

Centre No.					Paper Reference	Surname	Initial(s)
Candidate No.					6 3 5 3 / 0 1	Signature	

Paper Reference(s)

6353/01

Edexcel GCE

Economics

Advanced Subsidiary

Unit 3 – Managing the Economy

Friday 8 June 2007 – Afternoon

Time: 1 hour

Examiner's use only

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Team Leader's use only

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Question Number

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1

2

Materials required for examination

Nil

Items included with question papers

Nil

Instructions to Candidates

In the boxes above, write your centre number, candidate number, your surname, initial(s) and signature.

Check that you have the correct question paper.

Write your answers in the spaces provided in this question paper.

Answer EITHER Question 1 OR Question 2. Indicate which question you are answering by marking the box (☒). If you change your mind, put a line through the box (☒) and then indicate your new question with a cross (☒).

Information for Candidates

The marks for individual questions and the parts of questions are shown in round brackets: e.g. (2).

There are 2 questions in this question paper. The total mark for this paper is 40.

There are 20 pages in this question paper. Any blank pages are indicated.

Advice to Candidates

You will be assessed on your ability to organise and present information, ideas, descriptions and arguments clearly and logically, including your use of grammar, punctuation and spelling.

You are advised to spend the first 5 minutes reading the paper. In calculations you are advised to show all the steps in your working.

Total

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Answer EITHER Question 1 OR Question 2.

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

Question 1 The Inflation Target

Extract 1 Praise for the Bank's control of inflation

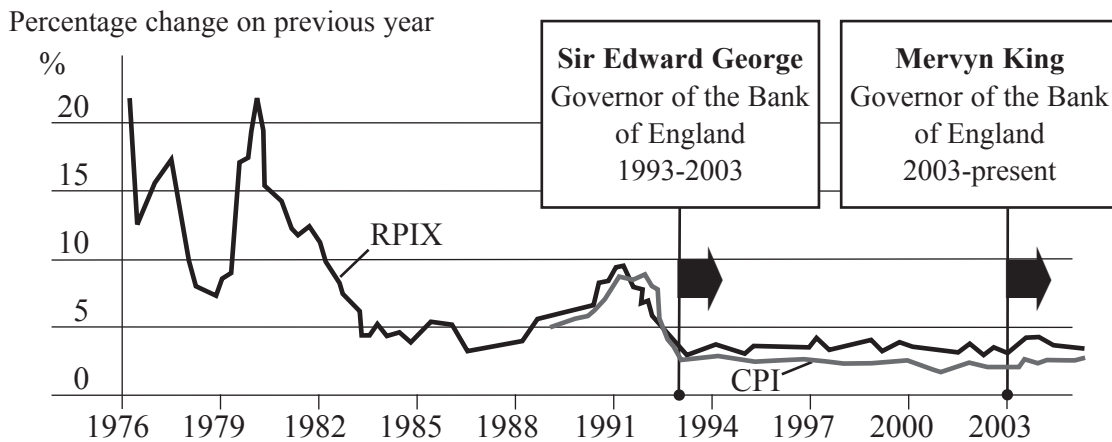
Yesterday, at its hundredth meeting, the Bank of England's Monetary Policy Committee (MPC) decided to cut interest rates for the first time in two years. The move, which took the Bank's interest rate (base rate) down from 4.75% to 4.5%, had been widely expected. The only debate was about the timing of the next interest rate cut.

'The fact that the MPC has stayed within one percentage point of the inflation target over the past eight years is extraordinary. We never thought it would be achieved,' said Alan Budd, who served on the MPC in its first two years. 'In the past you often had a stable world and an unstable Britain. Now it is the other way around.' The system, with its clearly defined target, industrial expertise, transparency and accountability, is a powerful combination. 5
10

Jonathan Loynes, of Capital Economics, says the inflation target has helped reduce swings in the economy but did not stop the significant increases in share and house prices in recent years. 'There is some concern that the MPC has been too pessimistic about inflation and kept interest rates higher than they needed to be' he said. He noted that the current rate of inflation, as measured by the Consumer Price Index, had only just risen to its target after seven years below it. This was an indication that monetary policy has been too restrictive. 15

Source: adapted from *The Guardian*, 5 August 2005

Figure 1 The history of UK inflation

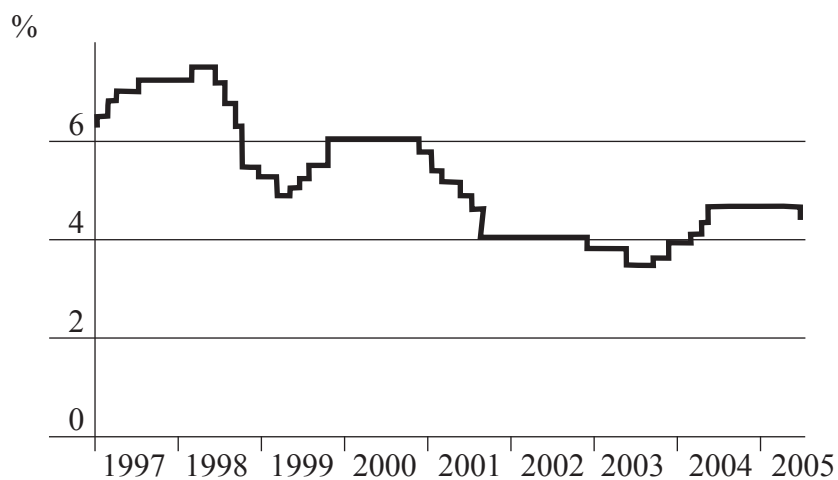


Note: Target changed in 2003 from retail price index excluding mortgage interest payments (RPIX) at 2.5% to consumer price index (CPI) at 2%.



Figure 2

UK base interest rate



(a) (i) With reference to Figure 1, explain how inflation is measured in the UK.

(3)

(ii) Outline how the Bank of England's Monetary Policy Committee (MPC) attempts to keep inflation 'within one percentage point of the inflation target' (*Extract 1, line 5*).

(4)



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(ii) Outline **two** sources of information, **apart from share and house prices**, used by the MPC when it makes its interest rate decision.

(4)

(c) Assess the implications for the UK economy of the cut in the interest rate, 'down from 4.75% to 4.5%' (*Extract 1 line 3*).



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

Question 2 Fiscal and Supply Side Policies in the UK

Extract 1 Gordon Brown's Pre-Budget Report, December 2005

This Government is the first of any party to achieve eight years of uninterrupted growth since 1805. For the fifth successive year running, British growth is higher than in France, higher than in Germany, and higher than in Italy. Real GDP growth is expected to be 1.75 per cent in 2005 [revised downwards from the March 2005 estimate of 3.5 per cent].

There are several sources of growth: British business investment is rising this year by 3 per cent, and is expected to increase again next year by up to 3.5 per cent and then in 2007 by more than 4.5 per cent. As production grows, we expect exports to rise by more than 5 per cent next year and the year after. In addition, the Government is committed to providing new investment in Britain's public services. Spending on public services will be £63 billion a year higher by 2007-08 compared with 2004-05. About 75 per cent of this increase will be spent on the Government's priorities of education, health, social services, transport, housing and the fight against crime. The budget deficit is forecast to be £37 billion in 2005-06.

Figure 1 UK government spending on health and education

£ billions (rounded to nearest billion), current prices

	Health	Education
2004–2005	83	65
2005–2006	90	68
2006–2007	98	72
2007–2008	109	75



Extract 2 The Chancellor has overspent and miscalculated

For the seventh forecast running, Gordon Brown had to admit that the current budget deficit was overshooting his targets for this year. His Pre-Budget report suggests that he is going to bridge the gap by increasing government spending more slowly than projected rises in tax revenues. Spending as a percentage of national income would peak at 38% in 2006 and then fall by 0.7 per cent of GDP over the following four years. Tax revenues are expected to rise by almost £16 billion (current prices), of which £2 billion will be raised by taxes on North Sea oil. This will produce a £20 billion improvement in the budget balance over the next five years. 5

Source: adapted from news report on the Pre-Budget News Report December 2005, *Financial Times*

(a) (i) What is meant by a **budget deficit** (*Extract 1, line 13*)?

(2)

(ii) From Figure 1, **calculate** the percentage change in total spending on health and education from 2004-05 to 2007-08.

(2)



(b) (i) Outline **one** reason why it might be necessary to revise the estimates for changes in GDP (*Extract 1, lines 3 and 4*).

(2)

(ii) Analyse **one** possible implication for government policy of the inaccuracy of growth figures.

(4)



(c) Analyse the likely impact of the expected rise in exports of 5% on GDP growth and the UK Balance of Payments (*Extract 1, lines 7–8*).

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(7)



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Lined writing area for student responses.

(15)

Q2

(Total 40 marks)

TOTAL FOR PAPER: 40 MARKS

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