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Edexcel GCE

Economics
Advanced Subsidiary
Unit 2: Managing the Economy

Friday 27 May 2011 – Morning Time: 1 hour 30 minutes	Paper Reference 6EC02/01
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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 Unemployment in the UK

Figure 1 Selected changes to the CPI basket of goods and services, 2010

IN	OUT
Cereal Bars	Hairdryer
Fruit drink in a bottle	Fizzy canned drink
Blu-ray disc players	Disposable camera
Lip gloss	Lipstick

<http://www.guardian.co.uk/news/datablog/2010/mar/15/inflation-basket>

Extract 1 King says inflation surge ‘short term’

When inflation, measured by the Consumer Price Index (CPI), moves outside the tolerance of 2% + or – 1%, the Governor of the Bank of England is required to write an open letter to the Chancellor explaining the reasons for it. In February 2010 CPI inflation reached 3.5%.

In his February letter the Governor, Mr King, pointed to three factors: the rise in VAT back to its pre-recession 17.5% rate, a sharp increase in oil prices of roughly 70% over the past year, and the sharp depreciation of sterling in 2007 and 2008.

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However, Mr King also stressed that inflation might eventually fall below target because of the sharp fall in consumer and investment spending and the build-up of spare capacity in the economy as labour, factories and equipment lie idle.

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He noted that the Monetary Policy Committee (MPC) has already cut interest rates to 0.5% and the Bank of England has bought £200 bn of government bonds to encourage the commercial banks to increase lending.

Source: Based on the following articles in the FT “King says inflation surge ‘short term’” by Norma Cohen published on February 16 2010 and “Farewell to QE” by Lex on 4 February 2010

<http://www.ft.com/cms/s/0/d29d8984-1aea-11df-88fa-00144feab49a.html> and <http://www.ft.com/cms/s/3/3963580c-1199-11df-9195-00144feab49a.html>

Extract 2 Unemployment Headlines from the Guardian, March 2010

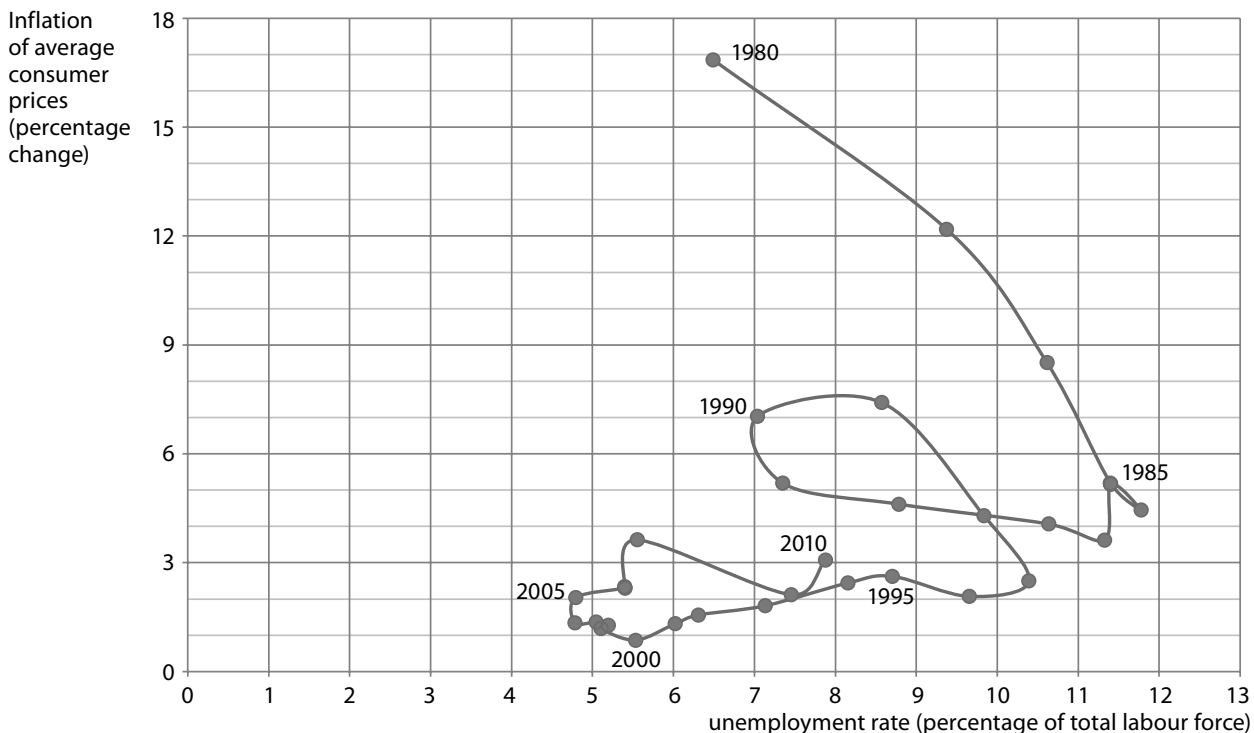
- Claimant count falls to 1.59 million people
- Labour Force Survey measure falls 33,000 to 2.45 million people
- But ‘economically inactive’ people rises to record 8.16 million
- Youth unemployment (16–25) reached over 20% (1 million)
- Employment level hits lowest since 2006

5

<http://www.guardian.co.uk/business/2010/mar/17/unemployment-fall-raises-recovery-hopes>



Figure 2 UK Inflation and Unemployment 1980–2010*



*The 2010 figure is predicted

Source: <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx>

Figure 3 United Kingdom Unemployment rate by duration (annual data from the Labour Force Survey)

Date	Unemployed for less than one year %	Unemployed for more than one year %	Total %
2004	3.8	1.0	4.8
2005	3.9	1.0	4.9
2006	4.2	1.2	5.4
2007	4.1	1.3	5.4
2008	4.3	1.4	5.7
2009	5.8	2.0	7.8

Source: <http://www.bankofengland.co.uk/publications/inflationreport/ir10feb3.xls>



- (a) (i) With reference to Figure 1, explain why it is necessary to regularly update the CPI basket of goods and services. (6)
- (ii) Using aggregate demand and aggregate supply analysis, explain the likely impact on the equilibrium price level and level of real output in the UK of the 'sharp increase in oil prices' (*Extract 1, line 6*). (10)
- (iii) Assess the usefulness of the information provided in Extracts 1 and 2 and Figure 3 to the MPC when making interest rate decisions. (12)
- (b) (i) What relationship might be expected between average earnings growth and the unemployment rate? (6)
- (ii) Is the relationship supported by the data in Figure 2? (4)
- *(c) Assess the extent to which a sharp depreciation of the pound will improve the UK current account of the balance of payments. (12)
- *(d) Discuss the fiscal and supply side policies the UK Government could pursue to reduce the rate of unemployment. Refer to Extract 2 and Figure 3 in your answer. (30)



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(iii) Assess the usefulness of the information provided in Extracts 1 and 2 and Figure 3 to the MPC when making interest rate decisions.

(12)

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(ii) Is the relationship supported by the data in Figure 2?

(4)

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*(c) Assess the extent to which a sharp depreciation of the pound will improve the UK current account of the balance of payments.

(12)

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*(d) Discuss the fiscal and supply side policies the UK Government could pursue to reduce the rate of unemployment. Refer to Extract 2 and Figure 3 in your answer.

(30)

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(Total for Question 1 = 80 marks)



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

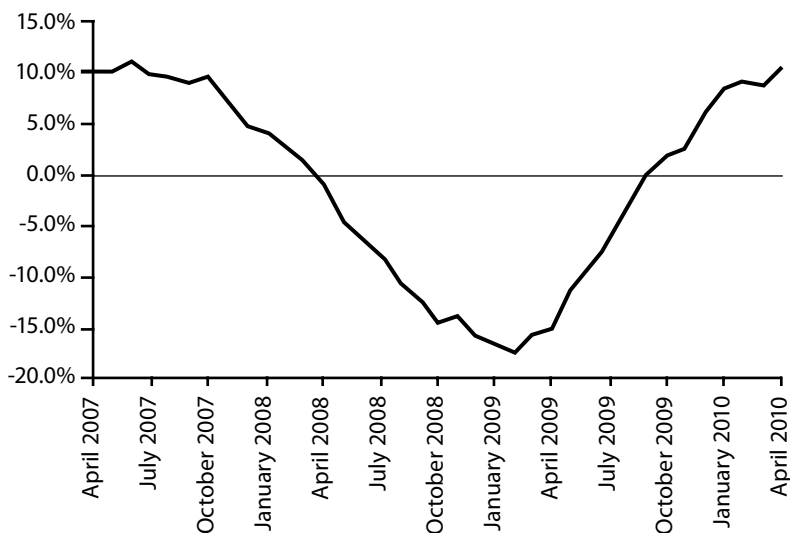
2 Interest Rates, House Prices, Savings and Growth

Figure 1 UK base rate of interest, 2001–2010



Source: <http://www.thisismoney.co.uk/interest-rates>

Figure 2 Quarterly percentage change in UK house prices, April 2007 to April 2010

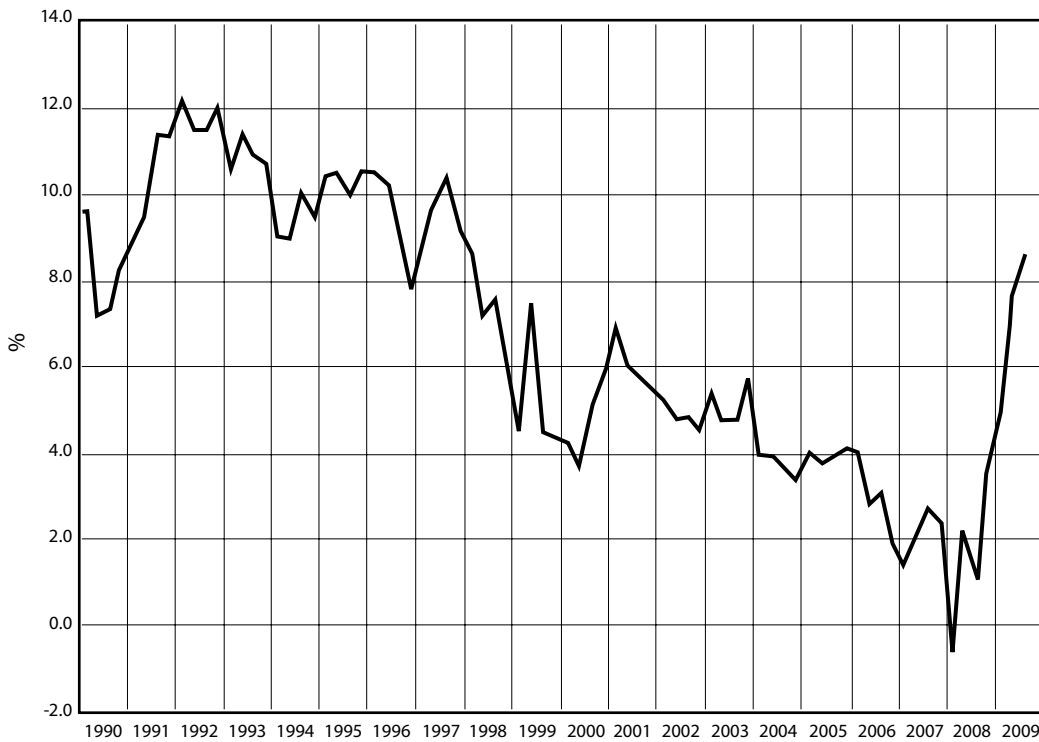


Source: http://www.nationwide.co.uk/hpi/historical/Apr_2010.pdf



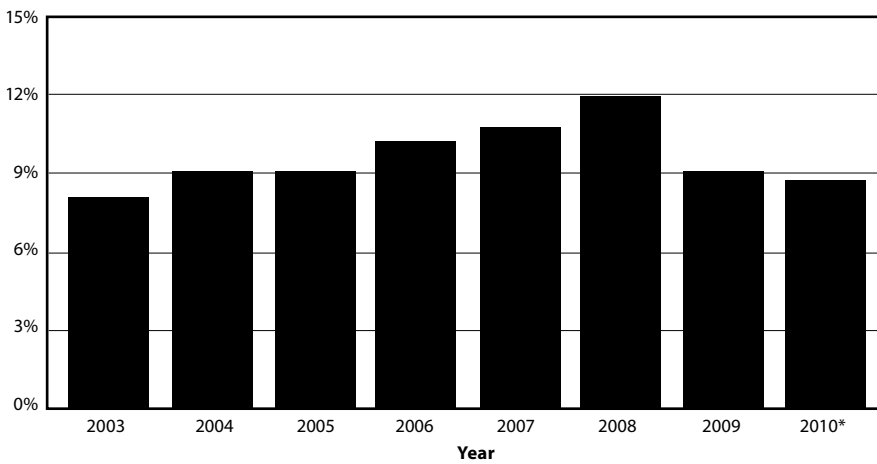
Figure 3 UK Household Savings Ratio

(percentage of disposable income that is saved, using quarterly data)



Source: <http://www.tutor2u.net/blog/index.php/economics/tagged/tag/savings+ratio>

Figure 4 Real GDP growth rates in China, 2003–2010



* Forecast

Source: http://www.indexmundi.com/china/gdp_real_growth_rate.html



- (a) (i) With reference to Figure 1, explain the term “rate of interest”. (4)
- (ii) Explain how a change in interest rates might affect the level of investment. (6)
- (iii) With reference to Figure 2, assess the likely impact of a fall in house prices on the economy. (12)
- (b) (i) With reference to Figure 3, explain **two** factors that could influence the level of household saving. (6)
- (ii) Using aggregate demand and aggregate supply analysis, explain the likely impact on the equilibrium price level and the level of real output of an increase in the savings ratio. Refer to Figure 3 in your answer. (10)
- *(iii) With reference to Figure 4, discuss **two** factors that might enable a country, such as China, to achieve a rapid rate of economic growth. (12)
- *(c) To what extent might rapid economic growth conflict with at least **two** other macroeconomic objectives? (30)



(iii) With reference to Figure 2, assess the likely impact of a fall in house prices on the economy.

(12)

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(b) (i) With reference to Figure 3, explain **two** factors that could influence the level of household saving.

(6)

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QUESTION 2 CONTINUES ON THE NEXT PAGE



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*(iii) With reference to Figure 4, discuss **two** factors that might enable a country, such as China, to achieve a rapid rate of economic growth.

(12)

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*(c) To what extent might rapid economic growth conflict with at least **two** other macroeconomic objectives?

(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

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