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**Edexcel GCE**

**Economics**  
**Advanced Subsidiary**  
**Unit 2: Managing the Economy**

Monday 28 January 2013 – Afternoon <b>Time: 1 hour 30 minutes</b>	Paper Reference <b>6EC02/01</b>
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**You do not need any other materials.**

Total Marks
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### 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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**PEARSON**

**Answer EITHER Question 1 or Question 2.**

**If you answer Question 1 put a cross in this box**

**1 Consumption, Investment and the UK Government's Fiscal Target**

**Extract 1 Components of Aggregate Demand (Report from the Office of Budgetary Responsibility)**

The real disposable income of UK households is forecast to have fallen by 2.3% in 2011, a post-war record. Earnings growth is not expected to overtake inflation again until 2013 and not by a significant margin until 2014. As a result, we expect consumer spending to remain broadly constant in real terms in 2012 before picking up as real household disposable income starts growing again. 5

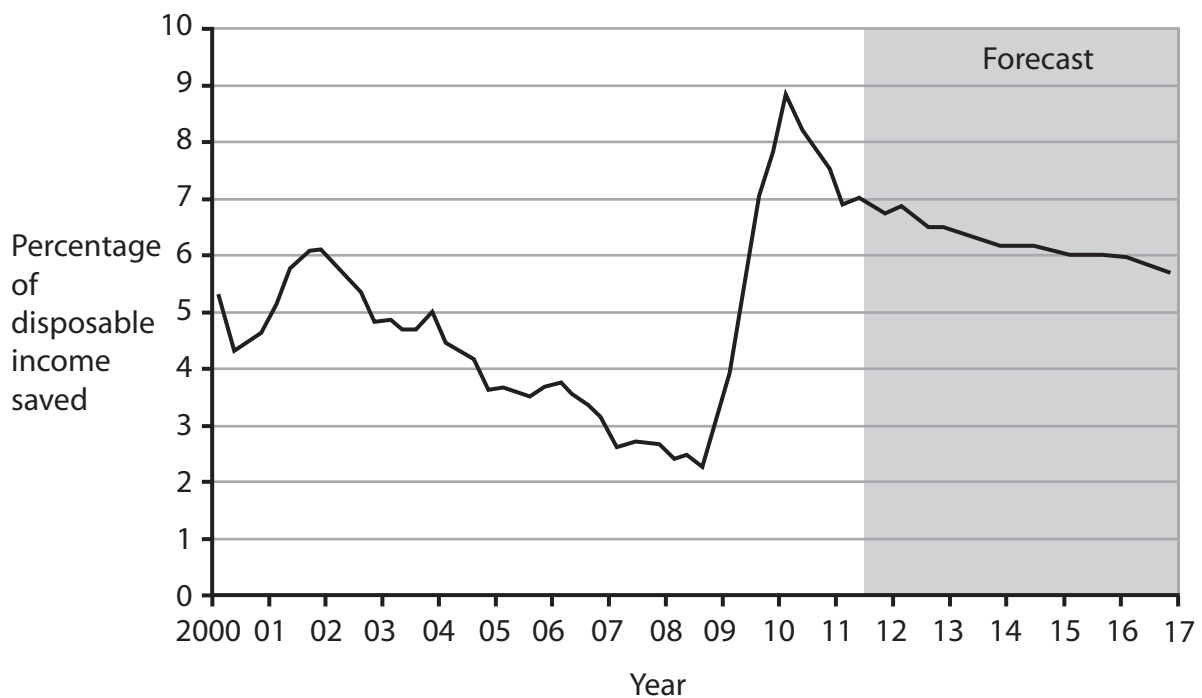
We expect private sector employment to rise by around 1.7 million between the start of 2011 and the start of 2017, but this will be partly offset by a fall of around 710,000 in general government employment. The government still aims to reduce the budget deficit rapidly in order to achieve its fiscal target.

Business investment has shown virtually no growth in 2011. The CBI's latest Quarterly Industrial Trends Survey suggests that the investment that has taken place has largely replaced worn out assets, rather than added to the capital stock. 10

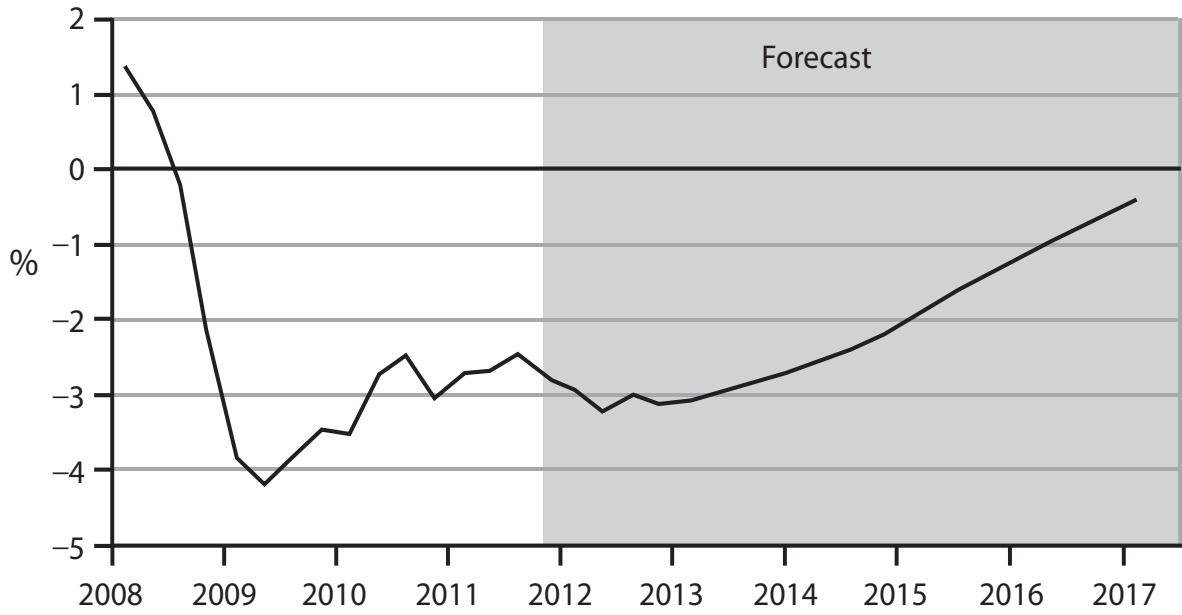
Businesses have used some of their profits to pay back bank loans and they may also have started to build up cash reserves against further shocks as uncertainty over the outlook has risen. This might lead to a reduction in business investment in 2012. We also continue to predict a small current account deficit in the medium term. 15

(Source: © Crown Copyright Office of Budgetary Responsibility Autumn Report, November 2011)

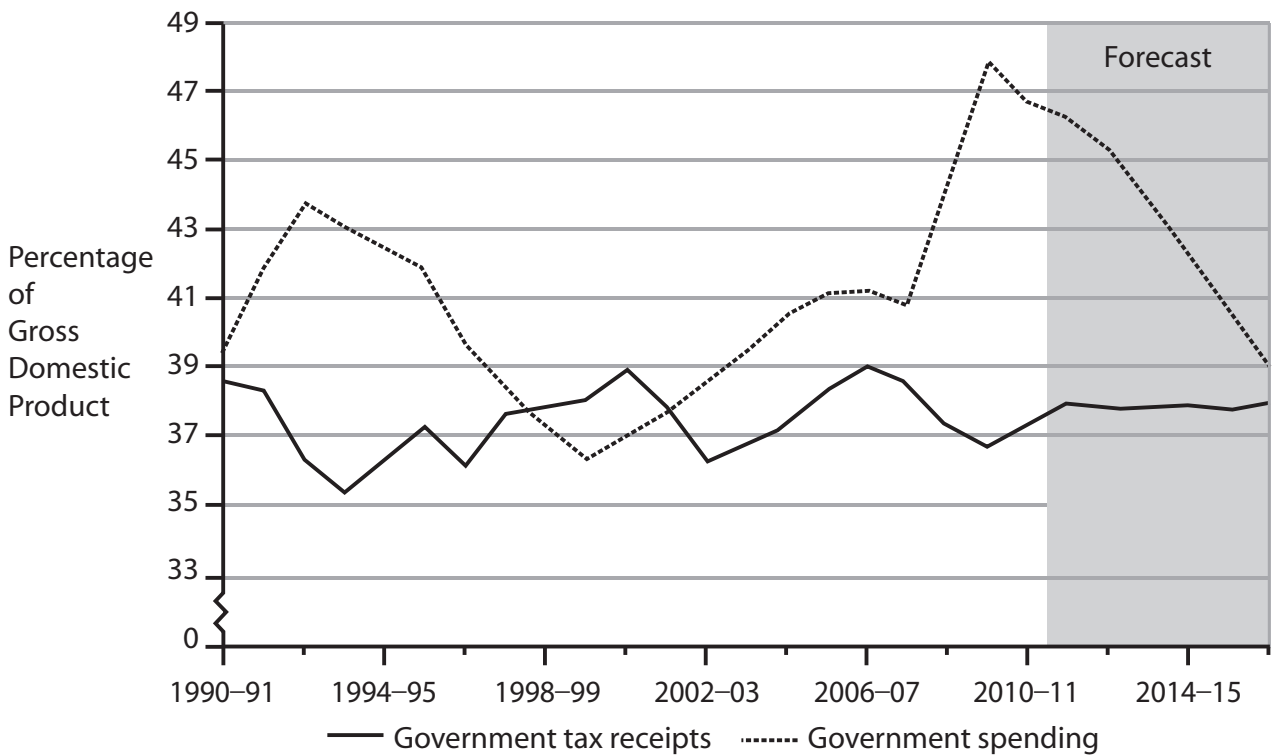
**Figure 1 UK savings ratio: percentage of UK household disposable income saved**



**Figure 2 The UK output gap**



**Figure 3 Total UK Government public spending and tax receipts**



(Source for Figures 1-3: © Crown Copyright Office of Budget Responsibility Economic and Fiscal Outlook, November 2011)



- (a) (i) With reference to Extract 1, outline the components of *aggregate demand*. (6)
- (ii) Identify and explain **two** factors that influence the level of business investment (Extract 1, line 10). (8)
- (iii) With the aid of an aggregate demand and aggregate supply diagram, assess the likely effects on the UK economy of 'a reduction in business investment' (Extract 1, line 15). (12)
- (b) (i) With reference to Figure 1, explain how the forecast change in the savings ratio from 2010 might affect the value of the multiplier. (8)
- \* (ii) With reference to Figure 2, discuss **two** likely consequences of the output gap from 2009. (12)
- (c) (i) With reference to Figure 3, identify the change in the UK budget deficit between 2002–03 and 2010–11. (4)
- \* (ii) Evaluate the macroeconomic effects of the UK government trying to reduce its budget deficit, assuming economic growth remains weak. (30)



(a) (i) With reference to Extract 1, outline the components of *aggregate demand*.

(6)

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(ii) Identify and explain **two** factors that influence the level of business investment  
(Extract 1, line 10).

(8)

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(iii) With the aid of an aggregate demand and aggregate supply diagram, assess the likely effects on the UK economy of 'a reduction in business investment' (Extract 1, line 15).

(12)

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(b) (i) With reference to Figure 1, explain how the forecast change in the savings ratio from 2010 might affect the value of the multiplier.

(8)

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\* (ii) With reference to Figure 2, discuss **two** likely consequences of the output gap from 2009.

(12)

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(c) (i) With reference to Figure 3, identify the change in the UK budget deficit between 2002–03 and 2010–11.

(4)

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\*(ii) Evaluate the macroeconomic effects of the UK government trying to reduce its budget deficit, assuming economic growth remains weak.

(30)

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**(Total for Question 1 = 80 marks)**





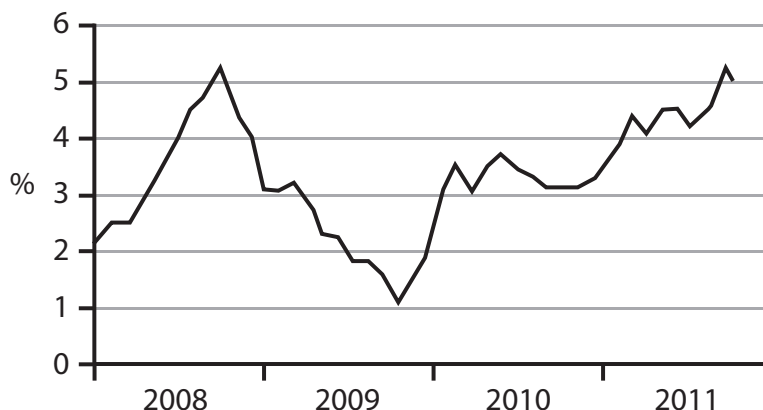
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If you answer Question 2 put a cross in this box

**2 Inflation and the Standard of Living**

**Figure 1 UK rate of inflation (annual percentage change as measured by the CPI)**



**Extract 1 The UK rate of inflation falls**

A supermarket price war, cheaper air fares and lower petrol prices caused inflation to slow to 5% in October 2011, ending its recent upward trend and prompting economists to predict it will fall sharply in 2012. The annual increase in the consumer price index peaked at 5.2% in September 2011. With the cost of petrol, food and air travel all dropping in October, having risen in the same month in 2010, the overall rate of inflation was pushed down. 5

Even though the rate of inflation has begun to fall as economists had expected, the annual rate remains well above the Bank of England's 2% target, prompting another letter of explanation from Sir Mervyn King, Governor of the Bank of England, to George Osborne, Chancellor of the Exchequer. In November 2011, Sir Mervyn wrote that "inflation will fall back sharply in the next six months or so and continue falling thereafter to around target by the end of next year". 10

He could make the prediction because large price rises that occurred towards the end of 2010 were beginning to drop out of the inflation calculation, since they happened over a year previously. The rate of inflation would fall sharply as this process accelerated in early 2012 once the rise in value added tax to 20% no longer counted in the measure. 15

Even though Sir Mervyn pointed to lower inflation in the future, the average rate tolerated by the Bank of England over the previous four years had been 3.5%, far above the 2% target.

He said the Bank had used low interest rates and monetary expansion ('quantitative easing') to aid the economy's adjustment to higher energy and import prices. Without these policies, the economy would have been more vulnerable to a recession. 20

(Source for Figure 1 and Extract 1: adapted from 'Supermarket price war eases inflation', © Financial Times, 15 November 2011)



**Figure 2 Selected data on living standards**

	Human Development Index (HDI) 2011	Gross National Income per head 2011 (Constant 2005 PPP \$)
Germany	0.905	34,854
Spain	0.878	26,508
United Kingdom	0.863	33,296
Fiji	0.688	4,145
China	0.687	7,476
Ethiopia	0.363	971

(Source: Data retrieved from the UNDP Human Development Report website: <http://hdr.undp.org/en/statistics/> © UNDP)

- (a) (i) With reference to Figure 1, explain what happened to the UK price level from late 2008 to mid-2009. (4)
- (ii) In Extract 1, the UK's rate of inflation is predicted to be significantly lower in 2012 than in 2011. Explain **two** likely economic consequences of the lower rate of inflation in 2012. (8)
- (iii) With reference to Figure 1, Extract 1 and your own knowledge, assess the effectiveness of UK monetary policy. (12)
- (b) (i) Explain the three main components of the Human Development Index. (6)
- (ii) With reference to Figure 2, explain **two** difficulties of comparing living standards between countries. (8)
- \*(iii) With the aid of an aggregate demand and aggregate supply diagram, assess the possible effects on the UK economy of an increase in government expenditure on education. (12)
- \*(c) Other than investing in education, evaluate policies a government can implement to raise living standards. (30)



(a) (i) With reference to Figure 1, explain what happened to the UK price level from late 2008 to mid-2009.

(4)

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(iii) With reference to Figure 1, Extract 1 and your own knowledge, assess the effectiveness of UK monetary policy.

(12)

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(ii) With reference to Figure 2, explain **two** difficulties of comparing living standards between countries.

(8)

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\* (iii) With the aid of an aggregate demand and aggregate supply diagram, assess the possible effects on the UK economy of an increase in government expenditure on education.

(12)

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\*(c) Other than investing in education, evaluate policies a government can implement to raise living standards.

(30)

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**(Total for Question 2 = 80 marks)**

**TOTAL FOR PAPER = 80 MARKS**



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