Write your name here

Surname	Other names

Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Friday 17 May 2013 – Afternoon
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.
- 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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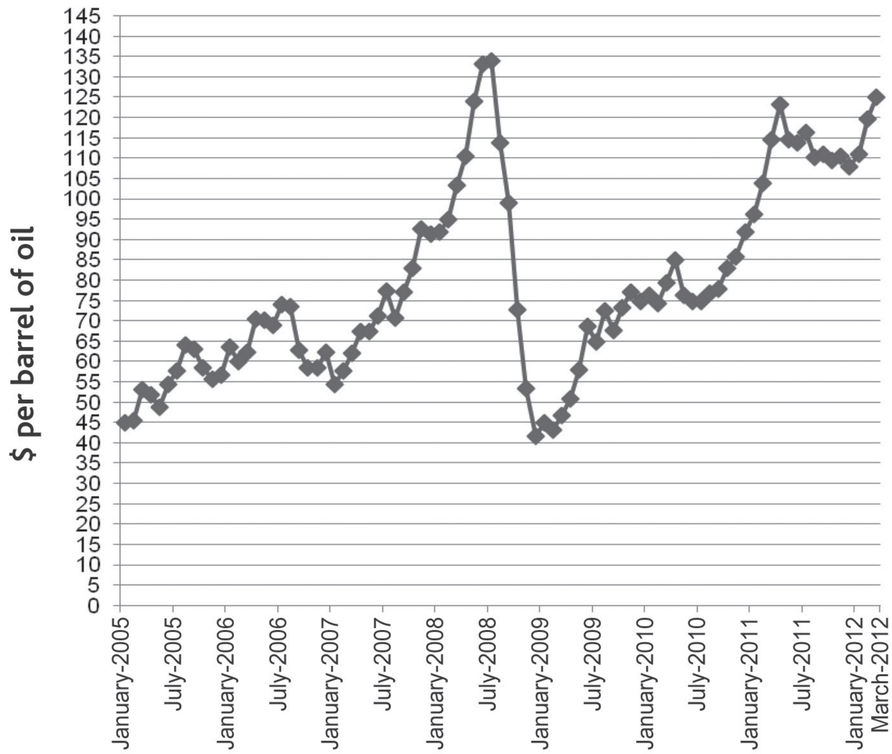
Answer EITHER Question 1 or Question 2.

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

1 Balance of payments, Inflation and Investment

Figure 1 Oil price (Brent Crude Oil), US dollars per barrel from January 2005 to March 2012



(Source: adapted from © Financial Times, May 3rd 2012)

Extract 1 The deficit on the current account of the balance of payments continues into the first quarter of 2012

When sterling's exchange rate fell 25% between mid-2007 and early 2009, economists thought that this would reduce the deficit in the trade of goods and services on the current account of the balance payments and boost the UK's economic growth. They were only half right. Exports of British goods have indeed recovered from the depths of recession – volumes are up 21% since 2009 – and a recent survey of manufacturers suggested activity expanding at a healthy pace. However the volume of goods imported has also increased, by 16% since 2009, and inflation has continued well above target.

David Blanchflower, a former member of the Bank of England Monetary Policy Committee, said: "We underestimated the uplift to inflation from the depreciation … but we probably overestimated the positive effect of UK manufacturers replacing imports." In a recent paper, two Bank of England economists tried to explain these inaccurate estimates. Perhaps, they suggested, after the long contraction of UK manufacturing, some goods are no longer made in the UK, so it is impossible to replace certain imports. British manufacturers have almost entirely abandoned some markets, particularly those for products that are labour intensive. In 1997, for example, UK producers made 16% and 22% respectively of all the leather goods and clothing sold in the country. In 2009, these market shares had fallen to 6% and 8%.

Manufacturing goods in the UK also often necessitates importing raw materials, components and capital goods. This dependency on overseas suppliers is partly explained by the fact that many manufacturers agreed long-term supply contracts with cheaper overseas suppliers before the depreciation of sterling.

The Bank of England economists also noted there is still a large price differential with countries such as China and India, even after sterling's depreciation. Furthermore, many UK manufacturers learnt long ago to compete on brand and quality rather than price, which can mean that big changes in the exchange rate have little effect on sales.

However, there are hints that things might start to change as the lower exchange rate and other factors have an impact on strategic decisions. Many manufacturers are discussing bringing parts of their production home because of high wage inflation in emerging markets, the desire for more responsive supply chains and lower shipping costs.

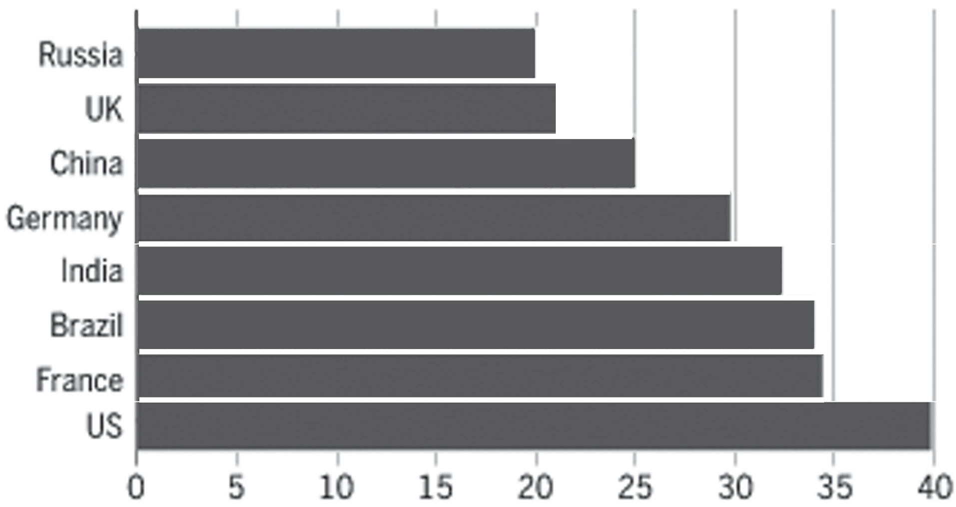
(Source: adapted from © Financial Times, April 3rd 2012)

Extract 2 Business Investment and Corporation tax

Business investment as a share of GDP fell from nearly 13% in 2000 to below 8% in 2011 and surveys of business confidence are pessimistic. The previous government reduced corporation tax – a tax on company profits – from 30% to 28% in 2008. The current Chancellor is gradually reducing it further to 21% by 2014, which he hopes will increase investment by between 5% and 10% per annum during 2013–16.

(Source: adapted from © Crown copyright)

Figure 2 Main corporation tax rate (%) planned for 2014 (selected G20 and G7 countries)



% corporation tax

(Source: © Financial Times, 21 March 2012)

(a) (i) Referring to the data in Figure 1, calculate an index number for the oil price in March 2012, using January 2005 as the base period. Show your working.

(6)

(ii) With reference to Figure 1, explain **two** possible ways in which changes in the world economy could cause the movements in the oil price shown.

(8)

(iii) Using an aggregate demand and aggregate supply diagram, assess the effect on the UK economy of the rise in oil prices since 2009.

(12)

(b) (i) With reference to Extract 1, define a "deficit in the trade of goods and services on the current account of the balance of payments" (lines 2–3).

(4)

(ii) Explain **two** likely costs to the UK economy of a sustained deficit in the trade of goods and services on the current account of the balance of payments.

(8)

***(iii)** With reference to Extract 1, assess the likely effect of a fall in the sterling exchange rate on the UK's deficit in the trade of goods and services.

(12)

***(c)** Using the information provided and your own knowledge, assess the use of supply side policies, including a reduction in corporation tax, as a means of increasing UK economic growth.

(30)

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(Total for Question 1 = 80 marks)

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

2 Real incomes, growth and monetary and fiscal policy

Extract 1 UK incomes fall more than 3.5% in real terms in 2011, ONS reveals

UK households are facing pay cuts in real terms of more than 3.5% as salary increases fail to keep pace with inflation, official figures reveal. The median salary for a full-time worker in the UK rose 1.4% in 2011 to £26 244, compared with a headline Consumer Price Index (CPI) inflation rate of 5%, according to the Office for National Statistics (ONS).

The General Secretary of the Trades Union Congress (TUC), Brendan Barber, said the latest figures showed the UK's sluggish economic growth was due to a squeeze on wages rather than the wider economic crises. "Today's figures confirm that 2011 has been a year of wage stagnation, with pay rises far outstripped by inflation, and low-paid employees being squeezed particularly hard," he said. "Falling wages and self-defeating austerity have been the main reasons for the UK's economic woes, rather than a eurozone crisis which has yet to fully show up in official statistics," he further added.

(Source: © The Guardian News and Media Limited, 23 November 2011)

Extract 2 UK growth for final quarter of 2011 revised down

Britain's struggle to shake off the effects of the recession has been set back by news that the economy shrank more than previously thought in the final quarter of 2011 and remains no bigger than in the autumn of 2010. The Office for National Statistics estimated that the Gross Domestic Product (GDP) fell 0.3% in the fourth quarter of 2011, down from its previous estimate of 0.2%. Though most think the economy is now growing again, the figures still provided fresh information for critics of the coalition government's fiscal (budget) deficit reduction policies of cuts in government spending and increases in tax. An opposition spokesman said the news showed the March 2012 Budget from Chancellor George Osborne "made the wrong choice in sticking to policies that are failing on jobs, growth and the deficit."

(Source: adapted from © Financial Times, 28 March 2012)

Extract 3 Outlook for the UK Economy 2012–3

Weak international demand, continued low household consumption and the needed reduction in the fiscal deficit has halted the recovery. Growth will start to pick up during 2012 as exports and household consumption recover, with further strengthening in 2013. Unemployment is rising and will reach 9% in 2013, while inflation is presently peaking as anticipated and is expected to fall below the 2% target in 2013 as the temporary inflationary effects from the increase in VAT and higher commodity prices diminish. Monetary policy is supporting economic recovery, with the Bank of England interest rate at 0.5% and quantitative easing being resumed. The ambitious fiscal deficit reduction programme has helped to keep market interest rates low by maintaining confidence in the money markets.

(Source: adapted from © OECD Outlook 90 database)

(a) (i) Explain how the Consumer Price Index (CPI) is calculated.

(6)

(ii) Analyse **two** possible reasons why the CPI measure of inflation was above its target range in 2011.

(8)

(iii) Assess the likely impact of a reduction in households' real income on the standard of living in the UK.

(12)

(b) (i) With reference to Extract 2, outline **one** possible reason why GDP estimates are frequently revised.

(4)

(ii) Explain **two** likely economic consequences of inflation falling "below the 2% target" (Extract 3, lines 5–6).

(8)

*(iii) With reference to Extract 3 and using an aggregate demand and aggregate supply diagram, discuss the extent to which "Monetary policy is supporting economic recovery" (Extract 3, lines 7–8).

(12)

*(c) To what extent is the policy of reducing the 'fiscal (budget) deficit' (Extract 2, line 7) helping the government to achieve its macroeconomic objectives?

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(30)

(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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