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 16 January 2009 – Morning

Time: 1 hour

Examiner's use only

Team Leader's use only

Question Number	Leave Blank
1	
2	
Total	

Materials required for examination	Items included with question papers
Nil	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.

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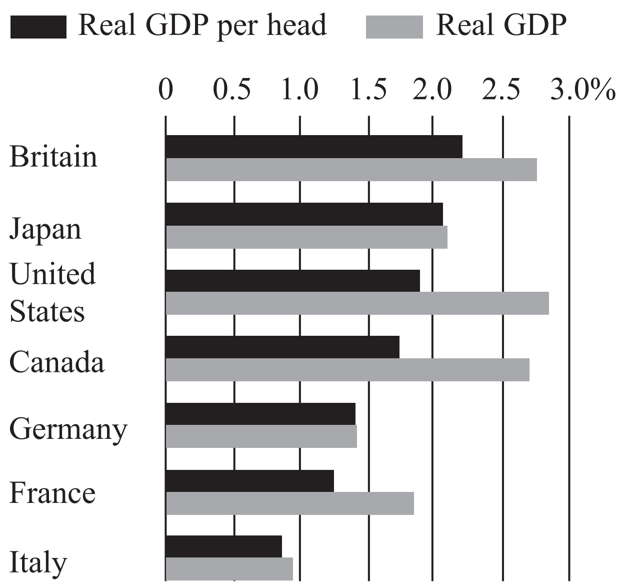
Answer EITHER Question 1 OR Question 2.

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

Question 1 **Economic Growth**

Figure 1: Average annual percentage increase in real GDP 2003-2007



Source: *The Economist* 13 March 2008 "Grossly distorted picture"

Figure 2: Investment in selected countries
(Average annual percentage of GDP, 2003–2007)

Country	**Investment as a % of GDP 2003–07**
Britain	18.1
Japan	23.4
United States	19.1
Canada	21.5
Germany	17.5
France	20.1
Italy	21.1

Source: www.imf.org (World Economic Outlook database April 2008)

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Extract 1 **GDP and living standards**

Which economy has enjoyed the better economic performance over the past five years: the USA's or Japan's? Most people would pick the USA. It is true that the USA's average annual real GDP growth of 2.9% was much faster than that of Japan's 2.1%. However, the best single indicator of economic performance is not growth of real GDP but real GDP per head, which is a rough guide to living standards.

GDP growth figures flatter the USA's performance, because its population is rising much faster because of immigration and a higher birth rate. In contrast, the size of the Japanese population has been shrinking since 2005. Once this is taken into account Japan's real GDP per head increased at an annual rate of 2.1% in the five years to 2007, slightly faster than the USA's at 1.9%. However, many Americans see the absolute size of a country's real GDP as the best measure of economic power and influence. There are other reasons why Americans criticise the use of real GDP per head especially with reference to Japan. First, Japan's shrinking population is also an ageing one in which the working population will decline as a share of the population. Unless this is offset by more rapid productivity growth, tax revenues may fall, making it harder to fund state pensions. This issue also applies to Britain and Italy: it is estimated that by 2050, the proportion of the population over 65 will be 35.9 per cent in Italy, compared with 27.3 per cent in Britain. Secondly, corporate profits depend upon the absolute rate of growth of an economy and companies wanting to invest abroad will favour markets that are expanding more rapidly.

Source: adapted from *The Economist* 13 March 2008 "Grossly distorted picture"

(a) With reference to Figure 1, explain what is meant by 'Average annual percentage increase in real GDP 2003–2007'.

(3)

(b) (i) With reference to Figure 1 and Extract 1, suggest **one** reason why the rates of growth in real GDP per head differ between the United States and Japan.

(3)

Leave blank

(b) (ii) With reference to the information provided, examine the reasons why changes in real GDP per head might be considered as an inaccurate indicator of changes in living standards between countries.

(8)

Leave blank

(c) (i) With reference to Figure 2, use aggregate demand and aggregate supply analysis to explain the significance of investment for economic growth.

(7)

Leave blank

(c) (ii) Apart from investment, outline **two** other factors which might explain the difference in growth rates between Britain and Italy as shown in Figure 1.

(4)

Leave blank

(d) Evaluate the benefits of economic growth for Britain.

Leave blank

Leave blank

(15)

Q1

(Total 40 marks)

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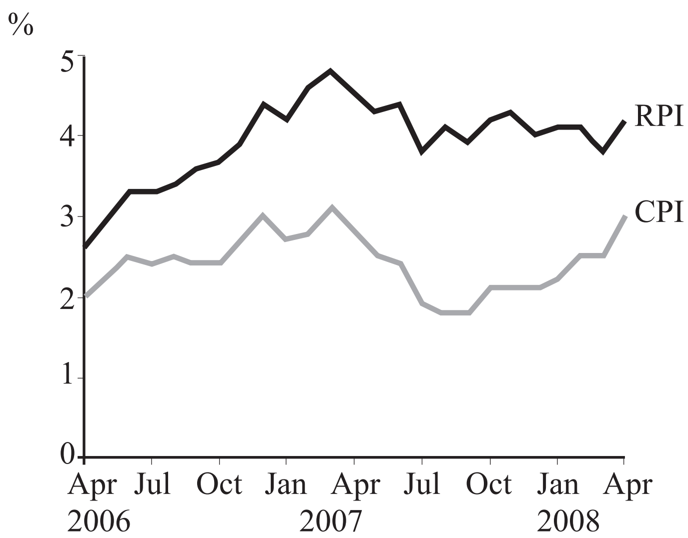
If you answer Question 2 put a cross in this box ☒ .

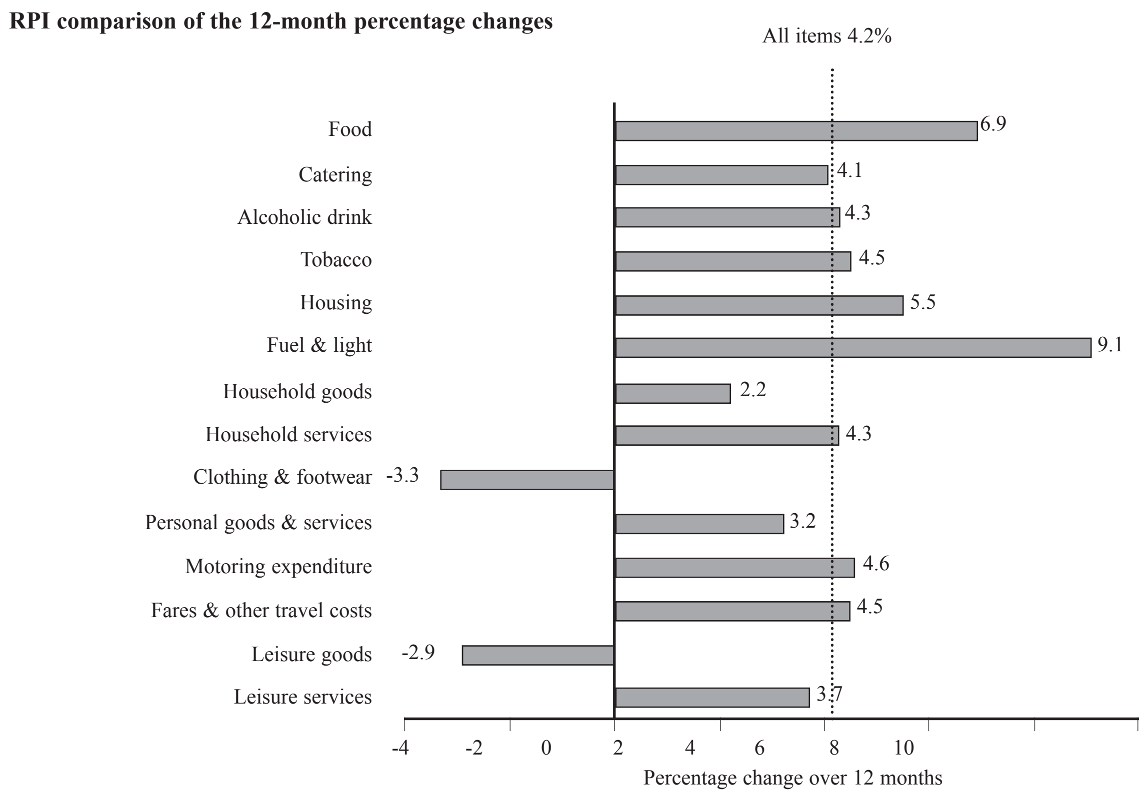
Question 2 **Inflation**

Figure 1: UK Inflation rate as measured by the Retail Price Index (RPI) and Consumer Price Index (CPI)



Source: www.statistics.gov.uk

Figure 2: Price changes of categories of goods April 2007 – April 2008



Source: www.statistics.gov.uk

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Extract 1 **The spectre of stagflation**

A combination of stagnant output and high inflation (stagflation) has not been seen for decades but is set to trouble policymakers for months if not years to come.

Even with the credit crunch, falling house prices, weak high street sales and industry reporting a collapse in orders, prices are still rising. The Chancellor, Alistair Darling, did not admit as much in his mini-budget on 13 May. But his injection of £2.7 billion of spending power into the economy (by increasing tax-free allowances) may be designed to prevent a catastrophic collapse in demand. Meanwhile, the Monetary Policy Committee of the Bank of England finds its ability to cut interest rates constrained by a rising rate of inflation.

The increase in the rate of inflation (CPI) to 3% in April 2008 from 2.5% in March, is the most dramatic since 2002. Increases in basic items that families have to buy were the highest. Food prices have risen 6.9% since April 2007, the fastest since 1990, with analysts expecting prices to rise 10% within a few months. And it's the essentials which have increased the most: bread by 13 per cent, butter by 32.2 per cent and eggs by a third. Oil prices are 70 per cent higher than in April 2007, pushing up petrol and other energy prices.

The 15 per cent fall in the value of sterling has further increased inflationary pressures. This is hitting living standards, especially for the poorest and pensioners.

Source: adapted from *The Independent* 14 May 2008

(a) With reference to Figure 1 and Figure 2:

(i) explain how the rate of inflation is measured

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(3)

Leave blank

(ii) outline **two** disadvantages of a rising rate of inflation

(4)

(b) With reference to Figure 2, how might the price changes in the following be explained?

(i) Fuel and light

(ii) Clothing and footwear

(4)

Leave blank

(c) Using aggregate demand and aggregate supply analysis, assess the impact of the change in oil and energy prices, described in Extract 1, on real output and the price level.

(8)

Leave blank

(d) Explain the likely economic effect of "the 15 per cent fall in the value of sterling" (Extract 1, line 15) on aggregate demand.

(6)

Leave blank

(e) Evaluate the macro-economic effects of the "injection of £2.7 billion of spending power into the economy" (Extract 1, lines 5-6) in the light of the information provided.

Leave blank

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(15) **Q2**

(Total 40 marks)

TOTAL FOR PAPER: 40 MARKS

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