11df-88eb-00144feab49a.html#)

Extract 2   Latest figures show the majority of claimants being found fit for work

The conditions for people to receive Job Seeker's Allowance have become more and more difficult. Some economists see a link between this and the increase in people claiming long term sickness benefit, or incapacity benefit (IB) over the same period. This increase could well be concealing many long term unemployed.

The Government has therefore started reassessing those on the old style IB for a replacement benefit, the Employment and Support Allowance (ESA) programme. This will be completed in 2011. According to official statistics from a pilot study, three-quarters of people applying for the new ESA were either found to be fit for work or withdrew their benefit claim before they completed a medical assessment.

The Employment Minister, Chris Grayling, commented that with over two million people trapped on incapacity benefits, this pilot study underlined how important it is to make sure that everyone who has the potential to work gets the right help to move off benefits and into a job. He also expressed his view that the medical assessment should be designed fairly and explained that an independent review is being undertaken with a number of charities representing disabled people and those with mental health issues.

The following day the Daily Mail's headline was "75% of incapacity claimants are fit to work" and the paper estimated this reform would slash the £12.5 billion spent on incapacity benefits a year to just over £4 billion.

(Source: © Crown copyright and '75% of incapacity claimants are fit to work', Gerri Peev © Daily Mail
27 October 2010)

(a) (i) With reference to Figure 1, what is meant by 'labour productivity'?

(4)

(ii) Explain **two** possible reasons why UK labour productivity declined during the period 2007-2009 (Figure 1).

(8)

(iii) With reference to the data, evaluate the effects of declining productivity on the UK economy.

(12)

(b) (i) With reference to Extract 1, explain what is likely to be 'the biggest risk to growth in the UK.' (Lines 1 -2)

(6)

(ii) Explain **two** factors that might lead to an increase in investment in the UK.

(8)

*(iii) With reference to Figure 2, discuss the significance of investment for economic growth. Illustrate your answer with an aggregate demand and supply diagram.

(12)

*(c) Assess the likely impact of UK government labour market policies on any **three** macroeconomic objectives. Refer to the information provided and to your own knowledge.

(30)

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(Total for Question 1 = 80 marks)

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

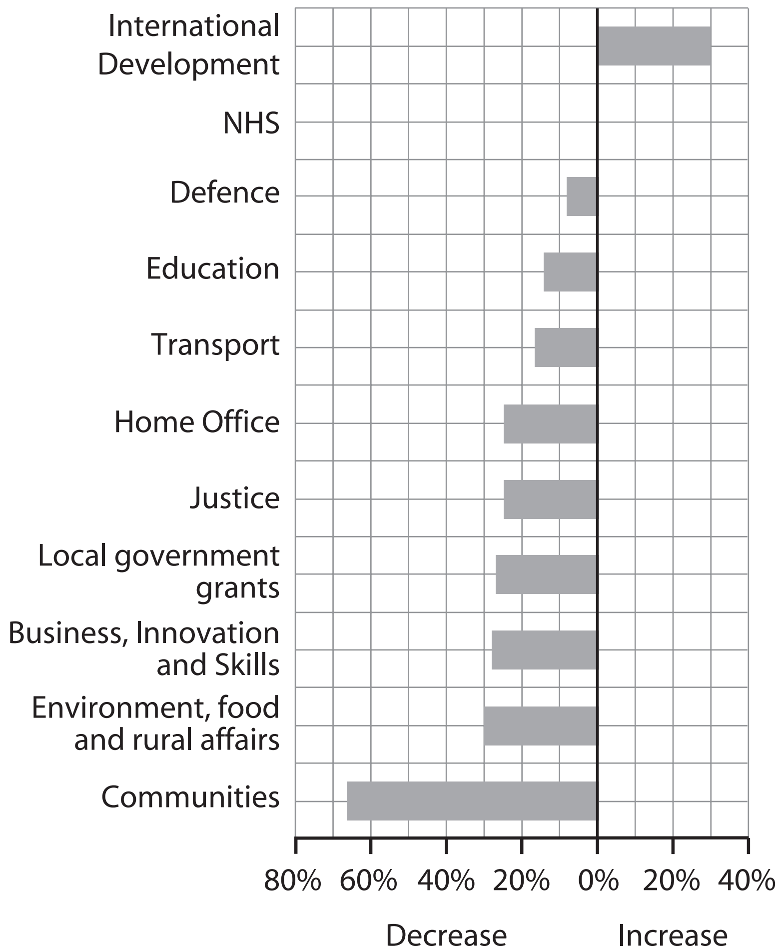
2 Public Sector cuts, unemployment and inflation targets

Extract 1 Cutting back the state

The Chancellor of the Exchequer, George Osborne, insisted that harsh medicine was vital to cut Britain's huge budget deficit, expected to be 10% of GDP in 2010–11. Total cuts in public sector spending of £81 billion are to be made by 2014–15. Nevertheless, total spending is planned to be 6% higher in cash terms in 2014–15 than 2010–11, but in real terms to be 3% lower. Some spending is beyond the Chancellor's control: debt interest is likely to rise from £43 billion this year to £63 billion by 2014–15 as a result of the surge in government borrowing.

As well as efficiency savings, one obvious way to reduce costs is to keep pay down. The government has already announced a two-year pay freeze for public-sector staff. State employers could carry on in this spirit after that, pointing out that the more pay can be kept down, the fewer the job losses. But job losses there will be, amounting to probably about half a million (out of a public sector workforce of about 6 million) by the end of 2014.

Figure 1 Planned real percentage changes in UK public expenditure by government department between the fiscal years 2010–11 and 2014–15



(Source for figure 1 and extract 1: © The Economist Newspaper, Oct 21st 2010)

Extract 2   The inflation overshoot continues

For the fourth time this year, the Governor of the Bank of England, Mervyn King, has had to write to the Chancellor of the Exchequer explaining why inflation is above 3%. According to the Bank's own forecast published in its Inflation Report on November 10th 2010, Mr King is likely to be writing yet more letters in 2011 to George Osborne at the Treasury.

Figures out today from the Office for National Statistics showed that consumer prices rose by 3.2% in the year to October 2010. The new numbers triggered the letter, which the Governor has to write every three months if inflation remains more than a percentage point above (or below) the 2% target. It marked the ninth since the Bank of England's Monetary Policy Committee was given operational control over monetary policy in 1997. Since the spring of 2007, inflation has been above the 2% target in all but nine of the past 54 months.

Britain is unusual in facing high inflation. Consumer prices in the Euro zone rose by 1.9% in the year to October 2010 and in the USA annual inflation was 1.1% in September 2010.

In his letter to the Chancellor, Mr King struck what has become a familiar note, by drawing a distinction between temporary upward and long term downward pressures on inflation. The inflation overshoot, he said, largely reflected a number of temporary factors, including the restoration of the main rate of VAT from its emergency rate of 15% during the recession to 17.5% in January 2010, past rises in oil prices and the continued effects of higher import prices resulting from the big 25% fall in sterling from mid-2007. These factors were offsetting the downward effects from spare capacity caused by the recession.

However, the temporary effects keep on coming. World food prices have risen by 31.5% in the past year. On January 4th 2011 the standard rate of VAT will rise again, to 20% as part of the coalition government's budget deficit reduction strategy.

Mr King argued that once these further temporary effects ended, inflation would fall back towards the target, due to spare capacity in the economy. He insisted that "the depth of the recession means that a margin of spare capacity is likely to persist for some while". However, there is considerable uncertainty about just how much spare capacity there is in the economy.

The main danger from the persistence of inflation overshoots is that people start to expect higher inflation and to demand higher wages. Mr King was concerned that this would make it "more costly to bring inflation down".

(Source: © *The Economist Newspaper*, Nov 16th 2010)

(a) (i) With reference to Extract 1, what is meant by a "budget deficit" (line 2)?

(4)

(ii) With reference to Extract 1, explain the likely impact of a reduction in the budget deficit on the circular flow of income.

(8)

(iii) Using an aggregate demand and aggregate supply diagram, evaluate the effect on output of the half a million public sector job cuts (Extract 1, Line 12).

(12)

(b) (i) With reference to Extract 2, explain what has happened to "spare capacity" (line 29) in the context of the UK economy.

(6)

(ii) With reference to Extract 2, analyse **two** of the causes of inflationary pressure that the Governor views as "temporary".

(8)

*(iii) In light of the information provided, assess the case for an increase in the base interest rate set by the Monetary Policy Committee.

(12)

*(c) With reference to Extract 2, evaluate the likely impact of higher inflation on **three** macroeconomic objectives.

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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