EDEXCEL A-LEVEL ECONOMICS A

ECONOMICS



EXAM QUESTION PACK

UNIT 2 OLD SPECIFICATION PAPERS

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Write your name here

Surname	Other names

Pearson Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Monday 23 May 2016 – Morning
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.
- Check your answers if you have time at the end.

Turn over ▶

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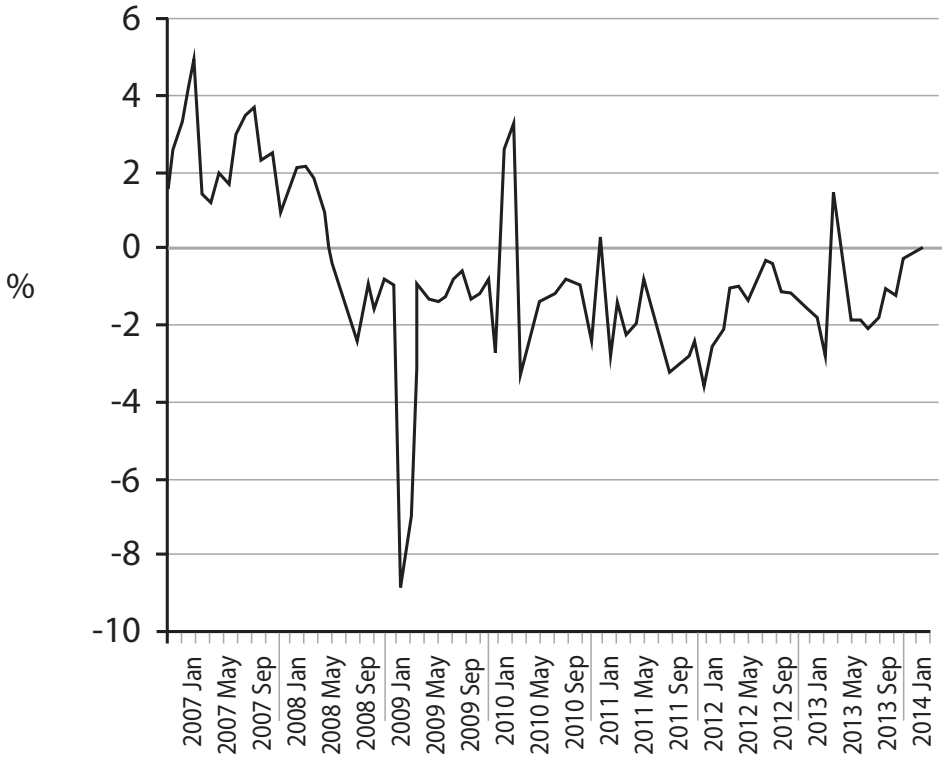
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Answer EITHER Question 1 OR Question 2.

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

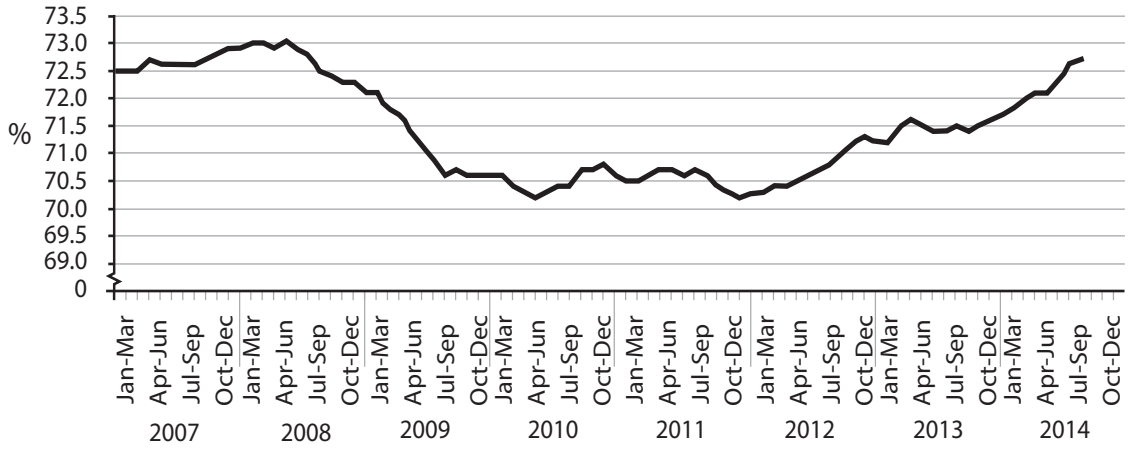
1 UK wages, employment, migration and the trade deficit

Figure 1 Real wage growth, per cent change on the same month a year ago



(Source: © ONS Economic Review June 2014, http://www.ons.gov.uk/ons/dcp171766_365818.pdf)

Figure 2 UK employment rate, % of 16–64 age group



(Source: © ONS Economic Review June 2014, http://www.ons.gov.uk/ons/dcp171766_365818.pdf)

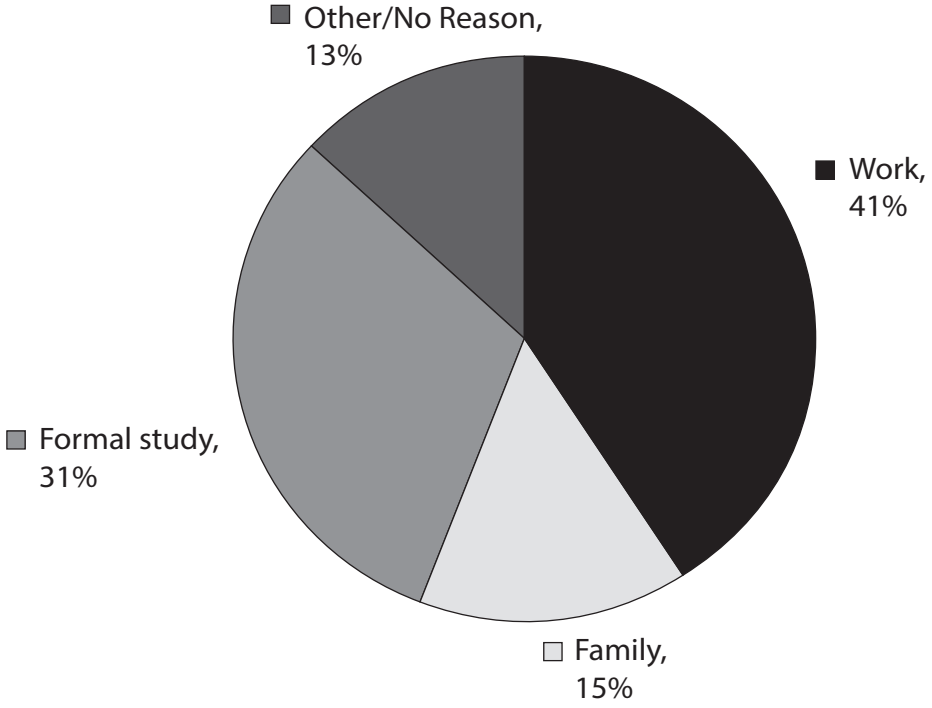
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Figure 3 Main reason for immigrating to UK, year ending March 2014



(Source: © ONS Migration Statistics Quarterly Report, August 2014, http://www.ons.gov.uk/ons/dcp171778_375307.pdf)

Extract 1 Migration trends

- Net long-term migration to the UK was estimated to be 244 000 in the year ending March 2014, an increase from 175 000 in the previous 12 months.
- 560 000 people immigrated to the UK in the year ending March 2014, an increase from 492 000 in the previous 12 months.
- An estimated 316 000 people emigrated from the UK in the year ending March 2014. Long-term emigration has been relatively stable since 2010.
- There was an increase in immigration for work (up 38 000 to 228 000).

(Source: adapted from © ONS Migration Statistics Quarterly Report, August 2014, http://www.ons.gov.uk/ons/dcp171778_375307.pdf)

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Extract 2 Trade deficit widens

The UK's trade position deteriorated unexpectedly in July 2014 after imports increased more than exports, frustrating the Coalition Government's ambitions to rebalance the economy. The trade in goods deficit widened to £10.2 billion from £9.4 billion in June 2014. It almost matched the largest monthly deficit on record. The broader trade in goods and services deficit also widened in July 2014, to £3.3 billion from £2.5 billion in June 2014. The Office for National Statistics data showed a larger goods deficit in July 2014 driven by a £1.3 billion rise in imports to £34.2 billion, outpacing a £0.5 billion increase in exports to £24 billion.

In 2012, the Government set a target of doubling UK exports to £1 trillion by 2020 as part of a broader ambition to rebalance the economy away from consumer spending and towards manufacturing and exports. However, exports increased by just 2.1% in 2013 to £505.6 billion, and this target is looking increasingly challenging. With the eurozone economy remaining weak and ongoing unrest in Eastern Europe and the Middle East, export growth is likely to remain low in the short term.

Exchange rates are of particular concern for UK trade, according to Martin Beck, a senior economic advisor: "With around 45% of UK manufactured goods exported, overseas sales are key for continued growth in the sector. The recent fall in the value of sterling should, temporarily, boost prospects for UK exporters."

(Source: adapted from © Guardian Newspaper Ltd., September 2014, http://www.theguardian.com/business/2014/sep/09/uk-trade-deficit-widens-unexpectedly)

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(a) With reference to Figure 1,

(i) explain the meaning of the term 'real wage growth.'

(4)

(ii) explain **two** likely reasons for the negative real wage growth experienced in the UK for much of the period 2009–2013.

(8)

(b) With reference to Figure 3 and Extract 1, assess the likely effects of rising immigration for employment **and** unemployment in the UK.

(12)

*(c) With reference to Extract 2 paragraph 1, evaluate the likely impact of the UK's deteriorating trade balance on the UK's price level and real output. Use an aggregate demand and aggregate supply diagram in your answer.

(12)

(d) (i) Explain the likely consequence of weakness in the eurozone economy for the UK's balance of trade.

(6)

(ii) Explain **two** likely effects of 'the recent fall in the value of sterling' (Extract 2, lines 17–18) on the UK economy.

(8)

*(e) Evaluate government policies that could be used to increase the employment rate in the UK.

(30)

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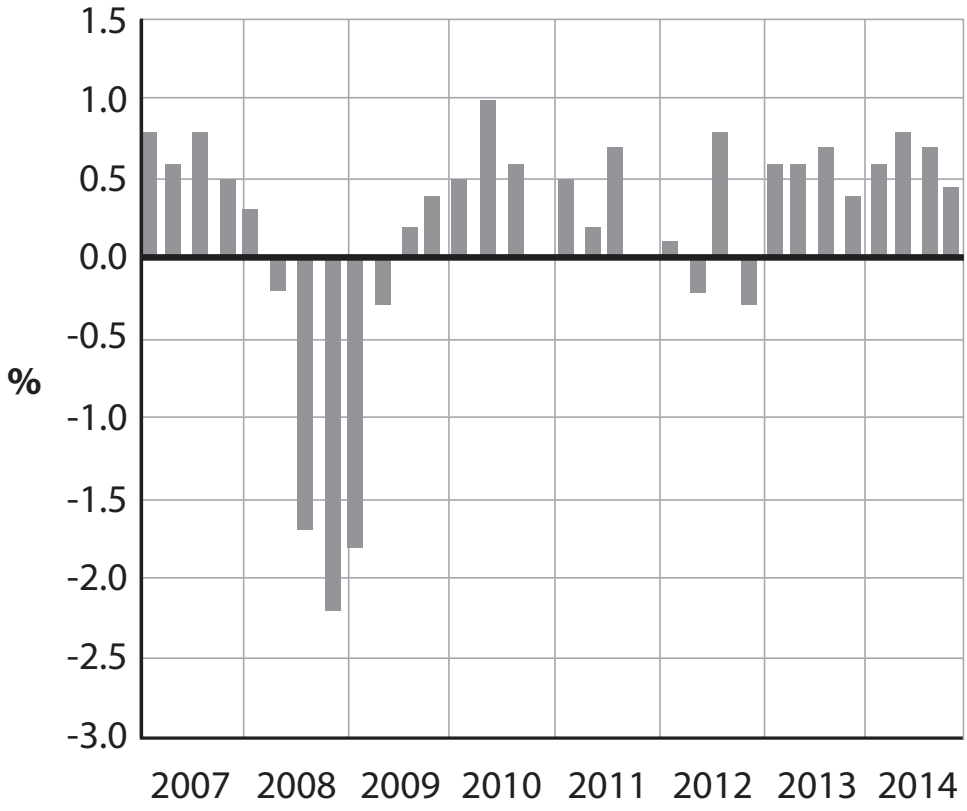
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QUESTION 2 BEGINS ON THE NEXT PAGE.

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

2 Macroeconomic indicators and policies

Figure 1 UK real GDP growth, quarter on previous quarter



(Source: ONS, http://www.ons.gov.uk/ons/dcp171778_392909.pdf)

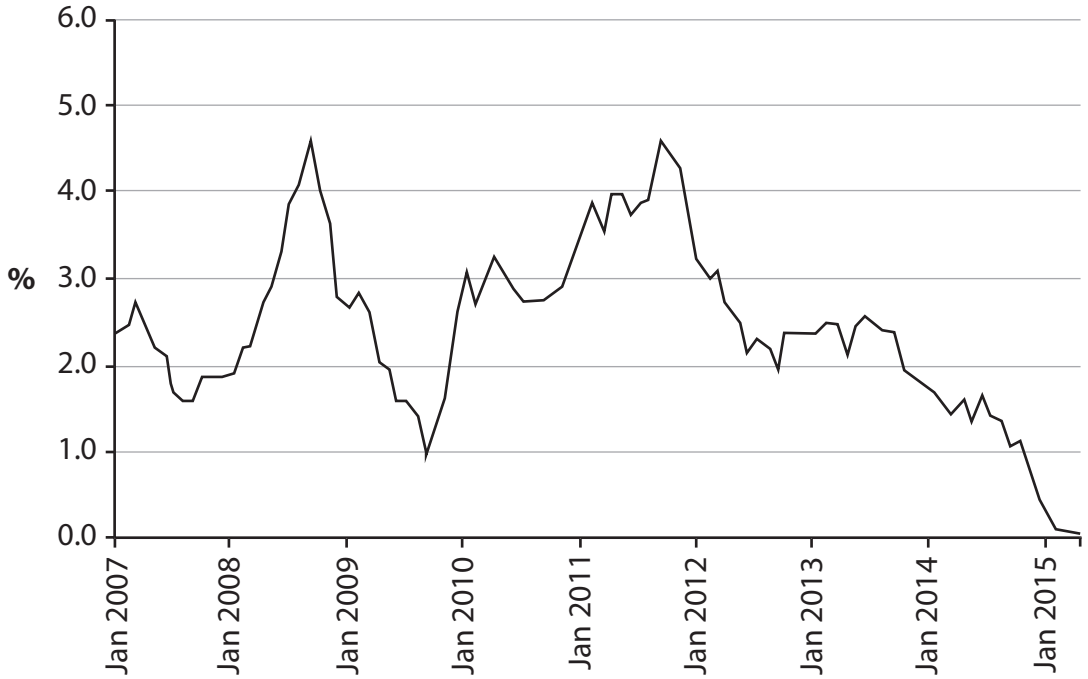
Figure 2 Top 5 countries in the Human Development Index (HDI)

HDI Rank	Country	Human Development Index 2013	Life expectancy at birth 2013 (years)	Mean years of schooling 2012	Expected years of schooling 2012	Gross national income per capita 2013 (2011 PPP US$)
1	Norway	0.944	81.5	12.6	17.6	63 909
2	Australia	0.933	82.5	12.8	19.9	41 524
3	Switzerland	0.917	82.6	12.2	15.7	53 762
4	Netherlands	0.915	81.0	11.9	17.9	42 397
5	United States	0.914	78.9	12.9	16.5	52 308

(Source: © United Nations Human Development Report, http://hdr.undp.org/en/content/table-1-human-development-index-and-its-components)

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Figure 3 UK Consumer Price Index (CPI) Inflation



(Source: © Bank of England Inflation Report February 2015, http://ons.gov.uk/ons/rel/cpi/consumer-price-indices/april-2015/consumer-price-inflation-summary--april-2015.html)

Extract 1 Bank of England could raise interest rates next spring, says Monetary Policy Committee (MPC) member

A Bank of England policymaker, Ian McCafferty, has reinforced expectations that the first rise in interest rates will come as soon as Spring 2015, in remarks that pushed up the UK's exchange rate.

Under Governor Mark Carney, earlier this month the Bank overhauled its forward guidance policy on when rates would rise from their record low of 0.5%. At the time it said a view in the financial markets that rates could rise in the second quarter of 2015 was consistent with its goal of keeping inflation close to the Government-set 2% target.

"The exact timing of course is going to depend on events that have yet to unfold in terms of how the recovery proceeds over the course of the next six to 12 months or so" said Ian McCafferty. He added that he was watching for pressures on inflation from pay deals negotiated in coming months. After years above its target, inflation has now fallen below 2% to stand at 1.9% in January 2014.

"If we did see some inflationary pressure – more than we currently expect in our central case – that would if anything, I suspect, lead the Committee to consider slightly earlier rate rises."

(Source: adapted from © Guardian Newspaper Ltd., February 2014, http://www.theguardian.com/business/2014/feb/25/bank-england-raise-interest-rates-2015-mpc-mccafferty)

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(a) (i) With reference to Figure 1, explain the term 'real GDP growth'.

(4)

(ii) Discuss the advantages of using the Human Development Index (HDI) as a measure of the standard of living of a country.

(12)

(iii) With reference to Figure 2, explain **two** government policies that could be used to improve a country's Human Development Index (HDI) values.

(8)

(b) (i) Explain how the CPI measure of inflation is calculated. Refer to the concept of weighting in your answer.

(6)

(ii) Explain **two** factors that might encourage the Monetary Policy Committee of the Bank of England to increase the UK base rate of interest.

(8)

*(iii) Examine whether a very low rate of inflation is desirable for the UK economy.

(12)

*(c) To what extent is monetary policy effective in controlling the rate of inflation?

(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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Mark Scheme (Results)

Summer 2016

Pearson Edexcel GCE
in Economics (6EC02)
Paper 01 Managing the Economy

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Summer 2016
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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

Question Number	Indicative Content	Mark
1 (a) (i)	KAA 4 marks: • Increase/rise in wages/income (1) • adjusted for inflation (1) **2 marks for data reference -** Only 1 mark if no/inaccurate figures used from Figure 1	**(4)**

Question Number	Indicative Content	Mark
1 (a) (ii)	KAA 8 marks: **2 marks for data reference -** Only 1 mark if no/inaccurate figures used from Figure 1 Award 2 measures only. Max. 6 marks; 1 mark for solely identifying a relevant point 1 mark for limited development of this point Up to 1 further mark for clear analysis of this point For example: • higher rates of inflation experienced during this period • high unemployment depressing the wage growth • a lack of demand in the economy: could be due to recession, welfare cuts, etc. • lack of business confidence • falling labour productivity • high levels of immigration (can use Figure 3/Extract 1) depressing wages • increases in non-wage costs, such as pensions and employers' national insurance contributions • shift in labour market from well-paid manufacturing jobs to the lower paid service sector jobs that are flexible, with temporary/zero hour contracts • trade union bargaining power has been hit by economic problems at home and forces of globalisation	**(8)**

Question Number	Indicative Content	Mark
1 (b)	KAA 8 1 mark for only an identification of a point, 1 mark for identification and very brief explanation, further 1 marks for analysis/development of the point. **2 marks for reference to data** – Only 1 mark if no/inaccurate figures used. Maximum 6/8 if no data reference. Maximum 5/8 if no reference to employment and unemployment Effects for employment: up to 3 marks for 1 point • Increased size of population means that there is an increase in supply of labour, thus reducing wage rate and increasing demand for labour, so employment rises • 41% of people have immigrated for work and this is likely to lead to an increase in employment – these 228,000 immigrants may fill those vacancies that cannot be filled by indigenous workers • Increased consumer spending from an increased population means more jobs are created • Increased demand for public services creating increased demand for public sector workers Effects for unemployment: up to 3 marks for 1 point • Increased immigration means more people looking for work so likely to increase unemployment – 41% of immigrants looking for work, hence could displace current employees • Surplus labour in the market, e.g. family (15%), might attempt to join the labour market but with inappropriate skills Evaluation 4 marks (2+2 or 4): • Magnitude: only 41% coming for work • Magnitude of net immigration– 244,000 in the year ending March 2014 • 31% are for formal study so may only be short-term migrants; also not sure they will remain in the UK after study • Different sectors of the economy may be affected differently • Growing UK economy can take on more labour without increasing unemployment • Evidence might not be accurate/reliable, • Depends on the skills of the immigrants	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing reasons with at least one evaluative point
Level 2	5-8	2 convincing reasons with no connections, or 1 convincing impact with some good analysis but no evaluative point; 1 or 2 less-convincing impacts with some evaluation
Level 1	1-4	Identification of relevant reasons with or without brief evaluative keywords

Question Number	Indicative Content	Mark
***1 (c) QWC i-iii**	KAA 8 **Up to 4 marks for the diagram:** Diagram demonstrating a leftward shift of AD: correct shift of AD **(1)**, lines labelled **(1)**, axes labelled **(1)**, equilibria labelled **(1)** **Up to 2 marks for the analysis:** • AD=C + I + G + (X-M); widening deficit means (X-M) is a negative value and so AD will fall (1) • Impact on price level and real output (1) • Reference to the circular flow of income: leakages are greater than injections (1) • Reference to the multiplier effect causing impact across economy (1) **2 marks for reference to data** - Only 1 mark if no/inaccurate figures used. Maximum 6/8 if no data reference present Evaluation 4 marks (2+2 or 4): • depends on other factors (e.g. could be offset by a change in consumption) • other factors may be more significant parts of aggregate demand • exports have increased • may be due to short-term shifts in exchange rates • consideration of magnitude • consideration of time lags • elasticity of the AS curve • depends on the size of the multiplier **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	1 convincing impact with AD/AS diagram, with at least one evaluative point
Level 2	5-8	1 convincing effect with evaluation but no/incorrect diagram, or 1 convincing impact with diagram but no evaluative point; less-convincing impact or diagram with some evaluation
Level 1	1-4	Identification of relevant impacts with or without brief evaluative keywords

Question Number	Answer	Mark
1 (d) (i)	Definition / explanation of balance of trade: e.g. difference between value (1) of country's imports and exports (1) OR value of exports minus value of imports of a country (2) OR imports – exports (1) Lack of demand in the Eurozone economy leads onto lack of demand for UK exports (2) as large percentage - 50% - of UK exports go to these countries (2) so negative impact on UK balance of trade/deficit increases (2)	**(6)**

Question Number	Indicative Content	Mark
1 (d) (ii)	KAA 8 marks: 1 mark for solely identifying a relevant point 1 mark for limited development of this up to 2 further marks for clear analysis of this point Award 2 reasons only. Do not double award. For example: • Increased demand for UK exports as they are now relatively less expensive for foreigners / exports become more competitive • Reduced demand for UK imports as they are now relatively more expensive for UK citizens / imports less competitive • Increase in UK aggregate demand due to increase in net exports • Increase in imported / cost push inflation pushing up UK inflation rate • Increased employment in the UK due to an increased demand for domestic production and exports	**(8)**

Question Number	Indicative content	Mark
***1 (e) QWC i-iii**	KAA 18 marks Up to 6 marks: • Identification of government policies as fiscal or supply-side policy (2) • Definition of employment rate OR data reference to employment rate (2) • Diagram showing AD shift and/or AS shift consistent with analysis (4); axes labelled (1), equilibria labelled (1), AD/AS lines labelled (1), correct shift (1). No marks for diagram if shift inconsistent with analysis. Explanation of how the policies might help increase employment: 12 marks (3 x 4 marks or 2 x 6 marks); 1 mark for only identification of a point, 2 marks for identification and very brief explanation, up to further 4 marks for analysis/development of the point • Investment in education and training to provide a more skilled workforce through increases in the level of human capital • Reduction in minimum wage to encourage more firms to increase employment levels • Reduction in unemployment and associated benefits to increase incentive to find work • Grants/tax breaks to firms encourage increases in employment • Reduction in taxation to encourage firms to expand or set up in UK, therefore increasing employment • Reduction in income tax creating a larger incentive to work, increasing consumption and therefore, employment • Decreasing the power of trade unions will help reduce real wage unemployment • Improving geographical mobility of labour - government providing tax breaks to firms who set up in depressed areas/giving some financial assistance to unemployed workers who move to areas with high employment • Government improving the labour market flexibility by making it easier to hire and fire workers may encourage more job creation • Increase provision of free childcare	

	Evaluation 12 marks (2 x 6 marks or 3 x 4 marks or 6 + 4 + 2 marks) • Time lag (e.g. education takes a long time to have significant impact on productivity) and implementation lags • Government budget deficit and national debt make it difficult to pay for large investments or offer significant grants/tax breaks • External factors beyond UK government's control, e.g. recession in Eurozone • Magnitude of the policy change • Conflicts with other UK economic objectives • Conflicts between the policies • Depends if there is spare capacity • Creditworthiness of the UK government • Discussion of effectiveness of individual policies - this could be 3 separate points **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing points with at least two evaluative points (an evaluation points is worth up to a maximum of 6 marks
Level 3	19-24	2 or 3 convincing points with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing points with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

Question Number	Answer	Mark
2 (a) (i)	KAA: 4 marks • An increase (1) in the total value of goods and services produced in an economy/GDP • adjusted for inflation (1) **2 marks for data reference -** Only 1 mark if no/inaccurate figures used from Figure 1	**(4)**

Question Number	Indicative Content	Mark

2 (a) (ii)	KAA 8 Award 2 advantages only 1 mark for solely identifying a relevant point 1 mark for limited development of this point Up to 2 further marks for clear analysis of this point For example: • HDI is a composite measure: broader perspective on a country's standard of living, not solely a monetary basis for comparison • Easy to compare countries by rank: can quickly see which countries performing well and which are not • Could be used to focus aid on countries most in need • Use of education and health could be used as a measure of the success of different government's policies • GDP rank minus HDI rank as a useful measure of health and education • Shift of AS curve outwards as a sign of increased potential without increase in costs: HDI rank sign of future welfare Evaluation 4 marks (2+2 or 4): • Reliability of the data: e.g. possibility of some countries deliberately producing misleading data; some countries lacking an organised and independent statistics authority • Access to data for some countries: due to lack of availability of data, especially in less developed countries • Less up-to-date data: more data to collect and then collate, so this is much more time-consuming than one single piece of data such as GDP • PPP values change quickly and are likely to be inaccurate or misleading • Still little sense of income distribution and quality of life in this measure • Difficult to measure human development • Other measures, such as access to the internet/mobile phones, might be better • An indication of deprivation or poverty would increase the usefulness of HDI	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing advantages with at least one evaluative point
Level 2	5-8	2 convincing advantages with no connections, or 1 convincing advantage with some good analysis but no evaluative point; 1 or 2 less-convincing advantages with some evaluation
Level 1	1-4	Identification of relevant advantages with or without brief evaluative keywords

Question Number	Indicative Content	Mark
2 (a) (iii)	KAA 8 marks: **2 marks for data reference -** Only 1 mark if no/inaccurate figures used from Figure 2 Award 2 measures only. Max. 6 marks; 1 mark for solely identifying a relevant point 1 mark for limited development of this Up to 1 further mark for clear analysis of this point For example: • Measures to increase GDP e.g. reflationary fiscal policy • Higher government spending on benefits / social protection • Higher government spending on education e.g. building infrastructure, such as schools • Higher government spending on healthcare e.g. building infrastructure, such as hospitals • Better access to education / healthcare, e.g. providing incentives to children from poor families in countries where there is no state provision of education • Improved information / more support for jobseekers • Reduction in regulation to promote business investment • Raising of the compulsory school leaving age / increasing University enrolment and entry levels	**(8)**

Question Number	Answer	Mark
2 (b) (i)	2 marks: • Weights are attached to reflect relative importance of items (1) in terms of consumer spending/income (1) **OR** weights defined as a proportion of consumer spending/income spent on particular goods and services (2) KAA 4 - 1 mark per point • Price survey • Expenditure and Food Survey • Basket of goods / 650 goods and services • Contents of the basket revised annually • Use of an index • Base year • Price changes multiplied by weightings	**(6)**

Question Number	Indicative Content	Mark
2 (b) (ii)	KAA 8 marks: 1 mark for solely identifying a relevant point 1 mark for limited development of this up to 2 further marks for clear analysis of this point Award 2 reasons only. For example: • Inflation above target • Rapid wage growth • Other cost-push factors • Other demand-pull factors e.g. house prices • Consumer / business expectations of future price rises • Lack of spare capacity in the economy • Economy growing at 'unsustainable' level • Make imports cheaper by strengthening the value of the sterling pound (attract hot money flows)	**(8)**

Question	Indicative content	Mark

Number		
2 (b) (iii)	KAA 8 marks Up to 4 marks for identification and explanation of each point. Award 2 points only. 1 mark for only identification of a point, 2 marks for identification and brief explanation, further 2 marks for analysis/development of the point. For example, it is desirable: • Exports may increase and imports may decrease, improving UK trade balance and competitiveness • May lead to higher real wages or less erosion of fixed incomes, hence more spending • Could lower nominal interest rates which may encourage borrowing • Benefits of falling oil and commodity prices for the economy Evaluation 4 marks (2+2 or 4) For example, it is not desirable: • Expectation of falling prices in the future discourages purchases today; consumption and therefore AD falls • This is a cycle that it can be very hard for a country to get out of • May lead to increased unemployment • Increases real debt burden (could relate to consumers, business, or the government) **NB: Candidates may take reasons why a low rate of inflation is desirable as KAA, and why it's not as evaluation or vice versa.** Other evaluation points include: • Magnitude: Only 0.1% deflation • Deflation mainly caused by cost-push factors **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing reasons with at least one evaluative point
Level 2	5-8	2 convincing reasons with no connections, or 1 convincing impact with some good analysis but no evaluative point; 1 or 2 less-convincing impacts with some evaluation
Level 1	1-4	Identification of relevant reasons with or without brief evaluative keywords

Question Number	Indicative content	Mark
***2 (c) QWC i-iii**	KAA 18 marks Up to 6 marks: • Definition of Monetary Policy (2) • Definition of the rate of inflation or data reference to the rate of inflation (2) • Diagram showing AD shift and/or AS shift consistent with analysis (4); axes labelled (1), equilibria labelled (1), AD/AS lines labelled (1), correct shift (1). No marks for diagram if shift inconsistent with analysis. Explanation of how the monetary policy has been responsible for controlling inflation: 12 marks (3 x 4 marks or 2 x 6 marks); 1 mark for only identification of a point, 2 marks for identification and very brief explanation, up to further 4 marks for analysis/development of the point • Explanation of transmission mechanism- impact of changing interest rate on AD and therefore inflation (could count as 3 separate points, e.g. on consumption, investment, exchange rates and house prices) • Quantitative easing / changing money supply to further impact the inflation rate • Forward guidance? • Successfully kept inflation reasonably close to the target and within control (Figure 3) • Open, transparent and is operationally independent from political interference allowing it to focus on meeting inflation target Evaluation 12 marks (2 x 6 marks or 3 x 4 marks or 6 + 4 + 2 marks) • Cost-push factors are out of the Bank of	

	England's control, e.g. oil prices • Times where inflation is out of tolerance/not within target range (Figure 3) • Reluctance of banks to pass on changes in the base rate to their customers • Banks seeking to improve their capital ratios • Lack of confidence among consumers and/or businesses • MPC can only use interest rate and money supply as instruments which may restrict it from meeting the UK inflation target • Conflicts with other UK economic objectives • Time lags • Depends if there is spare capacity **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing points with at least two evaluative points (an evaluation points is worth up to a maximum of 6 marks
Level 3	19-24	2 or 3 convincing points with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing points with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

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Surname	Other names

Pearson Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Tuesday 19 May 2015 – 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.
- Check your answers if you have time at the end.

Turn over ▶

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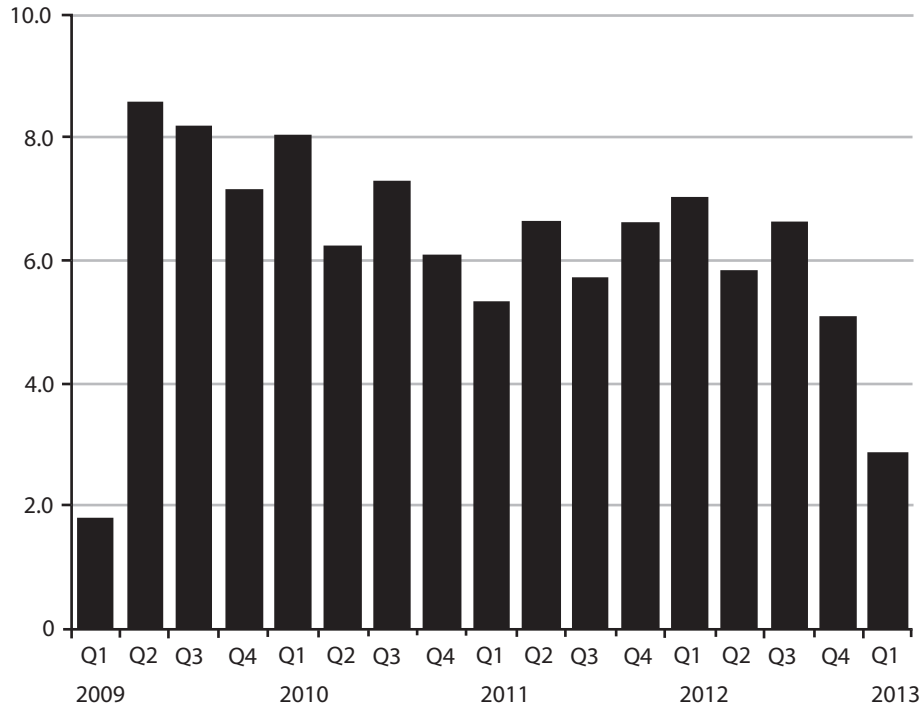
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Answer EITHER Question 1 OR Question 2.

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

1 Savings, GDP, housing market and monetary policy

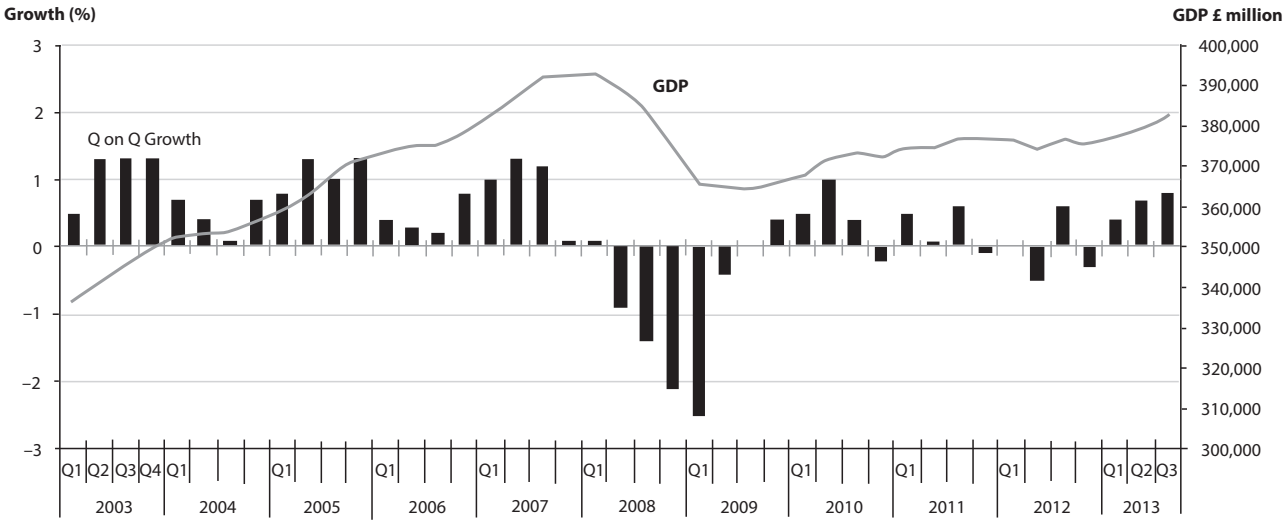
Figure 1 UK household savings ratio*



*Savings as a percentage of household disposable income

(Source: http://www.ons.gov.uk/ons/publications/re-referencetables.html?edition=tcm%3A77-324888)

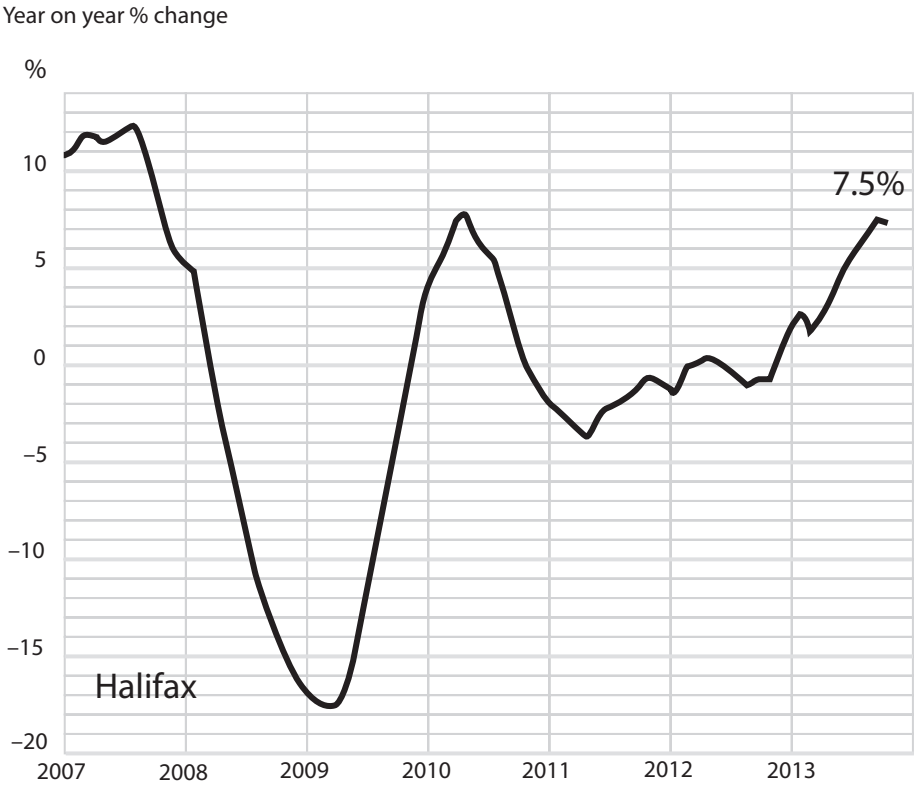
Figure 2 UK GDP and GDP growth (quarter on quarter)



(Source: http://www.ons.gov.uk/ons/resources/figure3_tcm77-332895.png)

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Figure 3 Percentage annual change in UK house prices



Halifax – annual comparison by quarter

(Source: Halifax)

Extract 1 House prices and the government's Help-to-Buy Scheme

The UK house price index from the Royal Institute of Chartered Surveyors showed that in September 2013 British house prices rose at their fastest monthly rate in 11 years and sales hit a four-year high. Both measures pointed to a sustained recovery in the property market. Prices rose in all regions except the north-east of England, and respondents now expect prices to grow by 2.6% in the next 12 months. Concerns have been expressed that a housing price bubble could threaten financial stability. 5

(Sources: adapted from http://uk.reuters.com/article/2013/10/07/uk-house-prices idUKBRE9960YL20131007 and http://www.lse.co.uk/AllNews.asp?code=kkj6mz7d&headline=MARKET_COMMENT_UK_House_Prices_Continue_To_Rise_As_US_Government_Remains_Shut)

Extract 2 UK monetary policy

Since 1997, the focus of the Bank of England's Monetary Policy Committee had been to maintain a low and stable inflation rate. However, the financial crisis forced a change in priorities.

The Governor of the Bank of England, Sir Mervyn King, stood down after holding the post for 10 years between 2003–2013. Amongst other things his governorship was marked by two major policy decisions.

Firstly, he encouraged a highly expansionary monetary policy. Interest rates traditionally moved in quarter-point changes, but once the full extent of the financial crisis was plain, Sir Mervyn persuaded the Monetary Policy Committee to cut rates by 1.5 percentage points in November 2008 and further big reductions over the following months. By March 2009, interest rates had been cut to 0.5% and remain at this level. In the same month, the Bank of England began to inject money into the economy through quantitative easing in a bid to reinflate the economy. Normalising monetary policy will take many years.

Secondly, Sir Mervyn publicly supported rapid fiscal consolidation, a policy of reducing the budget deficit as quickly as possible, in order to reduce the national debt. His comments were used by the Coalition Government to justify its decision to accelerate the budget deficit reduction programme.

(Source: adapted from http://www.ft.com/cms/s/0/e2fb7570-dfea-11e2-bf9d-00144feab7de.html#ixzz2hRoUSZMD June 29 2013)

(a) (i) With reference to Figure 1, explain **two** factors that might account for the change in the household savings ratio since the third quarter of 2012.

(8)

(ii) With reference to Figure 3 and Extract 1, assess the likely impact of an increase in house prices on the UK economy. Use an aggregate demand and aggregate supply diagram in your answer.

(12)

(b) (i) With reference to Extract 2, explain the meaning of the term 'monetary policy'.

(4)

*(ii) Evaluate **two** benefits of low and stable inflation for the UK economy.

(12)

(iii) Analyse **two** additional pieces of information, other than house price data, which the Bank of England's Monetary Policy Committee might have considered when deciding to keep interest rates unchanged since March 2009.

(8)

(c) Explain the likely impact of a government budget deficit on the circular flow of income.

(6)

*(d) To what extent do demand-side policies lead to conflicts between macroeconomic objectives?

(30)

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(12)

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(12)

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(6)

*(d) To what extent do demand-side policies lead to conflicts between macroeconomic objectives?

(30)

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(Total for Question 1 = 80 marks)

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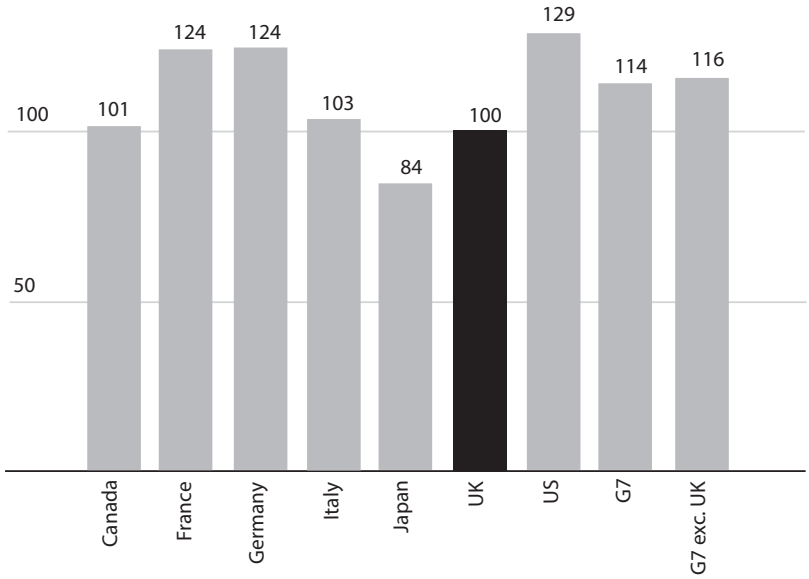
If you answer Question 2 put a cross in the box ☒ .

2 UK investment, productivity and the balance of payments

Figure 1 UK business investment (£bn at 2010 prices)

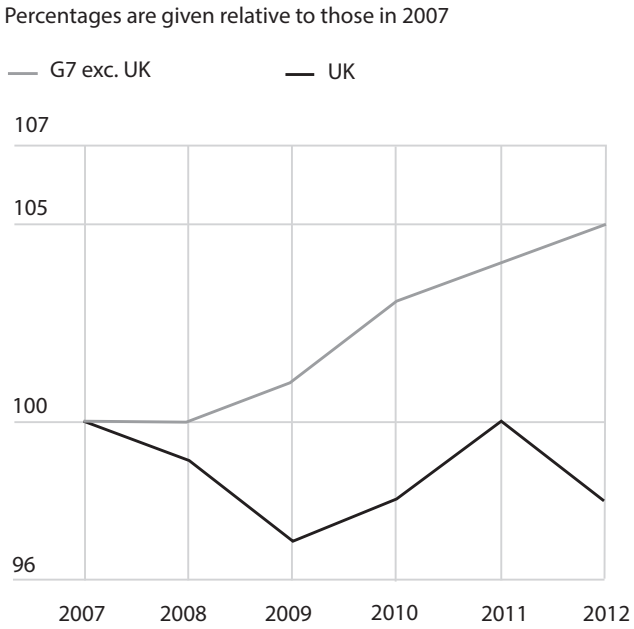


Figure 2 GDP per hour worked relative to the UK in 2012



(Source: http://www.theguardian.com/news/datablog/2013/sep/18/uk-workers-less-productive-ons)

Figure 3 Productivity per hour worked (GDP) since 2007



G7 countries: USA, UK, France, Germany, Italy, Canada and Japan

(Source: http://www.theguardian.com/news/datablog/2013/sep/18/uk-workers-less-productive-ons)

Figure 4 Current account of the UK's balance of payments as a percentage of GDP at current market prices

Year	% of GDP
2002	–2.1
2003	–1.7
2004	–2.0
2005	–1.8
2006	–2.8
2007	–2.2
2008	–0.9
2009	–1.4
2010	–2.7
2011	–1.5
2012	–3.8

(Sources: http://www.ons.gov.uk/ons/rel/bop/united-kingdom-balance-of-payments/2013/index.html and http://www.theguardian.com/business/2011/sep/20/uk-productivity-falls-behind-competitors)

Extract 1 Productivity gap between UK and the other G7 nations widens to largest in 20 years

Deep recession and slow recovery have widened Britain's productivity gap with the other rich G7 nations to its largest since 1994, according to official figures.

Data from the Office for National Statistics (ONS) showed that the output per hour from UK workers in 2012 was 2% down on its pre-slump levels in 2007 and 16% below the average of other leading industrialised nations.

The ONS said that output per hour worked in Britain was 29% lower than in the US and 24% lower than in Germany and France. Canada and Italy had slightly higher productivity than the UK and only one G7 nation – Japan – had a worse record.

Britain's gross domestic product is still below its peak reached in 2008, but despite the deepest recession of modern times, the shake-out in the labour market was less severe than in the downturns of the 1980s and 1990s. The combination of weak output and a willingness of workers to accept pay cuts to keep their jobs has resulted in a poor productivity record.

The ONS said that the gap with the rest of the G7 was even wider – 19% – using an alternative measure of productivity, output per worker.

John Philpott, Director of The Jobs Economist, said: "The relative improvement in the UK's productivity performance from the mid-1990s to the late 2000s has clearly gone into reverse in an economy reliant on falling real wages, rather than increased output, as the main driver of employment growth. According to the ONS output per hour in 2012 would have been 15 percentage points higher had the pre-recession rate of growth been maintained. Though some of this latter growth may have been 'illusory', in that it was propelled by an unsustainable boom, the UK economy clearly needs, in particular, a strong resurgence of business investment in order to regain its pre-recession productivity mojo."

The Bank of England is assuming that Britain's productivity will improve as demand recovers, although opinions differ about how much of the shortfall is caused by permanent damage from the recession.

Howard Archer, Chief UK Economist at IHS Global Insight, said the ONS's international comparisons made "very uncomfortable reading." He added: "An element of the UK's poor productivity performance does appear to have been companies' willingness to hold on to workers, particularly when the workers are skilled or experienced. There have also been reports that some companies employed more people, or at least retained workers, as they found winning and delivering work more resource-intensive in an environment of persistently weak demand."

(Source: adapted from http://www.theguardian.com/business/2013/sep/18/productivity-gap-uk-g7-output)

(a) (i) With reference to Figure 1, explain what is meant by 'investment at 2010 prices'.

(6)

(ii) With reference to Figure 1, explain **two** likely factors that caused the change in UK business investment between 2008 and 2013.

(8)

(iii) With reference to Figure 1, assess the likely impact of the change in business investment between 2008 and 2013, on the UK's real output and price level. Use an aggregate demand and aggregate supply diagram in your answer.

(12)

(b) (i) Outline the main components of the current account of the balance of payments.

(4)

(ii) Analyse **two** reasons, apart from the UK's productivity performance, that might explain the deficit in the current account of the balance of payments.

(8)

***(iii)** With reference to the information provided and your own knowledge, evaluate the likely impact of the UK's productivity performance on its economy.

(12)

***(c)** Evaluate the use of supply side policies in raising the level of real output in the UK economy.

(30)

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(6)

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(8)

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(iii) With reference to Figure 1, assess the likely impact of the change in business investment between 2008 and 2013, on the UK's real output and price level. Use an aggregate demand and aggregate supply diagram in your answer.

(12)

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(12)

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P 4 4 8 9 0 R R A 0 3 8 4 4

*(c) Evaluate the use of supply side policies in raising the level of real output in the UK economy.

(30)


P 4 4 8 9 0 R R A 0 4 2 4 4

(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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Mark Scheme (Results)

Summer 2015

Pearson Edexcel GCE Economics (6EC02/01)
Unit 2 Managing the Economy

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

FOR ALL QUESTIONS: No markscheme can cover all possible responses. Therefore, reward analysis, which is relevant to the question even if this is not specifically identified in the markscheme.

Question Number	Indicative content	Mark
1 (a) (i)	KAA 8 marks Use of data 1+1 marks- e.g. fell from approx. 6.5% in Q3 2012 to approx. 3% in Q1 2013 2 factors up to 3 marks each (2 x 3 marks). 1 mark for the identification and 2 marks for the explanation of each factor. • Increased consumer confidence • Low interest rates • Greater availability of credit following various initiatives e.g. quantitative easing; Help to Buy; Funding for Lending • Falling unemployment/greater job security • Rising incomes (savings ratio as a % of income)	(8)

Question Number	Indicative content	Mark
(a) (ii)	KAA 8 marks (maximum of 6 marks for KAA if no reference to data) Reference to data 2 marks e.g. from figure 3 house prices rising by over 10% in 2007; from extract 1: 'in September 2013 British house prices rose at their fastest monthly rate in 11 years' 2 marks for analysis of one point, e.g.: Identification of the wealth effect only (1) Analysis of wealth effect (1) e.g. an increase in the value of houses that will increase householder's confidence and thus encourage them to consume more (and/or save less) Also award for discussion of other effects beside the wealth effect (2) e.g. impact on: • Mobility of labour • Unemployment • Budget deficit Up to 4 marks for diagram demonstrating rightward shift of AD; correct shift in line (1), lines labelled (1), axes labelled (price level and real GDP/output/income) (1), equilibria labelled (both original and new) (1). Note diagrams where the line shift is incorrect receive no marks. Where candidates do not use a diagram but do write that real output and the price level should increase award 1 mark for each. Maximum 6/8 if no diagram. Evaluation 4 marks (1 x 4 marks or 2 x 2 marks). Factors might include: • Houses are a significant component of consumers' wealth and effect a large proportion of households (approximately 65% owner occupied) in the UK which will therefore have a **major effect** in expanding AD • Significance of elasticity of AS curve and the state of the UK economy • Consumption is approximately 2/3 of aggregate demand which implies a strong inter-relationship • Wealth effects take some time to trigger spending changes • Other factors may be more important in generating confidence such as the strength of the global economy's recovery • Regional differences in impact • Effect on first-time buyers so may lead to their consumption falling **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	(12)

Level	Mark	Descriptor
Level 3	9-12	Explanation of wealth effect with a good diagram and at least one evaluative point
Level 2	5-8	Explanation of the wealth effect with a good diagram but no evaluative point; or good diagram but with limited explanation or; explanation of the wealth effect but no diagram and some evaluation
Level 1	1-4	Identification of relevant effect with or without brief evaluative keywords

Question Number	Indicative content	Mark
1 (b) (i)	KAA 4 marks Reference to data (2): e.g. • Interest rate 'cut to 1.5% in 2008', 0.5% 'by March 2009' • 'further big reductions' since November 2008 • 'the Bank of England began to inject money into the economy through quantitative easing' Explanation of monetary policy: 2 marks: use of interest rates/quantitative easing/money supply (1) to control the level of economic growth/inflation in the economy (1)	(4)

Question Number	Indicative content	Mark
*(b) (ii) QWC i-iii	KAA 8 Up to 4 marks for identification and explanation of each benefit. Award 2 benefits only. 1 mark for only an identification of a point, 2 marks for identification and very brief explanation, further 2 marks for analysis/development of the point • Improved confidence among consumers and so supporting spending • Improved confidence among firms and so improving investment • Possibility of lower interest rates • Benefit to people on fixed incomes • Less enforced redistribution of income from creditors to borrowers • Lower shoe leather costs • Lower menu costs • Improved international competitiveness • Provides a more attractive environment for FDI • Stable inflation to avoid the risks of deflation • Problems associated with higher inflation that can be avoided Evaluation 4 marks (1 x 4 or 2 x 2) • Potential offsetting macro consequences e.g. higher unemployment • Long run and short run impacts such as reducing expectations • Relative importance of each impact • Lack of demand-pull inflation implies economy is doing badly • Targeting low inflation runs the risk of deflation **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	(12)

Level	Mark	Descriptor
Level 3	9-12	2 convincing benefits with at least one evaluative point
Level 2	5-8	2 convincing benefits with no connections, or 1 convincing benefit with some good analysis but no evaluative point; 1 or 2 less-convincing benefit with some evaluation
Level 1	1-4	Identification of relevant benefit with or without brief evaluative keywords

Question Number	Indicative content	Mark
(b) (iii)	KAA 8 marks 2 factors up to 4 marks each (2 x 2 marks) 1 mark for only an identification of a point, 2 marks for identification and very brief explanation, further 2 marks for analysis/development of the point • Unemployment levels • Debt • Savings • Change in retail sales • Exogenous shocks • Regional data • Exchange rate • Failure of previous interest rates and QE to have their full effect • Commodity prices • Skills shortages • Inflation (for any explanation marks there must be reference to expected rates or pattern of inflation) • Performance in other countries • Level of confidence in the economy • Economic growth/output gap • Investment Do not allow house prices	(8)

Question Number	Indicative content	Mark
(c)	KAA 6 marks Up to 2 marks for definitions (reward implicit understanding or correctly labelled diagram): • Government spending is greater than the revenue (accept tax) it receives (2) • Define the circular flow of income as a model of the economy which shows the movement of goods and services between households and firms, and their corresponding payments in money terms (2) • If the candidate's answer simply states that injections are I+G+X and withdrawals are S+T+M then award 2 marks. Up to 4 marks for explanation of the reasoning • The budget deficit is a net injection (2) and so therefore more money is flowing around the circular flow/AD increases (2) • The effect of a reduction in the deficit would be a reduction in net injections (2), which would mean that total spending in the economy would fall and so AD would fall. (2)	(6)

Question Number	Indicative content	Mark
(d) QWC i-iii	Up to 6 marks • Identification of fiscal policy as being demand-side macroeconomic policy (reward implicit understanding) (2) • Identification of monetary policy as being demand-side macroeconomic policy (reward implicit understanding) (2) • Identification of two macroeconomic objectives (1+1): ○ Economic Growth ○ Control of inflation ○ Reduction in unemployment ○ Making the distribution of income more equal ○ Accept reduction of the national debt or balancing the budget ○ Restoration of equilibrium in the balance of payments ○ Protection of the environment • AD/AS diagram showing shift in AD curve consistent with analysis (4 marks); correct shift in line (1), lines labelled (1), axes labelled (price level and real GDP/output/income) (1), equilibria labelled (both original and new) (1). Explanation of how the policies might conflict with UK macroeconomic objectives- 12 marks (3 x 4 marks; 2 x 6 marks); 1 mark for only an identification of a point, 2 marks for identification and very brief explanation, up to further 4 marks for analysis/development of the point Fiscal • Increasing government spending increasing employment and/or growth. Potential conflict with inflation and a balanced budget. • Reduction in taxation rates through borrowing or policy financed through lowering immediate tax burden increasing AD, increasing employment and/or growth. Potential conflict with inflation and a balanced budget. • Fiscal contraction through reducing government spending. Potential conflict with growth and employment. • Increasing taxation reducing inflation and/or improving government budget. Potential conflict with growth and employment. Monetary • Reduction in interest rates (or increase in money supply) increasing borrowing, reducing debt payments, increasing employment and growth. Potential conflict with inflation. • Reduction in interest rates (or increase in money supply) weakening exchange rate and improving competitiveness, increasing employment and growth and improving the current account. Potential conflict with inflation. Reward other valid explanations Evaluation 12 marks (3 x 4 marks, OR 2 x 6 marks, OR 6 + 4 + 2 marks) Comments might include reference to • If government increases spending on health/education AS will also increase so inflation might not occur • If increased government spending increases growth this should increase tax revenues • Lower interest rates might lead to increased investment causing AS to increase, reducing inflationary pressures	(30)

	• Relative merits of policies which justifies prioritisation • Other things being equal • Tax cuts ineffective if used to increase savings or repay debts • Cuts in Bank of England's interest rate ineffective if banks unwilling to lend or if banks do not reduce interest rates to customers • Reduced impact of interest rate cuts as they near zero • Long term debt payments to repay will reduce future living standards • Time lag for full effect such as with interest rates (18-24 months) • Depends on the elasticity of the AS • Depends on magnitude of multiplier (i.e. increased savings ratio because of lack of confidence leading to lower multiplier) • Magnitude of the changes • Apparent conflict between expansionary monetary policy and attempts to have austerity in fiscal policy **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing conflicts with at least two evaluative points (an evaluation points is worth up to a maximum of 6 marks
Level 3	19-24	2 or 3 convincing conflicts with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing conflicts with no evaluative point; 1 or 2 less-convincing conflicts with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

Question Number	Indicative content	Mark
2 (a) (i)	KAA 4 marks Up to 2 marks for a definition of investment, e.g. • Increase/spending/purchase of capital stock/machinery (2) • asset build up and replacing of depreciated assets (2) Up to 2 marks for explanation of '2010 prices': e.g. • discounts effect of inflation/real (1) since 2010 (1) • base year (1) of 2010 (1) Up to 2 marks for reference to data e.g., • investment was £40bn (1) in 2008 (1) • investment fell from 2008 onwards (1) • investment fluctuated during the period shown on figure 1 (1)	(6)

Question Number	Indicative content	Mark
(a) (ii)	Use of data 1+1 marks- e.g. fell from approx. £39bn in 2008 to £29bn in 2013 2 factors up to 3 marks each (2 x 3 marks). 1 mark for the identification and 2 marks for the explanation of each policy. Factors may include: • Low domestic growth led to greater uncertainty of return on investment • Less business confidence • Interest rates • Low growth in export markets reducing confidence • Unwillingness of banks to lend to business because of high risk of default in a period of low economic growth • Firms had spare capacity as demand was well below 2007 and/or firms were labour hoarding • Banks lacking capital to lend out for investment Also award for factors increasing investment if supported by appropriate data reference	(8)

Question Number	Indicative content	Mark
(a) (iii)	KAA 8 marks AD/AS diagram, consistent with the candidate's analysis (4 marks); correct shift in line (1), lines labelled (1), axes labelled (price level and real GDP/output/income) (1), equilibria labelled (both original and new) (1). 2 marks for correct effect on price level and real output . falling AD means price level falls (1) and real output falls (1) Up to 2 marks- transmission mechanism(s) explained, either AD or AS: Evaluation 4 marks (1 x 4 or 2 x 2) • Depends on the effects of other factors in the economy (consumer confidence and consumer debt) • Knowledge that investment is small but significant component of AD (about 15%) • Long term or short term effects • Relative importance each effect • Size of the multiplier • Other factors are more important • Different effects in different industries or parts of the country • Elasticity of AD and/or AS	(12)

Level	Mark	Descriptor
Level 3	9-12	Explanation of the effect with a good diagram and at least one evaluative point
Level 2	5-8	Explanation of the effect with a good diagram but no evaluative point; or good diagram but with limited explanation or; explanation of the effect but no diagram and some evaluation
Level 1	1-4	Identification of relevant effect with or without brief evaluative keywords

Question Number	Indicative content	Mark
(b) (i)	KAA 4 4 marks for identification of components (1+1+1+1) • Trade in goods • Trade in services • Investment income • Transfers Also award 2 marks for reference to imports and exports/inflows and outflows	(4)

Question Number	Indicative content	Mark
(b) (ii)	KAA 8 Award two factors only 1 mark for only an identification of a point, 2 marks for identification and very brief explanation, further 2 marks for analysis/development of the point Factors may include: • Relatively high value of pound/low value of dollar/other relative currencies. Within the point accept relatively high interest rates • Relatively low interest rates affecting AD (eg sucking in more imports) • Low quality of domestically produced goods or services • Relative inflation rates • Confidence shown in consumer spending and/or business investment • Price of oil/gas (UK net oil/gas importer) • Price of imports • Real wage costs rising, government tax policy, other changes to regulations makes X more expensive and M relatively cheap • Slowdown in other countries • Growth in UK increasing demand for imports Do not allow productivity changes per se	(8)

Question Number	Indicative content	Mark
*(b) (iii) QWC i-iii	KAA 8 (maximum of 6 marks for KAA if no reference to data) 2 points, up to 4 marks per point: 1 mark for only an identification of a point, 2 marks for identification and very brief explanation, further 2 marks for analysis/development of the point • Current account worsens or deficit grows, as a result of exports becoming less competitive; imports becoming more competitive • Falling real wages as workers do not receive pay rises • Rising unemployment as UK firms see lack of demand • Lower economic growth due to less demand for UK goods & services • Less investment • AS/AD analysis Reference to data/own knowledge (2) e.g. GDP per hour worked is lower in the UK in 2012 than in all countries shown in figure 2 except for Japan Evaluation 4 marks (1 x 4 or 2 x 2) • Depends on the price elasticity of demand for X and M • Does productivity determine current account or are other factors more important e.g. exchange rate, quality of goods and services • Problems with measuring productivity- e.g. especially with UK as a mainly services-based economy • Changes will take some time to come into effect • Depends on the productivity of other countries not listed in the data as well, but the key determinant is what is happening in the main trading countries • May not be a problem if there are large inflows from elsewhere (e.g. capital or income flows) **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately To use grammar, spelling and punctuation appropriately	(12)

Level	Mark	Descriptor
Level 3	9-12	Relevant effect with some good analysis and at least one evaluative point
Level 2	5-8	Relevant effect with some good analysis but no evaluative point; less-convincing explanation with some evaluation
Level 1	1-4	Identification of relevant effect with or without brief evaluative keywords

Question Number	Indicative content	Mark
(c) QWC i-iii	KAA 18 Up to 6 marks for • Definition of supply side policies (2); ○ a movement of AS to the right ○ increase in the quality/quantity of factor(s) of production ○ increase in productivity • Identification of a supply-side policy (2) • Defining real output as GDP or Economic Growth after inflation has been removed (2) • Use of a Production Possibility diagram to demonstrate growth (2) • AD/AS diagram showing rightward shift in AS (4 marks); correct shift in line (1), lines labelled (1), axes labelled (price level and real GDP/output/income) (1), equilibria labelled (both original and new) (1). Policies might include 12 marks (3 x 4 marks or 2 x 6 marks) 1 mark for only an identification of a point, 2 marks for identification and very brief explanation, further 2 marks for analysis/development of the point • Increased or improved education and or training would increase the productivity of the country • Increased or improved health care should reduce the number of days absence and so increase productivity • Changing the level of benefits and/or income tax to incentivise employment would increase the output per worker of those in work and increase the number of workers in work. • Cutting cost of bureaucracy and/or reduce regulation in firms would increase productivity • financial support for investment in economically-deprived regions should help overcome structural unemployment and increase the UK's total output • privatisation of an industry improving regulation and or competition of inefficient industries would increase the UK's productivity • privatisation which may lead to increased competition, innovation and efficiency which should lead to increased productivity • Reducing corporation tax and so increasing international competitiveness for investment which would increase UK productivity • infrastructure investment such as roads or broadband reducing industry's costs or improving access to market should increase the UK's productivity • Increased flexibility and/or mobility of labour market would increase the country's productivity and output • Improved childcare provision Evaluation 12 marks (2 x 6 marks or 3 x 4 marks or 6 + 4 + 2 marks); Comments might include reference to • Time it takes for supply side policies to take effect • effectiveness of supply side policies such as infrastructure investments/ education/ health care at delivering sustainable growth • Privatisation may lead to private monopolies and less efficiency and lower economic growth Business confidence may affect investment • Cut in income tax designed as an incentive to work and invest may be ineffective if workers use it as an opportunity to work less for the same income	(30)

	• Cut in corporation tax ineffective if companies use the cut in corporation tax to boost short term profits rather investment • Interest rates may affect investment • Effectiveness of policy to deliver desired outcome • The actions of other countries also trying to attract investment • Increase in UK taxation elsewhere may have an effect on incentives • Concern about the ability of the government to repay its debt if it gets too large • Magnitude of policy change **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing policies with at least two evaluative points
Level 3	19-24	2 or 3 convincing policies with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing policies with no evaluative point; 1 or 2 less-convincing policies with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

	Knowledge	Application	Analysis	Evaluation	Total
Question 1					
ai	2	2	4		8
aii	2	2	4	4	12
bi	2	2			4
bii	2	2	4	4	12
biii	2	4	2		8
c	4	2			6
d	6	6	6	12	30
Total	20	20	20	20	80
Question 2					
ai	4	2			6
aii	2	2	4		8
aiii	2	2	4	4	12
bi	2	2			4
bii	2	4	2		8
biii	2	2	4	4	12
c	6	6	6	12	30
Total	20	20	20	20	80

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Candidate Number | | | | |

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Wednesday 21 May 2014 – 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.
- Check your answers if you have time at the end.

Turn over ▶

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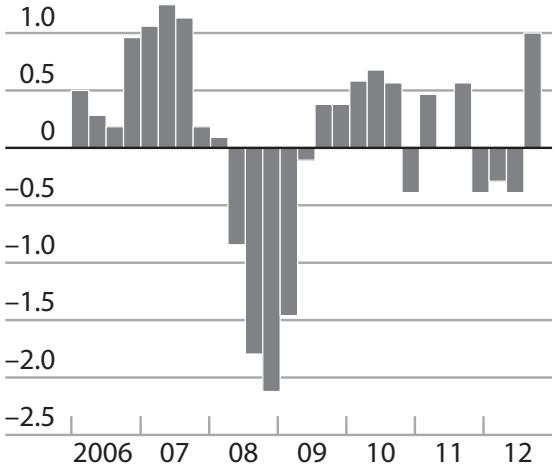
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Answer EITHER Question 1 or Question 2.

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

1 Growth, Productivity and Unemployment

Figure 1
UK Growth, percentage change in real GDP from previous quarter



Extract 1
Exceptional effects on growth

The 1% growth rate in real GDP in the third quarter of 2012 from the previous quarter was the strongest in five years. However, the economy is still no bigger than it was a year ago, and is 3% smaller than it was before the financial crisis hit in 2008. One-off factors such as the Queen's Diamond Jubilee and the London Olympics also improved the third quarter figure, which was better than the 0.6% economists predicted.

But few believed the better data signalled the start of a strong economic recovery. Employment is rising, real disposable incomes are recovering and retail sales are picking up. However, the global economy is slowing, the government plans to reduce its budget deficit further next year and confidence among businesses and households remains fragile.

(Source for Figure 1 and Extract 1: © The Financial Times Ltd 2013)

Extract 2
UK unemployment and employment

UK ILO unemployment is at 2.51 million, up 55% since 2007, a similar increase to the US and the eurozone, according to the OECD. That eurozone average disguises huge variations, however, from rises of well over 100% in Greece and Spain to a fall of 33% in Germany.

In past recessions, the proportion of the unemployed out of work for more than 12 months in the UK has typically increased to 40–50%. This time it has reached only 35%. This has been partly attributed to the welfare-to-work policies of current and previous governments which try to push people quickly back into whatever jobs are available.

The UK's strength in creating jobs, taking the number employed back above the pre-crisis level, has been balanced by concern about the quality of those jobs – a lot of them self-employed, part-time or temporary – and a poorer productivity performance than the average for developed countries.

(Source for Figure 1 and Extract 2: © stats.oecd.org)

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(a) (i) With reference to Figure 1, explain how the growth rate in the third quarter of 2012 can be "the strongest in five years" (Extract 1, line 2) while the economy is "smaller than it was before the financial crisis hit in 2008" (Extract 1, line 3).

(6)

(ii) With reference to Extract 1 and your own knowledge, explain **two** likely benefits of economic growth.

(8)

(iii) Using the concept of the multiplier, assess the contribution of "one-off factors such as the Queen's Diamond Jubilee and the London Olympics" (Extract 1, lines 3 and 4) to economic growth.

(12)

(b) (i) Explain how 'UK ILO unemployment' (Extract 2, line 1) is measured.

(4)

(ii) Explain **two** possible problems for the UK economy of 35% of the unemployed being "out of work for more than 12 months" (Extract 2, lines 5 – 6).

(8)

***(iii)** According to Extract 2 (lines 11 – 12) the UK has a "poorer productivity performance than the average for developed countries." Assess the likely impact of the UK's relatively poor productivity performance on its economy.

(12)

***(c)** With reference to the information provided and your own knowledge, evaluate the policies that the UK government could adopt to improve productivity.

(30)

(a) (i) With reference to Figure 1, explain how the growth rate in the third quarter of 2012 can be "the strongest in five years" (Extract 1, line 2) while the economy is "smaller than it was before the financial crisis hit in 2008" (Extract 1, line 3).

(6)

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(12)

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*(c) With reference to the information provided and your own knowledge, evaluate the policies that the UK government could adopt to improve productivity.

(30)

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(Total for Question 1 = 80 marks)

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

2 Inflation, living standards and monetary policy

Figure 1
UK Consumer Price Index (CPI)

	UK CPI (Annual Average) 2005 = 100	UK CPI percentage change over 12 months
2008	108.5	3.6%
2009	110.8	2.2%
2010	114.5	3.3%
2011	119.6	4.5%
2012	123.0	2.8%

(Source: adapted from data from the Office for National Statistics licensed under the Open Government Licence v.1.0.)

Extract 1
Living standards fall in the UK and inequality rises between generations

According to the Institute for Fiscal Studies the standard of living in Britain has fallen as the average household income fell by 2.4% over the period 2008–9 to 2010–11.

This has coincided with rising inequality of income between different generations. Using data from government income surveys of more than 750 000 households, analysis by the Financial Times shows that the average real household disposable income for people aged 20–29 fell 6.3% between 2008–09 and 2010–11. This figure takes account of CPI inflation reducing the purchasing power of money. If housing costs are included, the fall was even larger, at 9%.

In contrast, households with people in their 60s, 70s and 80s saw average real disposable incomes rise by about 1% over the same two-year period. That finding supports a longer-term study by the Office for National Statistics showing that pensioners saw the fastest growth in living standards for any group in Britain during the past 35 years.

According to Robert Joyce of the Institute for Fiscal Studies, the government's planned changes to the tax and benefit system up to 2015 will mean pensioner households will lose less on average than younger adults aged 20–29, who will see their living standards squeezed further. This latter age group is particularly affected by a high rate of unemployment, annual benefit rises capped at 1% in nominal terms and falling real wages.

(Source: © The Financial Times Ltd 2013)
(Source: Adapted from www.ifs.org.uk/comms)

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Extract 2
Inflation

Recessions are normally associated with falling inflation rates. However, since the recession started in 2008 the Bank of England's Monetary Policy Committee (MPC) has overseen several periods in which inflation has exceeded the upper limit of the target inflation rate's tolerance. There have been four sources of inflationary pressure. First, oil prices rose sharply because of popular unrest in many Arab nations which led to the development of uncertainty around the security of supply. Secondly, a period of bad weather resulted in harvest failure in many areas and wheat prices soared. In addition, the sterling exchange rate has weakened and since 2008 it has fallen by around 25% against the U.S. dollar. A final factor was the increase in VAT from 15% to 17.5% in January 2010 and then in January 2011 it was raised to 20%.

The monetary tools available to the MPC of the Bank of England have most impact on the demand side of the economy, which has been weak and was not the source of the inflationary shocks. The danger with raising interest rates to achieve the inflation target in the short term is that they might weaken the economy further.

(Based on a variety of media sources)

(a) (i) Figure 1 shows that in 2008 average prices were lower than in 2012. Calculate, in percentage terms, how much **higher** prices were in 2012 than in 2008.

(4)

(ii) Explain **two** reasons why the government has a low rate of inflation as a macroeconomic objective.

(8)

(iii) With reference to the information provided, evaluate the significance of **two** likely causes of UK inflation over the period 2008 to 2012.

(12)

(b) (i) Explain how the standard of living may be measured.

(6)

(ii) With reference to Extract 1 and your own knowledge, analyse **two** likely reasons why living standards have fallen for people aged 20–29.

(8)

***(iii)** Evaluate possible changes in government spending and taxation aimed at increasing living standards for younger adults in the UK.

(12)

***(c)** With reference to the information provided and your own knowledge, to what extent might monetary policy help the UK government achieve its macroeconomic objectives?

(30)

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(a) (i) Figure 1 shows that in 2008 average prices were lower than in 2012. Calculate, in percentage terms, how much **higher** prices were in 2012 than in 2008.

(4)

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(ii) Explain **two** reasons why the government has a low rate of inflation as a macroeconomic objective.

(8)

(iii) With reference to the information provided, evaluate the significance of **two** likely causes of UK inflation over the period 2008 to 2012.

(12)

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(6)

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(ii) With reference to Extract 1 and your own knowledge, analyse **two** likely reasons why living standards have fallen for people aged 20–29.

(8)

*(iii) Evaluate possible changes in government spending and taxation aimed at increasing living standards for younger adults in the UK.

(12)

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*(c) With reference to the information provided and your own knowledge, to what extent might monetary policy help the UK government achieve its macroeconomic objectives?

(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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Mark Scheme (Results)

Summer 2014

Pearson Edexcel GCE
in Economics (6EC02) Paper 01

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

FOR ALL QUESTIONS: No mark scheme can cover all possible responses. Therefore, reward analysis which is relevant to the question even if this is not specifically identified in the mark scheme.

Question Number	Indicative content	Mark
1 (a) (i)	KAA 6 marks Reward up to 4marks • Although real (or potential) output in 3rd quarter of 2012 increased at the highest rate since the start of the recession (2), the fall in the economy's real output was so large in 2008-9 that even with the increase in the third quarter output was yet to reach the level of 2007 (2) • Up to 2 marks for any one reason why growth was high in 2012 • Reward an illustrative graph of real output that is well explained e.g. output gap diagram (2) Up to 2 marks for correct use of any one piece of data • 1% in Q3 of 2012 • Q3 2012 is still 3% below 2007 levels	**(6)**

Question Number	Indicative content	Mark
(a) (ii)	KAA 8 marks 2 x 4 marks for identifying a benefit (2) and explaining it (2). Award 2 benefits only. • More employment opportunities/lower unemployment • Increase in real disposable income. Therefore, consumers can afford to buy more goods and services and/or have more leisure time – i.e. an increase in living standards • Retail sales increasing. Therefore, higher profits for companies which may be used to improve the quality of products or to produce new products • Increased tax revenues for the government which may be used to improve public services or redistribute incomes and/or reduce budget deficit • Higher profits may lead to higher share prices leading to the wealth effect and/or higher dividends leading to more consumption • If there is export-led growth, then the current account of the Balance of Payments would improve • Real economic growth increases LRAS and could lower inflation	**(8)**

Question Number	Indicative content	Mark
(a) (iii)	KAA 8 marks Definition of multiplier (2); the number of times a rise in national incomes exceeds the rise in injections that cause it. It measures the subsequent effects when an injection or withdrawal changes. Accept formula 1/(1-m.p.c.) or 1/m.p.w. or 1/(m.p.s.+m.p.m.+m.p.t.) Maximum 6 marks for KAA if no multiplier reference Other 6 marks for one or more of the following (maximum 4 marks if no reference to output/growth): • Increase in C as people spend money in the UK on tickets and food and merchandise and therefore AD and real output rises • Increase in exports as tourists spend money on tickets and holidays in the UK and therefore AD and real output rises • Impact on employment: boost to construction industry; higher wages for construction workers; Reward up to 2 marks for a relevant diagram which helps explain the transmission mechanism Evaluation 4 marks (1 x 4 marks or 2 x 2 marks). Factors might include: • Size of the multiplier will have an impact on the increase in economic growth • Significance of elasticity of AS curve on growth in output • Consumption is likely to have had a larger effect than exports on AD and therefore on growth in output • Regional differences in impact (i.e. most of the events of the Olympics and Jubilee were held in London) • Short-term/long term- impacts • One-off events unlikely to cause sustained growth • Extract: 'confidence is fragile'.	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing impacts with at least one evaluative point
Level 2	5-8	2 convincing impacts with no connections, or 1 convincing impact with some good analysis but no evaluative point; 1 or 2 less-convincing impacts with some evaluation
Level 1	1-4	Identification of relevant impacts with or without brief evaluative keywords

Question Number	Indicative content	Mark
(b) (i)	KAA 4 marks 4 x 1 mark: • It refers to those of working age who are not working (1) • Actively looking for a job and out of work in last four weeks (1) • Ready to work in two (1) • Labour Force Survey/survey (1) • Questionnaire/interview (1) • Conducted quarterly • Internationally recognised (1) • Age 16-64 (1) • Sample (1)	**(4)**

Question Number	Indicative content	Mark
(b) (ii)	KAA 8 marks Up to 4 marks for each cost identified and explained/applied. Award up to 2 costs only. Costs might include: • Loss of income and/or credit problems (such as house repossession) will have a downward pressure on consumption and AD, and therefore on output. It will have an upward pressure on unemployment. • Loss of skills and other human capital: hard to get into or back into labour market and increased welfare problems for individuals and dependents and poverty issues, possibly leading to a reduction in the PPF and a downward pressure on actual and potential growth. • Government revenue falls so spending likely to fall, leading to a downward pressure on AD and therefore on output. It will have an upward pressure on unemployment. • Increased government expenditure e.g. on benefits • Social costs: large numbers of idle workers can have a negative effect on society, for example crime, morale, social disintegration, possibly leading to a reduction in the PPF a downward pressure on actual and potential growth. • Opportunity costs: resources could be used elsewhere more effectively, leading to an actual output inside the PPF a downward pressure on actual growth • Downward pressure on wages caused by surplus of workers: could lead to increased inequality.	**(8)**

Question Number	Indicative content	Mark
***(b) (iii) QWC i-iii**	KAA 8 (2 x 4 marks: 2 for identification of point; 2 for analysis). Do not double award analysis • Impact on current account balance: UK goods and services will be less competitive. Therefore, exports will become relatively more expensive and imports are relatively less expensive • Increase in unemployment • Lowering of output • Reduction in investment • Increase in inflation • Exchange rate will weaken • Lower profits for firms leading to lower investment • Downwards pressure on wages Up to 2 marks for relevant diagram Evaluation 4 marks (1 x 4 or 2 x 2) • Depends on the price elasticity of demand for X and M • Other factors may be more important in determining the current account e.g. exchange rate, quality of goods and services • Problems with measuring productivity • Changes will take some time to come into effect • Impact of other factors • Magnitude **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	Effect identified and explained with at least one evaluative point
Level 2	5-8	Effect identified and explained , or effect identified and explained with some good analysis but no evaluative point; effect identified, less-convincing explanation with some evaluation
Level 1	1-4	Identification of relevant effects with or without brief evaluative keywords

Question Number	Indicative content	Mark
(c) QWC i-iii	KAA 18 6 marks • Identification of government policy as supply side and/or fiscal (2) • Productivity is output per unit of input (2) Accept labour productivity definition • Diagram showing AS shifts to the right (4); axes labelled (1),equilibria labelled (1), AD/AS lines labelled (1), correct shift (1). No marks for diagram if shift in wrong direction. Factors might include possible policies to raise productivity could include the following: N.B. 2 marks for identification of a relevant policy and 2/4 for analysis. Policies must be related directly to increases in productivity rather than to increased production for 2/4 analysis marks. • Increased government spending on infrastructure encouraging investment (inward and/or domestic). • Lower corporation tax to encourage investment (domestic and/or inward) • Redesigning taxes on incomes to create the incentive to work more productively i.e. increased competitiveness in the labour market • Redesigning benefits that create the incentive to work more productively • Improving the quality and focus of education and training will increase its effectiveness at raising productivity (Could be 2 separate points) • Improve health care to reduce sickness and absence which should increase output per worker • Facilitating inward migration of skilled labour increases output per worker • Deregulation to encourage competition leading to greater efficiency • Privatisation • Lower red tape encouragement of entrepreneurship and investment which should lead to higher productivity • Subsidy/tax break on investment such as creation of special enterprise zone or the increase in the use of new technology causing greater efficiency and productivity • Government measures to increase bank lending to further increase investment and productivity- Funding for Lending Evaluation 12 marks (2 x 6 marks or 3 x 4 marks or 6 + 4 + 2 marks); Comments might include reference to • Discussion of effectiveness of individual policies- this could be 3 separate points • Effectiveness of certain policies as some services have few opportunities to increase productivity	**(30)**

	• Prioritisation of objectives such as fiscal deficit reduction limiting scope • Creditworthiness of UK government • Availability of credit in the UK • Size of national debt • A combination of policies may be more effective (e.g. fiscal and supply side) • Time lag and implementation lags • Other things are not equal – e.g. depends on global economic changes or exchange rate movements • Conflict between policies • Conflict with other macroeconomic objectives • Counter argument e.g. effectiveness of training **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing policies with at least two evaluative points (an evaluation point is worth up to a maximum of 6 marks
Level 3	19-24	2 or 3 convincing policies with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing policies with no evaluative point; 1 or 2 less-convincing policies with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

Question Number	Indicative content	Mark
2 (a) (i)	KAA 4 marks 13.36% award 4 marks for anything between 13% and 13.4% without a % sign award 3 marks Award 3 marks for anything between 13.5% and 14% without a % sign award 2 marks ((New – Original)/Original) x 100 or equivalent (1 mark) or ((123 -108.5)/108.5) x 100 (2 marks) Award 1 mark if relevant CPI figures are identified as 108.5 and 123	**(4)**

Question Number	Indicative content	Mark
(a) (ii)	KAA 8 marks Award two reasons (2 x 4 marks) 2 marks for identifying each reason and up to 2 marks explaining each reason. • Help reduce inequality as inflation damages those on fixed incomes • Other widening of income gaps • To slow the erosion of real incomes • Maintain international competitiveness • Helps price signalling an the efficient functioning of a market • Increased confidence in government control of economy • Avoids the dangers of hyperinflation and/or deflation at the target is set at +2.0% • To maintain value of savings • To encourage long-term planning/investment by firms • Avoid inefficiencies in the economy such as shoe leather costs and/or menu costs	**(8)**

Question Number	Indicative content	Mark
(a) (iii)	KAA 8 marks 2 factors up to 4 marks each 2 marks for the identification and 2 marks for the explanation of each factor. Cost push inflation or increasing the cost of factors of production • Weakening exchange rates leading to the increased cost of imported components • Rising price of oil which is used by most businesses either directly or indirectly and the UK is a net importer • Rising price of food as the UK is a net importer of food • Tax increases such as VAT which will generate an increase in prices of most goods Evaluation 4 marks (1 x 4 or 2 x 2) factors might include • Fixed contracts limit impact of exchange rate depreciation • PED for imports • Magnitude of each factor • Likely persistence of each factor • Importance of each factor • Impact on different groups	**(12)**

Level	Mark	Descriptor
Level 3	9-12	1 convincing cause fully explained with at least one evaluative point
Level 2	5-8	1 convincing cause fully explained with no data, or 1 convincing cause with some good analysis but no evaluative point; 1 or 2 causes with some evaluation
Level 1	1-4	Identification of relevant cause with or without brief evaluative keywords

Question Number	Indicative content	Mark
(b) (i)	KAA 6 marks Up to 6 marks for the explanation • Definition of standard of living: e.g. measure of welfare of people living in an economy (2) • Real Gross National Income (accept Gross National Product and Gross Domestic Product) (2) per household or capita/head (2). • Average household income in the UK fell by 2.4% over the period 2008-9 and 2010-11 (2) • Reward other relevant measures such as HDI (2) made up of health, education, and economic growth/income (2). Health measures such as life expectancy at birth (2) and education measures such as number of years of schooling (2). Income measures such as GDP per capita or GNI per capita (2)	**(6)**

Question Number	Indicative content	Mark
(b) (ii)	KAA 8 marks 2 causes up to 4 marks each (2 x 2 marks) 2 marks for the identification and 2 marks for the explanation of each cause. • Incomes not keeping pace with inflation • Increased unemployment • Increased youth unemployment • Increased tuition fees at university • Cuts to unemployment and other state benefits • Increased housing costs • Cuts in training Reward use of data from Extract 1 (2) • The median household disposable income for those in their 20s fell 6.3 per cent between 2008-09 and 2010-11. If housing costs are included, the fall was even larger, at 9 per cent.	**(8)**

Question Number	Indicative content	Mark
***(b) (iii) QWC i-iii**	KAA 8 Up to 8 marks (2 x 4 marks) for explanation of policies. Award up to 4 marks for each policy & explanation • Increase government expenditure e.g. on training programs • Cuts in university tuition fees and/or bursaries for university courses • Increase benefits above 1% cap • Housing policies (mortgage relief, key worker subsidies) • Increased income tax threshold, cut national insurance contributions • Relaxation of austerity measures relaxed • Lower indirect taxes (e.g. VAT), assuming higher propensity to spend in young people • Cut in income tax rate e.g. reintroduction of 10% tax band • Lower corporation tax leading to increased investment, lower unemployment Maximum of 4 marks for listing policies with no explanation. Evaluation 4 marks (1 x 4 or 2 x 2) • Conflict with other objectives such as reducing the budget deficit and also the national debt (can award conflicts with different objectives) • Raising benefits might decrease living standards in the long run if it provides less incentive to find work • Long run and short run impacts • Relative importance of the policies • Likely effectiveness of the policies • Mitigating factors • Counter argument **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing policies with at least one evaluative point
Level 2	5-8	2 convincing policies but no evaluative point; 1 or 2 less-convincing policies with some evaluation
Level 1	1-4	Identification of relevant policy with or without brief evaluative keywords

Question Number	Indicative content	Mark
(c) **QWC i-iii**	Up to 6 marks • Identification of a macroeconomic objective (maximum 2 marks) o Economic Growth o Low and stable inflation o Reduction in unemployment o Reduction of the deficit on the current account of the balance of payments Accept o Reduction of the national debt or balancing the budget o Making the distribution of income more equal o Protection of the environment • Define monetary policy (2) • Diagram showing AD shift and/or AS shift consistent with analysis; axes labelled (1), equilibria labelled (1), AD/AS lines labelled (1), correct shift (1). No marks for diagram if shift inconsistent with analysis. Explanation of how the monetary policies might help achieve government objectives 12 marks (3 x 4 marks or 2 x 6 marks); Marks could be obtained as follows: Link between interest rates and an objective (2) and transmission mechanism explained (2/4). Must be link between monetary policy and objective. • Fiscal Policy constrained by austerity promises because of national debt • MPC remains independent with control of interest rates and free of political interference. This helped prevent inflation named target has been clear 2% inflation (+/- 1%) and transparency and openness maintained (open letters to chancellor from 2007) These led to reduced inflationary expectations which is self-fulfilling to some extent. This helps growth, reduce the balance of payments deficit, unemployment and price stability • An increase in interest rates designed to reduce rate of inflation; lower AD improving export price competitiveness • Low interest rates and/or quantitative easing help prevent deflation, high unemployment and low growth • Maintained financial stability in the banking sector helping growth and reduce unemployment and improve price stability • Low interest rates and/or quantitative easing encourage investment, growth, reduce the deficit on the current account of the balance of payments and reduce unemployment • Low interest rates and/or quantitative easing encourage consumption and growth and reduce unemployment	(30)

	Evaluation 12 marks (2 x 6 marks or 3 x 4 marks or 6 + 4 + 2 marks); Fluctuating state of the economy had inevitable effect on inflation • Fluctuating state of the economy had inevitable effect on inflation • Inflation in the recession has been caused by cost push inflation outside the Bank of England's control • Looking at Figure 1, out of tolerance but not out of control • Changed target to CPI which was more stable than RPI possibly because of absence of volatile housing market and mortgage interest payments • Financial stability to some extent has taken priority and the MPC has had loose monetary policy while fiscal policy remained tight • Uncertainty of effect of Quantitative Easing • Vicious cycle of deflation was avoided in 2009 • Other factors such as cheap imports in the early 2000s • Weak unions have prevented the wage-price spiral • Other issues were neglected such as exchange rate stability to promote trade • Conflicts of objectives **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing effects with at least two evaluative points (an evaluation points is worth up to a maximum of 6 marks
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Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

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Pearson Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Wednesday 21 May 2014 – Afternoon
Time: 1 hour 30 minutes

Paper Reference
6EC02/01R

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.
- 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 Growth

Extract 1 Stagnation in the UK economy

After the Great Recession comes the Great Stagnation. The United States, Japan and the euro area have all suffered very limited growth since the crash in 2008, yet Britain has under-performed them all. The economy has had almost no growth since the coalition Government took office in 2010, leaving gross domestic product more than 4% below its pre-crisis peak and the UK in a negative output gap.

For the moment all politicians are focusing on infrastructure as the solution to growth. Larry Summers, the former US Treasury Secretary, warned that unless the UK Government stimulates construction, it will face a re-run of America's fate in the Great Depression.

Yet the experience of Japan's extended stagnation offers a cautionary lesson. The country embarked on 15 stimulus packages between 1992 and 2008, including many massive infrastructure investment projects. But nearly 20 years after its financial bubble burst, the country is still stagnating. All those extra bullet (high-speed) trains failed to generate a period of growth in the economy's output. Investment projects need to be carefully chosen to have a real impact. Many of the ideas that we hear – a motorway connecting Oxford and Cambridge, for example – sound unlikely to generate long-term growth. Britain invested vast amounts of money in commercial property in the 2000s; it was not needed. Economists at a financial consultancy argue that there is a surplus of infrastructure in the UK following the collapse in GDP. Returns on private sector infrastructure investment are likely to be low or even negative. Encouraging banks to lend billions to finance more of it may provide a short-term boost but, in the long run, it will only increase Britain's debt problem.

Masaaki Shirakawa, the Governor of the Bank of Japan, argued in a speech last week that policy in Japan had to go beyond short-term fiscal and monetary policies, and focus on the longer term. That means lifting the economy's growth potential. In Britain, spending needs to be increased on the development of assets other than physical capital. The country needs to invest more in innovation, "intangible" assets such as intellectual property, software, design and patents, not just apartment blocks. Yet calculations published by Nesta, a charity, show that spending on research and innovation by British companies fell by as much as £24 billion in 2011. The governments of America, France, Germany and South Korea have committed more to research and innovation than the UK since the crisis began, according to the Nesta report.

UK Government policies are making the situation worse. It is difficult to understand why the Government is including students in its restrictions on immigration, given the critical role Britain's universities will play in the pursuit of growth. Instead of holding universities back with greater regulation and bureaucracy, it should be trying to help them to attract the top brains in global academia. The Government argues that it is just reducing the numbers of students coming to learn English at language schools and that overseas student numbers studying at British universities are slightly up on previous years.

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The Government's innovation strategy relies partly on a policy that cuts the corporation tax rate on income generated from UK patents. Yet, as the Institute for Fiscal Studies, a think-tank, has pointed out repeatedly, this costly incentive is poorly targeted: the companies that benefit are able to carry out the research outside the UK economy and then apply for a UK patent.

George Osborne, the Chancellor, has centred his growth strategy on low interest rates, but, as Spencer Dale of the Bank of England has pointed out, this comes at a cost. Extended periods of low rates can simply delay economic restructuring by covering up bad debts as weak companies are kept going. Here again, the Japanese experience is relevant. Mr Shirakawa admits that Japan's unwillingness to deal quickly with the bad debts of its failing companies played a significant part in condemning the country to lengthy stagnation.

The UK boom of the 1990s and 2000s did not create long-term growth. It was mainly generated by short-term, demand-side factors such as rising asset prices, easy finance and an unsustainable increase in the number of public sector employees. Growth was also stimulated by cheap imports from China, which are no longer falling in price. The Government has a critical role in leading the search for long-term supply-side growth. If it fails, the Great Stagnation could be with us for years to come.

(Source: The Times Newspapers Ltd, 10 Sept 2012)

(a) (i) With the aid of a diagram and reference to Extract 1, explain what is meant by "output gap" (Extract 1, line 5).

(6)

(ii) With reference to the third paragraph of Extract 1, define investment. (Extract 1, line 14).

(4)

(iii) Explain **two** likely causes, other than monetary policy, of the fall in investment in research and innovation by British companies (Extract 1, lines 29–30).

(8)

(b) (i) Assess the effects that **increasing** numbers of overseas students could have on the UK economy. Use an aggregate demand and aggregate supply diagram in your answer.

(12)

(ii) Outline **two** mechanisms by which "low interest rates" (Extract 1, lines 47–48) can lead to economic growth.

(8)

*(iii) Evaluate the impact of the "increase in the number of public sector employees" (Extract 1, line 56) on the UK economy.

(12)

*(c) Evaluate the merits of using supply-side policies to overcome 'the Great Stagnation' (Extract 1, line 1).

(30)

(a) (i) With the aid of a diagram and reference to Extract 1, explain what is meant by "output gap" (Extract 1, line 5).

(6)

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(ii) With reference to the third paragraph of Extract 1 only, define investment. (Extract 1, line 14).

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(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 UK economic performance and monetary policy

Figure 1 UK macroeconomic indicators

	Real GDP	Consumer Price Index (CPI)	ILO Unemployment	Balance of Payments on Current Account
	Annual % change	Annual % change	% of labour force	% of GDP
2005	2.8	1.9	4.9	–2.1
2006	2.6	3.0	5.4	–2.9
2007	3.6	2.1	5.3	–2.3
2008	–1.0	3.1	5.7	–1.0
2009	–4.0	2.9	7.7	–1.3
2010	1.8	3.7	7.8	–2.5
2011	0.9	4.2	8.1	–1.3
2012	0.2	2.7	8.0	–3.7

(Source: adapted from data from the Office for National Statistics licensed under the Open Government Licence v.1.0.)

Extract 1 Domestic demand, exports and exchange rates

Since 2008 domestic demand has been fragile in the UK and the savings ratio (percentage of household disposable income saved) has risen from –0.9% at the end of the boom in the first quarter of 2008 to around 6% in 2012.

Despite the weaker sterling exchange rate, imports have remained high and exports have been lower than hoped for. Lee Hopley, Chief Economist of the EEF manufacturers' organisation, said there were fewer UK suppliers than in the past, so while a weak pound makes export sales cheaper, it raises the cost of components and raw materials, which now have to be imported. Also, many exports are of niche products, which are less price-sensitive in demand. "Large aircraft manufacturers are not going to go somewhere else to buy aircraft landing gear because the exchange rate has moved," Ms Hopley said.

David Kern, Chief Economist at the British Chambers of Commerce, warned that a further depreciation in sterling would be damaging. "We have … reached the point where the benefits of a weaker pound for UK exports will be very small, while the potential damage to the economy because of high inflation and the squeeze it imposes on businesses and consumers is much bigger."

(Source: © The Financial Times Ltd 2013)

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Extract 2 UK inflation and interest rates

In February 2013, the Bank of England's Monetary Policy Committee (MPC) announced that the UK's inflation rate for January 2013 remained steady at 2.7% and its interest rate would remain at 0.5%. This means the interest rate has been at the same historically low level for four years since it was rapidly reduced in 2008 from over 5%.

Members of the MPC were split on whether to change interest rates. Inflationary pressure was evident in the service sector and from a weakening sterling exchange rate. However, on the other side, domestic consumption remained low and unemployment persisted.

(Source: © Bank of England)

(a) (i) Outline **two** main components of the Balance of Payments on Current Account.

(4)

(ii) Explain **two** possible problems for the UK economy of its persistent current account deficit as shown in Figure 1.

(8)

(iii) With reference to the information provided, assess the effect of a weakening of the sterling exchange rate on the UK Balance of Payments on Current Account.

(12)

*(b) With reference to the information and your own knowledge, examine **two** factors that might explain the change in the UK unemployment rate since 2008.

(12)

(c) (i) Explain how the rate of inflation is measured in the UK. Refer to the concept of weights in your answer.

(6)

(ii) With reference to Extract 1, explain how a rise in the "percentage of household disposable income saved" (Extract 1, line 2) may affect real output in the UK economy.

(8)

*(iii) With reference to the data and your own knowledge, discuss the issues that the Monetary Policy Committee of the Bank of England might consider when seeking to achieve its inflation target.

(30)

(a) (i) Outline **two** main components of the Balance of Payments on Current Account.

(4)

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(ii) Explain **two** possible problems for the UK economy of its persistent current account deficit as shown in Figure 1.

(8)

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(8)

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(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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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
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Information

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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.

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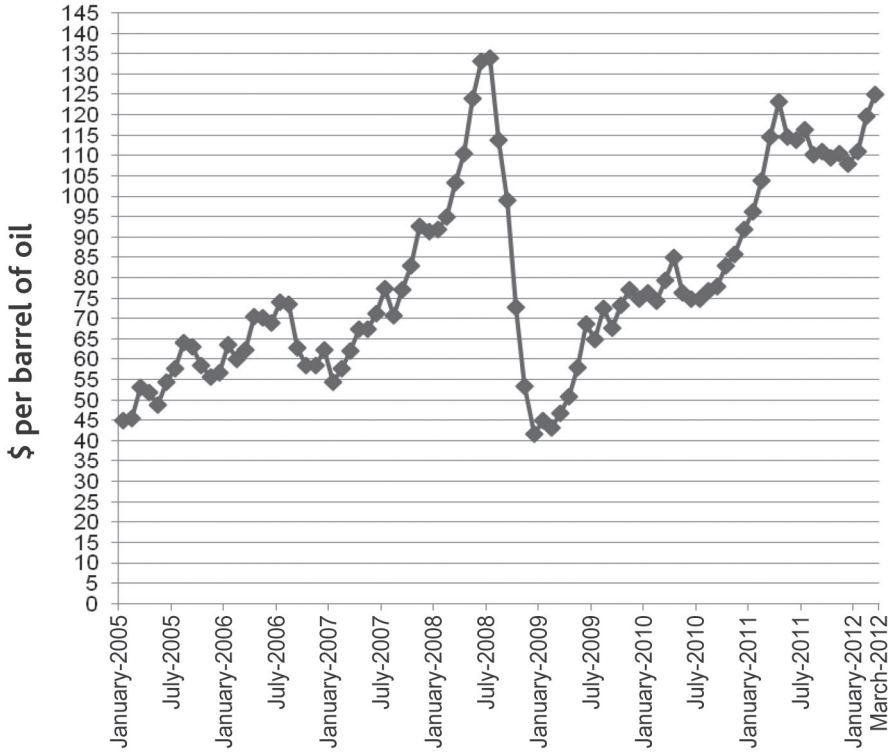
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Answer EITHER Question 1 or Question 2.

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)

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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.

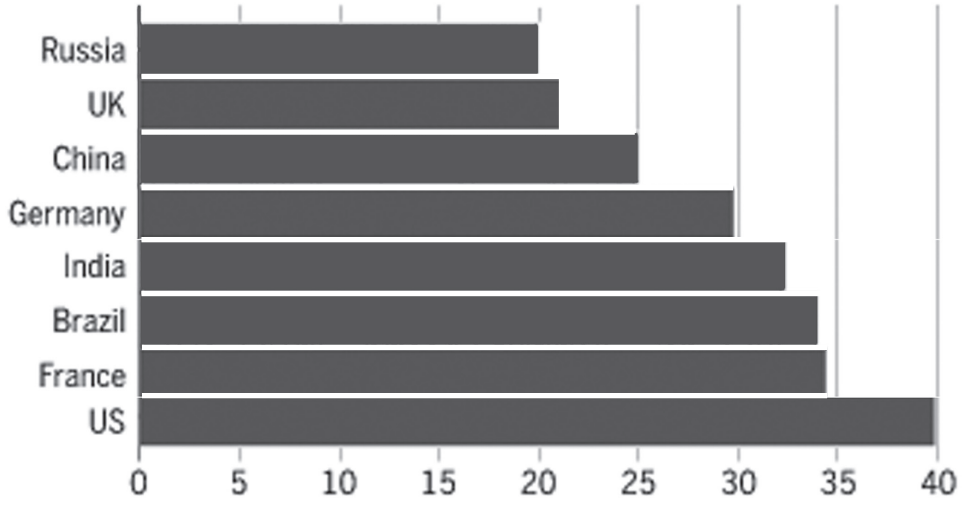
(Source: adapted from © Financial Times, April 3rd 2012)

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. 5

(Source: adapted from © Crown copyright)

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



(Source: © Financial Times, 21 March 2012)

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(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)

(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)

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(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)

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(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)

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(ii) Explain **two** likely costs to the UK economy of a sustained UK 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)

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*(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)

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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)

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(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?

(30)

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

(6)

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(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)

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

(4)

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(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)

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*(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?

(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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Mark Scheme (Results)

Summer 2013

GCE Economics (6EC02/01)

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Summer 2013
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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

Question Number	Indicative content	Mark
1 (a) (i)	Data reference: 2005 as $45 **(1)** and 2012 as $125 **(1)** Identification: base year (January 2005) of index = 100 **OR** $45 = 100 **(1)** Calculation of percentage increase in price as 177.7% (accept 177 or 178) (1) Calculation: (125/45)x100 **(2) OR** 177% increase + 100% **(2)** Answer = 277.77 accept 277 or 278 and anything in between these two numbers **(6)** If only (125/45)x100 and the answer is wrong award 4 marks For incorrect data reference, but correct calculation using incorrect data, award up to 3 marks	(6)

Question Number	Indicative content	Mark
(a) (ii)	KAA 8 Data reference **(2)** **Up to 4 marks each:** • Up to mid 2008 booming global economy **(2)** pushes demand for oil up, raising price **(2)** • Up to mid 2009 recession **(2)** and collapse in global demand, lowering demand for oil and hence price **(2)** • Up to end 2010 demand for oil recovers **(2)** mainly from developing countries such as China and India, raising price **(2)** • 2011 Arab spring **(2)** threatens supply of oil and/or stocks are bought up/speculative buying raises demand for oil, raising price **(2)** Accept correct supply and demand diagram for 2 marks within each point	(8)

Question Number	Indicative content	Mark
(a) (iii)	KAA 8 marks **Up to 4 marks for the diagram:** Diagram demonstrating leftward shift of AS **and/or** AD if linked to higher imports: correct shifts in line **(1)**, lines labelled **(1)**, axes labelled **(1)**, equilibria labelled **(1)**. **Note** diagrams where a single line shift is shown and it is incorrect receive no marks, even if curves and axes are labelled correctly. If one line shift is correct and the other shift is wrong then award 2 marks assuming the rest of the diagram is labelled correctly. **Up to 4 marks for the analysis** e.g. • Explanation that oil is a factor of production / costs of production rise **(2)** and that inflation occurs **(2)** • Aggregate supply and/or aggregate demand falls so real output will fall **(2)** and this could lead to a rise in unemployment **(2)** • Worsening of balance of payments on current account / trade balance **(2)** through increase in value of oil imports **(2)** • Rising costs of production for firms may lead them to reduce investment **(2)** causing further falls in AD and AS and hence real output **(2)** • Negative effect on income distribution (2) as price rise is regressive / could result in fuel poverty (2) Evaluation 4 marks **(1x4 or 2x2)** • The extent of the effect on the balance of payments on current account depends on the PED of oil. Oil is likely to have a low PED leading to a significant worsening of the current account balance. • The effect being offset by technological change/use of substitutes • Supply chain, stocks and fixed price contracts may mean price rise is not felt immediately • Different effects on different industries • Dependency on oil may be falling due to deindustrialisation / increasingly service-based economy, and/or increasing use of renewable energy sources • Magnitude of price increases • Extent of other factors offsetting this effect (questioning ceteris paribus) • Length of time oil price remains high for and timescale of the effects	(12)

Level	Mark	Descriptor
Level 3	9-12	One convincing effect with AS/AD diagram, with at least one evaluative point
Level 2	5-8	One convincing effect with evaluation but no/incorrect diagram, or one convincing effect with diagram but no evaluative point; Less-convincing effect or diagram with some evaluation
Level 1	1-4	Identification of relevant effect with or without brief evaluative keywords

Question Number	Indicative content	Mark
(b) (i)	KAA4 Data reference **(2)** for example: • 21% increase in export volumes (1) and 16% increase in import volumes (1) since 2009. • The fall in the exchange rate (1) by 25% between 2007 and 2009 (1) would make imports more expensive, supposedly reducing the total value we import, and exports cheaper, supposedly increasing the total value sold, reducing the deficit. The **value** of the country's imports of goods and services is greater than the **value** of the country's exports of goods and services **(2)** Amount/volume of exports or 'exports' less than amount/volume of imports or 'imports' **(1)**	(4)

Question Number	Indicative content	Mark
(b) (ii)	KAA 8 **Up to 4 marks for each consequence (2 x 4 marks)** - 2 marks for identification and 2 marks for explaining why it is a cost to UK economy • Low/constrained aggregate demand **(2)** leading to suppressed economic growth **(2)** • Net withdrawal from the circular flow of income **(2)** leading to falling output **(2)** • As labour is a derived demand **(2)** creation of unemployment in export and/or import substitute industries **(2)** • Rising unemployment means lower average incomes **(2)** and a consequence of that such as lower domestic consumption or higher total paid by government in unemployment benefits/lower tax revenue **(2)** • Weakening pound **(2)** which would lead to imported cost push inflation from products with price inelastic demand such as oil **(2)** • Loss of manufacturing skills **(2)** meaning no choice but to continue importing goods in the future / deficit will persist **(2)**	(8)

Question Number	Indicative content	Mark
*(b) (iii) QWC i-iii	KAA 8 **Up to 8 marks** • Reference to data **(2)** • Definition of a fall in the exchange rate **OR** the exchange rate **(2)** • Fall in the price of exports **(1)** leading to a rise in exports **(1)** • Rise in price of imports **(1)** leading to a reduction in imports **(1)** • Leading to a reduction in the trade deficit **(2)** Evaluation **(1 x 4 marks or 2 x 2 marks)** Factors might include: • 25% depreciation in exchange rate, so effects likely to be significant • Extract states that import volumes rose, rather than fell as would be expected • Large price differential persists even after depreciation • Imports and exports may not be that price sensitive (focus on quality) and so the deficit may not reduce so quickly • Depreciation may lead to inflation which may in the long run eliminate the trade benefits of a fall in the sterling exchange rate • Extent of industrial production reduction • Producers may not pass on depreciation in their final prices • Extent of dependency on overseas countries • Depends on economic conditions in UK's main export markets (questioning ceteris paribus) **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	(12)

Level	Mark	Descriptor
Level 3	9-12	Effect on trade deficit explained convincingly with at least one evaluative point
Level 2	5-8	Effect on trade deficit explained convincingly with no evaluation, or effect on trade deficit explained less convincingly with some evaluation
Level 1	1-4	Identification of effect on trade deficit with or without brief evaluative keywords

Question Number	Indicative content	Mark
(c) QWC i-iii	**KAA 18** **Up to 6 marks (3 x 2 marks)**: • Defining supply side policies as measures by the government to increase productive capacity of the economy **OR** increase LRAS • Defining economic growth as an increase in either real **OR** potential GDP • Use of relevant data (e.g. data on corporation tax rates from Extract 2 and/or Figure 2) • Use of a production possibility frontier diagram to demonstrate growth through SSP **OR** use of an AD/AS diagram to demonstrate growth through SSP Policies might include **(up to 12 marks**): Corporation tax reductions **(1 x 4 marks or 1 x 6 marks)** • increasing investment/productivity or attraction of overseas investment and link to economic growth Other SSP **(2 x 4 marks or 1 x 6 marks)** - 2 marks for identification of policy and up to 4 marks for link to economic growth • Increased or improved education • Increased and improved training • Increased or improved health care • Changing the level of benefits to incentivise employment • Reducing income tax to incentivise employment • Cutting cost of bureaucracy / increased deregulation • Privatisation of an industry such as Royal Mail, which may lead to increased competition, innovation and efficiency • Infrastructure investment such as roads or broadband, reducing industries' costs or improving access to market • Increased flexibility and/or mobility of labour market, e.g. reduce trade union power / improved information flows / reduce or abolish national minimum wage Reward use of diagrams (maximum of 2 marks each if develop analysis) Evaluation **12 marks**: Evaluation of reduction of corporation tax **(up to 2 x 6 or 3 x 4 marks)** • Cut in corporation tax ineffective if companies use the cut to boost dividend payments / retained profits rather than for investment • Interest rates / confidence may affect investment more than corporation tax rates (questioning ceteris paribus) • Positive or negative comparison to other countries' corporation tax rates Evaluation of other supply side policies **(up to 1 x 6 marks or 2 x 4 marks)** • Time it takes for supply side policies to take effect • Privatisation may lead to private monopolies and less efficiency and lower economic growth • Cut in income tax designed as an incentive to work and invest may be ineffective if workers use it as an opportunity to work less for the	(30)

	same income • The actions of other countries also trying to attract investment • Increase in UK taxation elsewhere may have an effect on incentives • Supply side policies ineffective if AD is very low • Elasticity of AD curve • Magnitude of policy changes **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
Level 4	25-30	Two or three convincing policies (including corporation tax cut) with at least two evaluative points
Level 3	19-24	Two or three convincing policies with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	Two or three convincing policies with no evaluative point; one or two less-convincing policy with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

Question Number	Indicative content	Mark
2 (a) (i)	KAA 6 **6 x 1 mark** • Definition of CPI: a measure of the average price level of goods and services in the UK • Price survey • Expenditure and Food Survey • of approximately 7,000 households • Basket of goods • containing approximately 650 goods and services • Contents of the basket revised annually • Weighted average • Weights are attached to reflect relative importance / further explanation of calculation **(1+1)** • Use of an index • Base year • Data is published monthly • Exclusion of most housing costs	(6)

Question Number	Indicative content	Mark
(a) (ii)	KAA 8 **Up to 4 marks each:** • Rising import prices **(2)** such as oil/commodity prices **(2)** • Rising import prices **(2)** such as food **(2)** • Rising raw material/energy prices **(2)** increase production costs for firms **(2)** • Weakening pound **(2)** making imports more expensive **(2)** • VAT rises **(2)** increasing the price of products sold **(2)** • Monetary tools tend to be more focussed on AD **(2)** so unable to combat cost-push inflation effectively **(2)** • Low interest rate **(2)** stimulating consumption/investment and AD growth **(2)** • Quantitative easing **(2)** / stimulating consumption/investment and AD growth **(2)** • Increase in nominal wages **(2)** leading to higher production costs for firms **(2)** Reward use of AS/AD diagrams (maximum of 2 marks each if develop analysis)	(8)

Question Number	Indicative content	Mark
(a) (iii)	KAA 8 marks **Up to 8 marks**: • Reference to data **(2)** • Definition of the standard of living as a measure of the welfare of people living in an economy / real GDP per capita PPP **(2) OR** a definition of real income **(2)** • Explanation of effects **(4+4 marks):** o Lower purchasing power of income **(2)** means fewer goods and services consumed **(2)** o Negative multiplier effect **(2)** leads to unemployment/further falls in income and fall in standard of living **(2)** o Consumers may save more as fearful about the future **(2)** so lower consumption of goods and services **(2)** o Change in purchasing preferences (weighting of the basket of goods) **(2)** as necessities remain relatively unaffected but luxuries are reduced **(2)** o Lower tax revenue for government **(2)** could feed through into cuts in government spending on public goods/goods with positive externalities etc. **(2)** Evaluation **(1 x 4 marks or 2 x 2 marks)** Factors might include: • Short run and long run effects • Magnitude of fall in real incomes - is 3.5% significant? • Size of the multiplier effect • Consumers may draw upon savings to maintain consumption levels • Unequal impact across society (e.g. different income groups, or those on fixed incomes) • Problems of accuracy of measuring output due to shadow or underground economy (i.e. cash in hand) • The value of non-marketed output including work done in the home • Regional variation in income, health and education • Leisure and working hours • Environmental considerations • How the standard of living should be measured (i.e. GDP per capita PPP too limited and broader HDI more representative) / other determinants of standard of living may be improving	(12)

Level	Mark	Descriptor
Level 3	9-12	Two convincing effects with at least one evaluative point
Level 2	5-8	Two convincing effects with no evaluative point; or one or two less-convincing effects with some evaluation
Level 1	1-4	Identification of relevant effects with or without brief evaluative keywords

Question Number	Indicative content	Mark
(b) (i)	KAA 4 marks (maximum of 2 marks for KAA if no reference to data) Data reference: output was lower than initially estimated **OR** that the growth estimate was revised from -0.2% to -0.3% **OR** other relevant data use **(2)** **Up to 2 marks**: • to reflect new or improved data (e.g. final official data rather than estimated data) (2) • to reflect greater accuracy (e.g. better estimates of unreported activity) (2) • to give a more accurate reflection of the underlying state of the economy for policy purposes (2)	(4)

Question Number	Indicative content	Mark
(b) (ii)	KAA 8 **2 x 4 marks for each consequence** - 2 marks for identifying consequence and 2 marks for linking to falling inflation • If nominal wages rise faster/gap between wage increase and inflation less large **(2)** then real incomes rise / real incomes not falling as fast **(2)** which may raise consumption **(2)** • Greater UK competitiveness **(2)** and rising exports **(2)** • Danger of falling into deflation if inflation rate goes below zero **(2)** and hence consumption delayed **(2)** • Further monetary policy stimulus **(2)** such as interest rate cuts OR QE **(2)** • Improved confidence that the UK can manage the economy at a low inflation level **(2)** leading to increased investment / consumption **(2)** • Effect on unemployment **(2)** supported by Phillip's curve analysis **(2)** OR increased (derived) demand for labour if consumption rises **(2)** • Effect on income distribution **(2)** as real value of savings and borrowings eroded at a slower rate **(2)**	(8)

Question Number	Indicative content	Mark
*(b) (iii) QWC i-iii	KAA 8 **Up to 4 marks:** • Use of data: low interest rates at 0.5% /greater QE **(2)** • Definition of monetary policy **(2)** • Explanation of increase (or at least reduction in fall) in components of AD and therefore increase UK output/reduce unemployment through: o consumption transmission mechanism with explanation **(2)** o Investment transmission mechanism with explanation **(2)** o Net trade transmission mechanism **(2)** **Up to 4 marks:** Diagram demonstrating rightward shift of AD and/or AS **(4)**; correct shifts in lines (1), lines labelled (1), axes labelled (1), equilibria labelled (1) **Note** diagrams where a single line shift is shown and it is incorrect receive no marks, even if curves and axes are labelled correctly. If one line shift is correct and the other shift is wrong then award 2 marks assuming the rest of the diagram is labelled correctly. Evaluation 4 marks **(1 x 4 or 2 x 2):** • Despite low Bank rate and a demand for loans, banks are unwilling to lend, or do not pass on low Bank rate • Evidence from the Extract suggests that loose monetary policy is not effective in supporting economic recovery, e.g. unemployment is rising • Because of the global or European recession businesses lack confidence to invest and consumers lack confidence to spend thus limiting economic recovery. • Those on fixed rate loans/mortgages are not affected by low interest rate • Low return on savings, so less consumption by those with savings • Reduced effectiveness of monetary policy as interest rate has been low for so long • Long run and short run impact • Other effects such as weakening pound helping exports • Other determinants of AD or AS produce counterbalancing effects **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	(12)

Level	Mark	Descriptor
Level 3	9-12	One or two convincing reasons with AS/AD diagram, with at least one evaluative point
Level 2	5-8	One or two convincing reasons with evaluation but no/incorrect diagram, or one convincing reason with diagram but no evaluative point; Less-convincing

		reason or diagram with some evaluation
Level 1	1-4	Identification of relevant reason with or without brief evaluative keywords

Question Number	Indicative content	Mark
(c) QWC i-iii	KAA 18 **Up to 6 marks (3 x 2marks)**: • Definition of macroeconomic objectives (the aims/targets of the government to improve economic welfare) • Definition of a fiscal (budget) deficit • Identification of cutting government spending • Identification of raising taxation • Use of relevant data • AS/AD diagram showing impact of falling government spending and/or rising taxation **12 marks (3 x 4 marks or 2 x 6 marks) - Identification of macroeconomic objective (2) and explanation of effect on objective (up to 4 marks)** Factors might include: • Reduce unemployment / achieve full employment (2) - AD would be reduced leading to lower demand for labour and increased unemployment (2) • Low, stable inflation (2) - AD would be reduced leading to reduced price level or deflationary demand-pull pressure (2) • Sustainable economic growth (2)- AD would be reduced leading to lower real output (2) • Equilibrium on balance of payments on current account (2) - falling real incomes leads to lower demand for imported goods and services which would reduce the deficit on the current account of the balance of payments (2) • More equal income distribution (2) - cuts in government spending likely to affect lower income earners more, but rising tax rates could have a regressive or progressive effect (2) • Achievement of environmental goals - likely to be positive as real output / production levels fall • Reduction of national debt or balancing the budget - objective achieved Reward use of diagrams (maximum of 2 marks each if develop analysis) Evaluation **12 marks (2 x 6 marks or 3 x 4 marks)**: • Despite fiscal retrenchment unemployment is falling and employment is at an historic high, although this could be accounted for by record number of part time workers • Despite fiscal retrenchment inflation remains above target, although	(30)

	this could be accounted for by cost push inflation from a weakening exchange rate or rising raw material prices • The impact on the deficit on current account might be relatively small if imports are relatively income inelastic such as oil / food • Rising tax on firms and falling government spending may reduce international competitiveness, worsening the current account position • Falling real incomes should lead to lower demand for imports which will reduce the leakages from the circular flow of income and the size of AD's fall. • Fiscal retrenchment will reduce the speed of economic recovery so delay reduction of the budget deficit and national debt (Labour argument) • Prioritisation of objectives • Elasticity of AS curve / level of spare capacity • LR / SR effects • Availability of credit • Size of the multiplier • Size and speed of reduction of fiscal deficit • Size of national debt • Time lag and implementation lags • Other things are not equal – e.g. depends on global economic changes • Conflict between policies **Award either as:** • **KAA marks for objectives that this does help the government achieve** • **Evaluation marks for objectives that this doesn't help the government achieve** **OR** • **KAA marks for objectives that this may or may not help the government achieve** • **Evaluation marks for discussing the extent to which this would occur** **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
Level 4	25-30	Two or three convincing effect with at least two evaluative points
Level 3	19-24	Two or three convincing effects with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	Two or three convincing effects with no evaluative point; one or two less-convincing effect with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

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Surname	Other names

Centre Number | Candidate Number

Edexcel GCE

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Monday 28 January 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. 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 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.

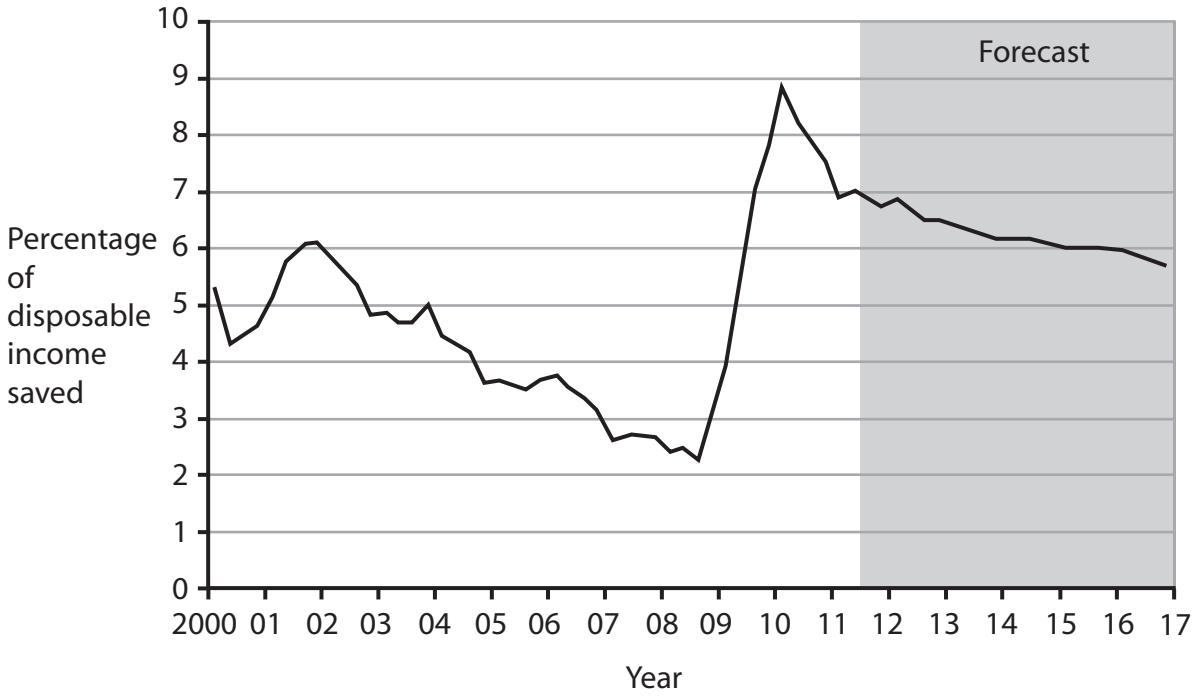
We expect private sector employment to rise by around 1.7 million between the start of 2011 and the start of 2017, but this will be partly offset by a fall of around 710,000 in general government employment. The government still aims to reduce the budget deficit rapidly in order to achieve its fiscal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

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.

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

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



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Figure 2 The UK output gap

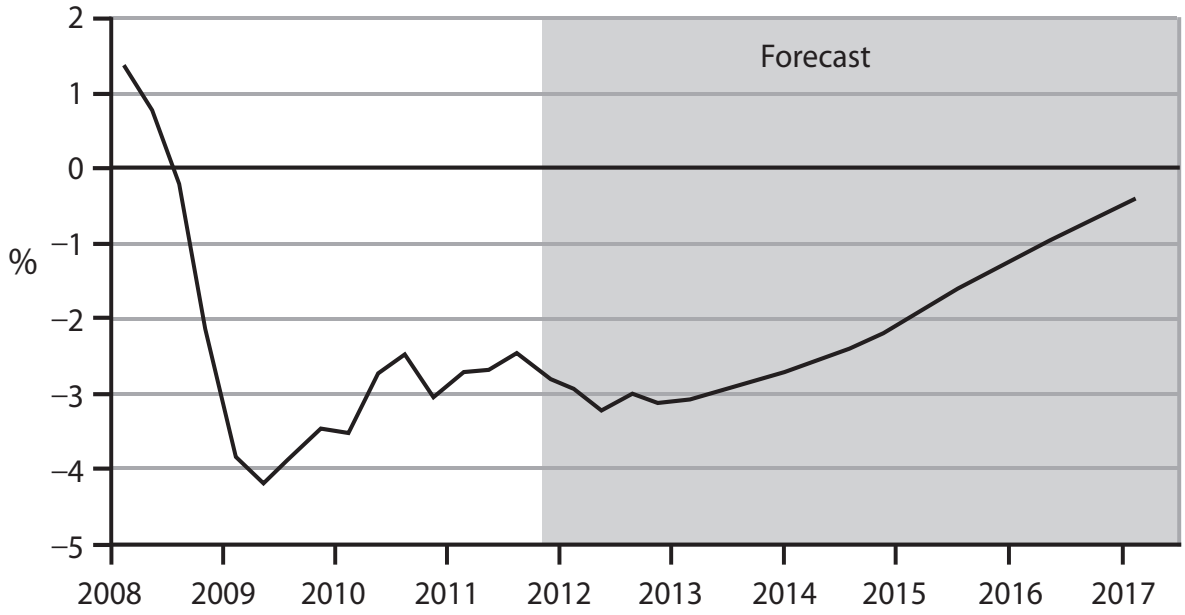
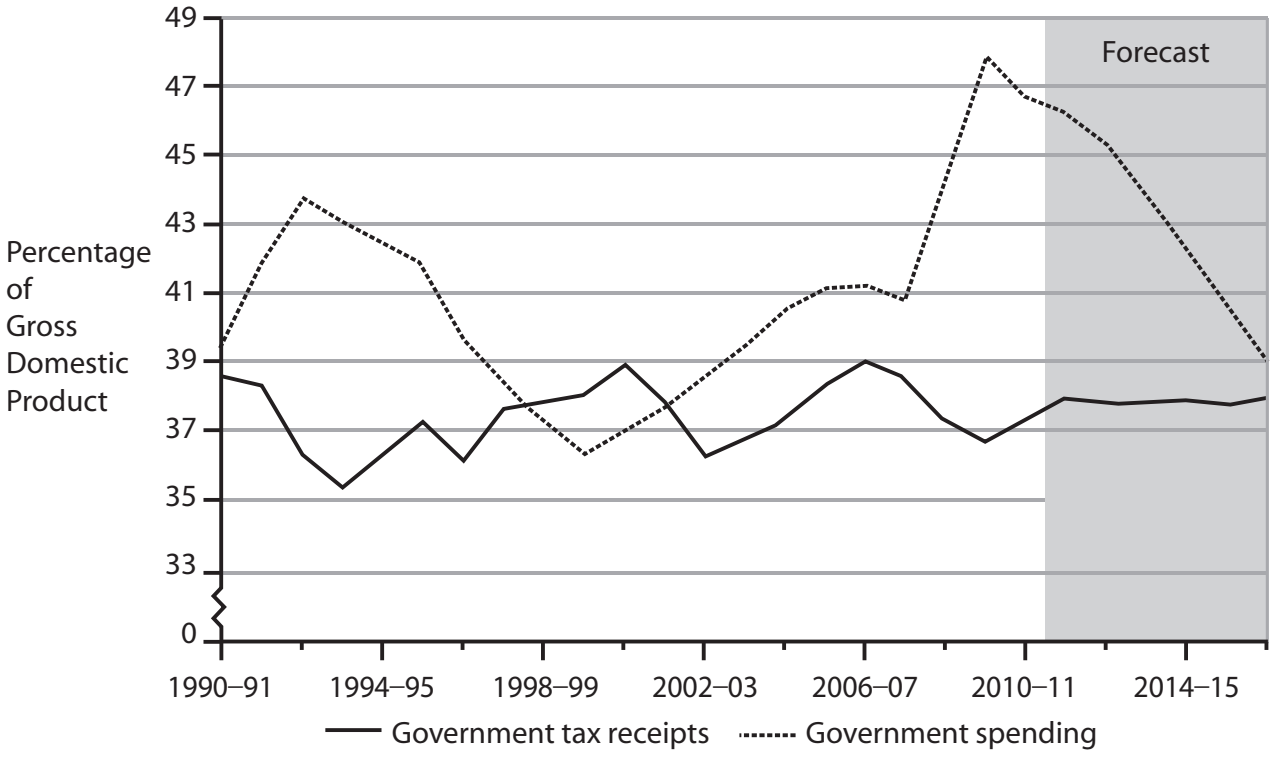


Figure 3 Total UK Government public spending and tax receipts



(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)

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(30)

(Total for Question 1 = 80 marks)

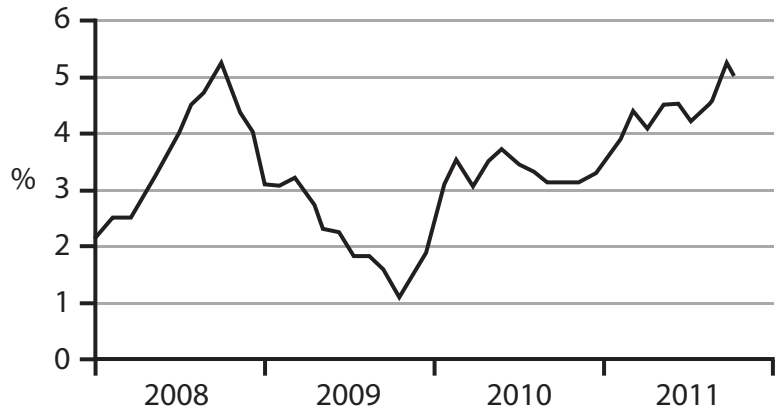
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If you answer Question 2 put a cross in this box ☒

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.

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".

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.

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.

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

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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)

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(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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Mark Scheme (Results)

January 2013

GCE Economics (6EC02/01)

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Summer 2012
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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

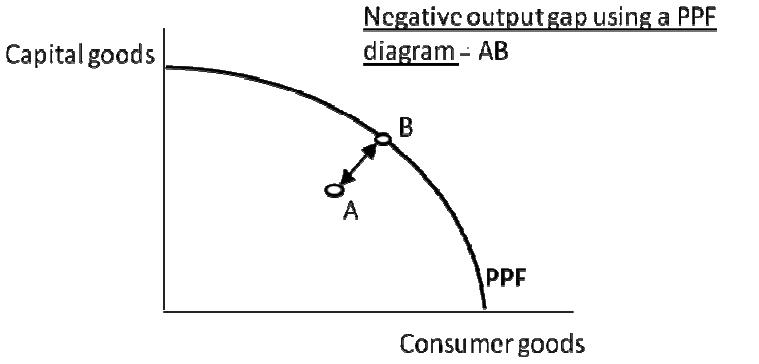
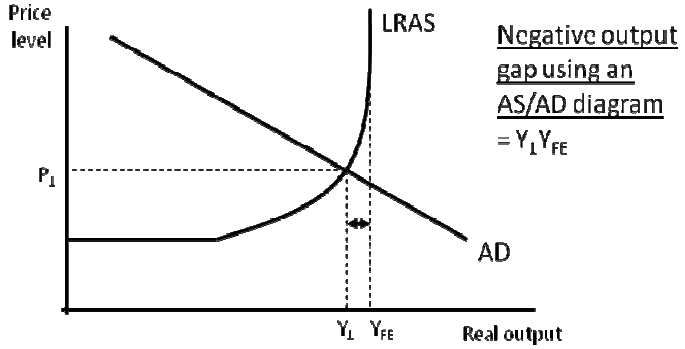
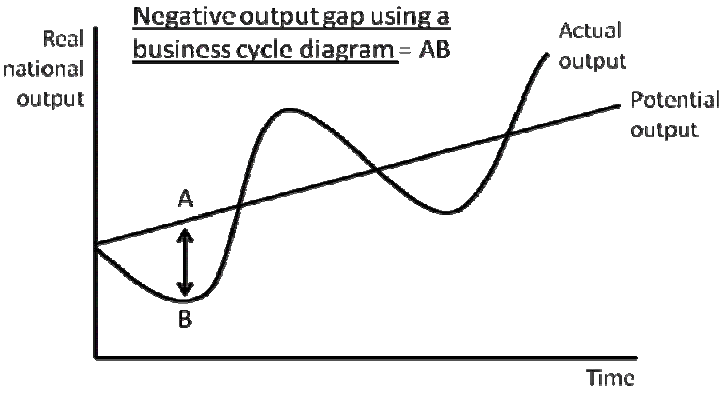
Question Number	Answer	Mark
1(a)(i)	Up to 4 marks: • Consumption (1) • Investment (1) • Government Spending (1) • Exports minus Imports (1) • Award AD = C+I+G+X-M as a maximum of 2 marks unless each component stated in full (i.e. 'consumption') Reference to data (2)	**(6)**

Question Number	Answer	Mark
1(a)(ii)	Award **two** influences only Two factors identified (2 marks each) and linked to investment (2 marks each) Factors may include: • business confidence or start of the recovery/fear of a recession/uncertainty • interest rates • Willingness of banks to lend to business • Government incentives such as a reduction in corporation tax or tax breaks for investment • level of aggregate demand/spare capacity/unemployment/average incomes in the economy • level of consumer confidence • rate of corporation tax • level of pre-tax profits made, or existing debt owed by firms • economic conditions in export markets • exchange rate fluctuations • availability of new technology • the rate of inflation	**(8)**

Question Number	Answer	Mark
1(a)(iii)	KAA - 8 marks (4 marks for diagram, 4 marks for explanation and analysis) Diagram demonstrating effect on AD and/or AS (4); correct shifts in line(s) - shift in AD to the left and/or shift in AS to left (1), lines labelled (1), axes labelled (1), equilibria labelled (1). (**Note**: diagrams where a single shift is incorrect receive no marks. If one shift is correct and the other wrong then award up to 2 marks, assuming the rest of the diagram is labelled correctly) Up to 4 marks: Each effect identified (2) and explained (2) • Change in unemployment • Fall in output • Change in price level or inflation • PPF moves inward • Loss of international competitiveness (2) and worsening of the current account deficit (2) • Fall in productivity **NB: if no AS/AD diagram, award a maximum of 4 KAA marks** Evaluation - 4 marks (1 x 4 or 2 x 2) factors might include: • Long term or short term effects • Relative importance each effect • Size of the multiplier • Other factors are more important - ceteris paribus might not hold • Investment is the smallest component of AD, so effects might not be large • Effects depend on the level of spare capacity/shape of the AS curve/elasticity of AD • Effect on the price level may be cancelled out by decrease in AS as well as AD • Different effects in different industries or parts of the country	**(12)**

Level	Mark	Descriptor
Level 3	9-12	1 convincing effect with a correct AS/AD diagram and at least one evaluative point
Level 2	5-8	1 convincing effect with a correct AS/AD diagram but no evaluative point; 1 or 2 less-convincing effect with an incorrect, incorrect or no AS/AD diagram, with some evaluation
Level 1	1-4	Identification of relevant effect, incorrect, incomplete or no AS/AD diagram, with or without brief evaluative keywords

Question Number	Answer	Mark
1(b)(i)	Up to 6 marks for the following: • Definition of multiplier (2): the number of times a rise in national income exceeds the rise in injections that caused it / it measures the knock-on effects when an injection or withdrawal changes / the idea that one person's expenditure becomes another person's income. • Withdrawals/leakages from the circular flow fall **OR** the marginal propensity to save/withdraw falls (2) • Consumption is likely to rise **OR** the marginal propensity to consume is likely to rise (2) • The size of the multiplier increases (2) Reference to Data (up to 2 marks): 'savings ratio has fallen (1) use of correct figures (1) e.g. it is forecast to fall (1) below 7% from 2011 onwards (1)	**(8)**

Question Number	Answer	Mark
1(b)(ii) *	KAA 8 Up to 2 marks for: Definition **OR** diagram illustrating the output gap: • A measure of the difference between actual and potential (or trend) growth/output/GDP (2) • The potential output is where the economy is at full capacity whereas the actual level of real GDP is at the intersection of AD and AS below that (2) • Appropriate diagram (AS/AD, PPF, or business cycle showing actual and potential growth/output/GDP (2) e.g.   	

	Up to 8 marks for: Two consequences identified (2 marks each) and explained (2 marks each) Award **two** consequences only Accept changes in: • Unemployment • Real GDP • Real incomes/levels of consumption/ standard of living • Confidence • Investment • Government budget balance • International competitiveness • Trade balance **NB** Answers must relate to the post 2009 situation, i.e. be in the context of a negative output gap, although credit answers which discuss the positive consequences of a decrease in the size of the negative output gap. **Do not credit answers which solely state that the size of the negative output gap has/will increased since 2009.** Data reference (2 marks): identification of a negative output gap (1), use of figures showing size of output gap (1), e.g. there was a negative output gap (1) of approx. 3% in late 2010 (1). Evaluation - 4 marks (1 x 4 or 2 x 2) factors might include: • Magnitude of different consequences • Short term and long term consequences • Vicious cycle/spiral • Although the output gap is negative, it has been decreasing in size since mid-2009 • Extract 1 predicts a continuing current account deficit, rather than an improving balance • Forecast may be wrong **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing consequences with at least one evaluative point
Level 2	5-8	2 convincing consequences with no connections, or 1 convincing consequences with some good analysis but no evaluative point; 1 or 2 less-convincing consequences with some evaluation
Level 1	1-4	Identification of relevant consequences with or without brief evaluative keywords

Question Number	Answer	Mark
1(c)(i)	KAA (4 marks) • Budget deficit has increased (2) • Reference to data (up to 2 marks): • Over 3 times as a % of GDP (2) • From approximately -2.5% (36.5% - 39%) to -9% (37.5% - 46.5%) of GDP (2) • government tax receipts as a proportion of GDP rose from (or remained steady at) approximately 36.5% to 37.5% whereas government spending as a proportion of GDP rose even further from 39% - 46.5%. (2) (Candidates must refer to changes in both G and T for these 2 marks) • Descriptive references to changes in the deficit/rates of increase from the data (1) e.g. the deficit peaked in 2009. (1)	**(4)**

Question Number	Answer	Mark
1(c)(ii)*	KAA 18 Up to 6 marks: • Define economic growth (2) • Define budget deficit (2) • Identification of policy or policies to reduce a budget deficit: o Decrease in spending (2) o Increase in taxation (2) o Reduce borrowing (2) • Correctly labelled AD/AS diagram showing an AD (and possible AS) shift to the left as a result of a reduction in the budget deficit. Accept also circular flow of income diagram that demonstrates a reduction in the circular flow of income (2). Identification and explanation of the effects of the policies - 12 marks (3 x 4 marks or 2 x 6 marks): • Rising unemployment • Reduction in real output • Effect of reduced government investment on long term growth/productive potential of	

	economy • Deflationary effect • Improvement in the balance of payments on current account as net exports rise • Environmental impact • Increasing inequality • Falling real incomes / standard of living • Falling real wages in public sector effect on output • Decrease in HDI Reward use of diagrams (maximum of 2 marks each if they develop analysis) Evaluation - 12 marks (2 x 6 marks or 3 x 4 marks): • Reduction in transfer payments may reduce frictional/voluntary unemployment • Time lags – (e.g. length of time for former claimants to find jobs) • Short run and long run macroeconomic effects • Size of the multiplier effect • Shape of the AS curve • Effects depend on to what extent private sector spending/employment can replace public sector spending/employment • Effects depend on what taxes/government spending areas are changed • Critical consideration of the effectiveness of policies • Potential increase in black economy (cash in hand work) **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing effects with at least two evaluative points (an evaluation points is worth up to a maximum of 6 marks
Level 3	19-24	2 or 3 convincing effects with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing effects with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

Question Number	Answer	Mark
2(a)(i)	The general price level rose less quickly / at a decreasing rate (2) Use of data (2) e.g. 'inflation rate fell (1) from approx. 5% in late 2008 to approx. 2% in mid-2009 (1)'	**(4)**

Question Number	Answer	Mark
2(a)(ii)	Award **two** consequences only Two consequences identified (2 marks each) and explained (2 marks each) Consequences may include: • Greater economic confidence among consumers (2) and thus more spending (2) • Unexpectedly higher real wages or unexpectedly less erosion of fixed incomes (2) and thus more spending (2) • Greater economic confidence among firms (2) and thus more investment (2) • Lower nominal interest rates (2) which will encourage borrowing (2) • Conversely, higher real interest rates (2) may encourage saving (2) • Phillips curve (2) would suggest that unemployment would rise (2) • Downward pressure on firms' costs, e.g. lower wage demands, lower input costs (2) increasing price competitiveness (2) • Exports may increase and imports may decrease (2), improving the trade balance (2) **OR** leading to an appreciation in the value of the pound (2) • Longer-term risk of deflation (2) if inflation falls below zero should the UK head into a recession (2)	**(8)**

Question Number	Answer	Mark
2(a)(iii)	KAA 8 marks Up to 4 marks for: • Definition of monetary policy (2) • How the Monetary Policy Committee use interest rates to meet the inflation target (2) Up to 8 marks for: Identify some criterion that might indicate success (2 marks each) and further explanation or reference to data (2 marks each) Award **two** criteria only • Looking at Figure 1, out of tolerance but not out of control • Inflation expected to be back around target by the end of 2012 • Recent inflation has been caused by cost push inflation outside the Bank of England's control • Lack of business/consumer confidence has reduced the effectiveness of monetary policy outside of the Bank of England's control • Has been successful in helping the economy to recover from recession • Looking at Figure 1 no deflation in 2009 / vicious cycle of deflation seems to have been avoided in 2009 / inflation has not fallen below the 1% floor Named target has been clear 2% inflation (tolerance +/- 1% point) • Transparency and openness maintained (open letters to Chancellor from 2007) • MPC remains operationally independent with control of interest rates and free of political interference • Reduced inflationary expectations which is self-fulfilling to some extent • Maintained financial stability in the banking sector • Reward discussion of more recent problems **Candidates may consider arguments for and against UK monetary policy being effective. The development of one point of view constitutes KAA and the alternative view is considered as evaluation.** Evaluation - (1 x 4 marks or 2 x 2 marks). Factors might include: • Looking at Figure 1 generally out of tolerance • Inflation rate as measured by RPI was even more volatile • Very little control over cost push inflation • Interest rates and QE are only part of the solution	

	• Financial stability to some extent has taken priority, and uncertainty of effect of Quantitative Easing • Other factors such as weak unions have prevented the wage price spiral, not the operation of monetary policy • Opportunity cost of pursuing interest rate/QE policy • Time lags	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing criteria with at least one evaluative point
Level 2	5-8	2 convincing criteria with no further analysis or explanation, or 1 convincing criterion with some good analysis but no evaluative point; 1 or 2 less-convincing criterion with some evaluation
Level 1	1-4	Identification of relevant criterion with or without brief evaluative keywords

<table>
<tr><th>Question Number</th><th>Answer</th><th>Mark</th></tr>
<tr><td>2(b)(i)</td><td>Up to 2 marks for each component
• Health (1) life expectancy at birth (1)
• Education (1) expected years of schooling of a child of school-going age OR mean years of schooling of 25 year olds (1)
• Living standards/income (1) Gross National Income per capita PPP US dollars. (Accept Gross National Income per capita) (1)

<table>
<tr><th>Dimension</th><th>Pre-2010 indicator</th><th>2010 onwards indicator</th></tr>
<tr><td>Health</td><td>Life expectancy at birth</td><td>Life expectancy at birth</td></tr>
<tr><td>Education</td><td>Adult literacy rate and school enrolment rates (for primary through university years)</td><td>Mean of years of schooling for adults aged 25 years and expected years of schooling for children of school entering age</td></tr>
<tr><td>Living standards / income</td><td>GDP per capita (PPP$)</td><td>GNI per capita (PPP$)</td></tr>
</table>
</td><td>(6)</td></tr>
</table>

Question Number	Answer	Mark
2(b)(ii)	KAA 8 Award **two** difficulties only Two difficulties identified (2 marks each) and explained (2 marks each) Difficulties may include: • Which index to use, e.g. GDP per capita, HDI etc. • Inaccuracies/problems in information gathering / use of population samples/estimates etc. • Differences in rankings between the two indices given in Figure 2 (e.g. Spain and UK) • Problems of accuracy of measuring output due to shadow or underground economy • The value of non-marketed output including work done in the home • Inequality in the distribution of income and wealth • Regional variation in income, health and education • Leisure and working hours • Variation between current and future standards of living caused by imbalances between consumption and investment • Improvements in life expectancy/education aren't accounted for in some measures (such as GDP per capita) • Innovation and the development of new products • Environmental considerations • Defence expenditure • Limitations of the purchasing power parity adjustment • Local indirect taxes and tariffs cause differences in the cost of living Reference to data (2) **NB Do not award references to differences in population size or costs of living.**	**(8)**

Question Number	Answer	Mark
2(b)(iii) *	KAA - 8 marks (4 marks for diagram, 4 marks for explanation and analysis) Diagram demonstrating rightward shift of AD and/or AS (4); correct shifts in lines (1), lines labelled (1), axes labelled (1), equilibria labelled (1). (**Note:** diagrams where a single shift is incorrect receive no marks. If one shift is correct and the other wrong then award 2 marks assuming the rest of the diagram is labelled correctly) Up to 4 marks: Each effect identified (2) and explained (2) • Price level should fall or remain the same if shifts cancel each other out, or rise if AD shifts only/more • Real output should rise • Increase in productivity • Increase in competitiveness of UK goods and services, leading to an improvement in the Balance of Payments on current account • Reduction in unemployment / increased occupational mobility of labour • Effects on the government budget position • Improvement in the UK's HDI **NB: if no AS/AD diagram, award a maximum of 4 KAA marks** Evaluation - 4 marks (1 x 4 or 2 x 2) • Spending might not affect quality of output – e.g. managerial expenses may absorb expenditure • Effects depend on the type/level of education improved • Time lag • The effects depends on the shape of the AS curve • Reduction in government spending elsewhere (opportunity cost) • Increase in taxation elsewhere may have an effect on incentives • Other determinants of AD such as exchange rates changing - ceteris paribus may not hold • Long run and short run effects • May have no effect on price level if shift in AD cancels out the effect on AS **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately	**(12)**

	• To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
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Level 1	1-4	Identification of relevant effect, incorrect, incomplete or no AS/AD diagram, with or without brief evaluative keywords

Question Number	Answer	Mark
2(c)*	KAA 18 Up to 6 marks • 2 marks for defining living standards (may be implicit): o raising real or potential GDP o increase in (average) real income o non-GDP economic and social indicators, i.e. the quality of life or reduction in income inequality o Other methods of measurement or comparison • Identification of a type of policy the government can implement to raise living standards: o Fiscal policy (2) o Monetary policy (2) o Supply side policy (2) • 2 marks for use of a correctly labelled diagram to demonstrate an increase in output (such as an outward shift of AD or AS or a movement towards the existing or outwardly moving PPF) Identification and explanation of the effects of specific policies - 12 marks (3 x 4 marks or 2 x 6 marks): • Increased government spending (may count as up to 3 separate policies) • Cutting tax • Monetary policy, e.g. cutting interest rates • Improved trade, e.g. export-led growth • Supply side policies (may count as up to 3 separate policies) • Redistributive policies to increase living standards in short run and possibly long run • Improve the quality of the living standards	

	Reward use of diagrams (maximum of 2 marks each if they develop analysis) Evaluation - 12 marks (2 x 6 marks or 3 x 4 marks) factors might include: • Different approaches in developed and developing countries • Comparison of Spain and UK, i.e. UK has a higher per capita income but lower HDI • Depends on elasticity of AS when AD shifts • Supply side policies are ineffective when AD is very low • Opportunity cost of government spending • Many economies are currently not in a position to finance expansionary fiscal or supply side policies • Time lag and implementation lags • Other things are not equal – e.g. depends on global economic changes • Magnitude of multiplier effect • Other negative side effects of policies, e.g. some policies may increase GDP but reduce living standards in terms of inequality/environment. **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing policies with at least two evaluative points (an evaluation points is worth up to a maximum of 6 marks
Level 3	19-24	2 or 3 convincing policies with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing policies with no evaluative point; 1 or 2 less-convincing policies with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

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Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Friday 25 May 2012 – Morning
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 Real Income and Unemployment

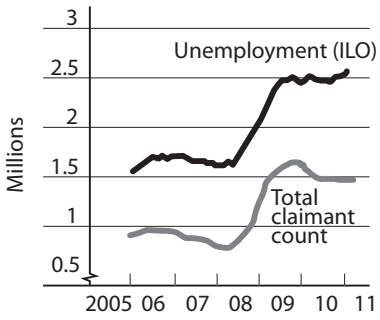
Extract 1 UK households' real disposable incomes

New GDP figures show real household disposable incomes falling by 0.8% in 2010. This is the first time the measure has fallen since 1981.

Nominal wage growth edged up with average earnings rising 2.3% in the year to January 2011. This annual growth rate for workers' pay was mainly driven by bonus payments in the finance and business services sector. Meanwhile, CPI inflation was 4.0% in January 2011.

(Source: Adapted from an article by Brian Groom from the Financial Times on 16 March 2011
© The Financial Times Limited 2011)

Figure 1 UK unemployment at 17-year high, millions



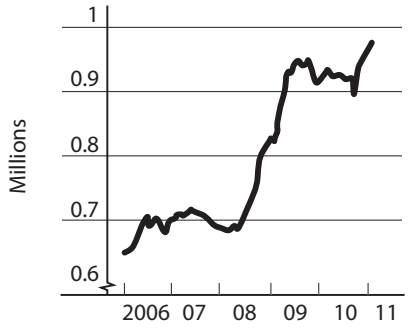
(Source for Figure 1: Adapted from the Financial Times on 16 March 2011
© The Financial Times Limited 2011)

Extract 2 Unemployment measurements diverge

The unemployment rate, as measured by the International Labour Organisation (ILO), for the three months to January 2011 was 8.0% of the economically active population. The total number of unemployed people, using the ILO measure, increased by 0.1% (27,000) over the three months to January 2011 to reach 2.53 million, the highest figure since 1994. The number of people claiming Jobseeker's Allowance (the claimant count) fell by 10,200 between January and February 2011 to reach 1.45 million.

(Source for Extract 2: Adapted from the Office of National Statistics 16 March 2011
© Crown Copyright)

Figure 2 ILO survey of youth (aged 16-24) unemployment, millions



(Source: Adapted from the Financial Times on 16 March 2011
© The Financial Times Limited 2011)

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Extract 3 Youth unemployment

The ILO unemployment level for those aged from 16 to 24 reached 974,000 in the three months to January 2011, the highest figure in percentage and absolute terms since comparable records began in 1992. Chris Grayling, the employment minister, has questioned the accuracy of the ILO figure and the survey method used.

Grayling claimed that youth unemployment had fallen if young people in education were excluded from the figures. The ILO survey should make sure that full time students who cannot find a part-time job while they study are not included in this measure of unemployment.

(Source: Adapted from © Guardian News & Media Ltd 2011, April 13 2011)

(a) (i) With reference to Extract 1, explain the difference between real and nominal incomes.

(4)

(ii) With reference to the extracts and your own knowledge, explain **two** possible causes of falling real disposable income in the UK during 2010.

(8)

(iii) Assess the likely impact of falling real incomes on the price level and equilibrium output. Illustrate your answer with an aggregate demand and aggregate supply diagram.

(12)

(b) (i) With reference to Figure 1 and Extracts 2 and 3, distinguish between the claimant count and the ILO measures of unemployment.

(6)

(ii) With reference to Figure 1 and Extracts 2 and 3, outline **two** possible reasons why the trends in the claimant count rate and the ILO measure of unemployment differ after 2009.

(8)

*(iii) With reference to the information and your own knowledge, examine **two** factors which might explain the rise in UK unemployment since 2008.

(12)

***(c)** Evaluate macroeconomic policies which may be used to reduce the level of unemployment in the UK.

(30)

(a) (i) With reference to Extract 1, explain the difference between real and nominal incomes.

(4)

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(30)

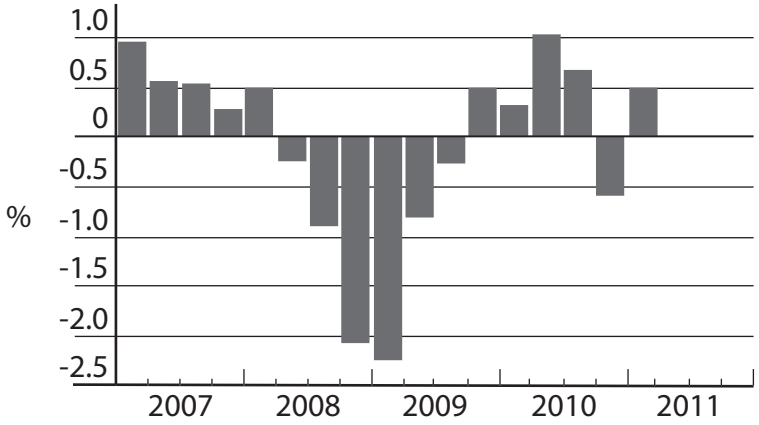
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(Total for Question 1 = 80 marks)

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

Question 2 UK Growth and the Balance of Payments

Figure 1 UK Real GDP growth, quarter on quarter



Source: ONS, Thomson Reuters

(Source: Adapted from the Financial Times © The Financial Times 2011)

Figure 2 UK Balance of Payments Current Account 2009-10 (£ billions)

	2009	**2010**
Trade in goods	-82.4	-97.8
Trade in services	52.7	49.3
Subtotal: Trade in goods and services	**-29.7**	**-48.5**
Income (interest, profits and dividends)	20.6	31.8
Current transfers	-4.9	-19.7
Total: Current account balance	**-14.0**	**-36.4**
Current account balance as % of GDP	**-1.7%**	**-2.5%**

(Source: Adapted from the Office of National Statistics © Crown Copyright)

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Extract 1 For many the real recession starts now

The economy is still showing only very limited signs of the hoped-for rebalancing of aggregate demand away from debt financed consumption and government spending to investment and exports.

The government's deflationary fiscal policy will start to reduce its budget deficit. The Office for Budget Responsibility forecasts that in order to maintain their living standards, households will have to reduce their savings and increase their borrowing further. Household debt is forecast to grow from 160% of disposable income to a record 175%, or £2.1trillion, by 2015.

Exports are growing, but not as strongly as those of some other European countries. What is more, the 20% plus depreciation in the pound since 2008 seems to be having virtually no impact on imports. This has contributed to the UK's largest ever recorded trade in goods deficit in 2010. As the Bank of England's Monetary Policy Committee (MPC) said in minutes to its last meeting, it's possible "that domestic substitutes for some imported goods and services are not available".

Britain's manufacturing base is so depleted that the economy may no longer be capable of responding to gains in competitiveness. The recent decisions of the MPC to maintain a record low 0.5% base interest rate have not yet led to the hoped-for increase in business investment. Some economists now predict an early rise in this base rate to act against inflation being above the target rate.

(Source: Adapted from © Copyright Telegraph Media Group Limited 2011, 25th April 2011)

(a) (i) Using the data in Figure 1, explain what is meant by a recession.

(6)

(ii) With reference to Figure 1, explain why economists might consider that a negative output gap existed in 2008-9. Use an appropriate diagram in your answer.

(8)

(iii) With reference to Extract 1, assess **two** factors likely to affect the level of aggregate demand in the UK.

(12)

(b) (i) With reference to Figure 2, explain why the UK current account balance in 2010 was a net withdrawal from the UK's circular flow of income.

(4)

(ii) Explain **two** possible problems for the UK economy of its persistent and increasing current account deficit.

(8)

*(iii) Examine **two** possible causes of the "largest ever recorded trade in goods deficit in 2010" (Extract 1, lines 11–12).

(12)

*(c) Evaluate the benefits of economic growth for the UK.

(30)

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(6)

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(12)

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*(c) Evaluate the benefits of economic growth for the UK.

(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

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Mark Scheme (Results)

Summer 2012

GCE Economics (6EC02)
Paper 01

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

Question Number	Indicative Content	Mark
1(a)(i)	KAA 4 marks Explanation 2 marks. Real income is the value after the effects of inflation have been removed. Accept also reference to the real income's internal purchasing power being identified but not with nominal incomes. Use of data 2 marks • Real household disposable income falling by 0.8% in 2010 • Nominal wage growth edged up with average earnings rising 2.3 % whereas CPI inflation was 4.0% in the year to January 2011	**(4)**

Question Number	Indicative Content	Mark
1(a)(ii)	KAA 8 marks 2 causes up to 4 marks each (2 x 2 marks) 2 marks for the identification and 2 marks for the explanation of each cause. • Weak aggregate demand maintaining unemployment • Cuts to public sector employment • Decline in manufacturing sector employment • Rising unemployment, highest in North-East of England • Lower productivity increases in UK than in other countries • Falling value of the £ • Inflation • Low union power - unable to keep pace with inflation • Increase in income tax • Reduction in welfare benefits Reward other valid explanations Also reward use of data to support explanation up to 2 marks: • Real household disposable income falling by 0.8% in 2010 • Nominal wage growth edged up with average earnings rising 2.3% whereas CPI inflation was 4.0% in the year to January 2011	**(8)**

Question Number	Indicative Content	Mark
1(a)(iii)	KAA 8 marks Explanations of likely impact up to 4 marks include: • Falling real incomes lead to falling consumption (2) • With lower consumption firms will reduce investment (2) • Written description of fall in price level (1) and in real output (1) Diagram up to 4 marks; AD/AS diagram showing leftward shift in AD curve; axes labelled (1), equilibria labelled (1), AD/AS lines labelled (1), correct shift (1). No marks for diagram if shift in wrong direction. Evaluation 4 marks (1 x 4 or 2 x 2) factors might include • The relative impact of other factors • Elasticity of AD and AS • Timing – Short Run- Long Run • Regional/sectoral/occupational differences • Inequality or equity issues • Magnitude of the fall	**(12)**

Question Number	Indicative Content	Mark
1(b)(i)	KAA 6 marks Use of data up to 2 marks for any one of the following: • Figure 1 ILO typically 1 million higher than Claimant Count 05-11 • Extract 2 ILO approximately 1 million higher than Claimant Count Jan 2011 • Extract 3 Grayling's view that full time students who cannot find a part time job while they study should not be included in the ILO. **N.B. Must use actual figures to gain data marks. Award only 1 mark if it is stated that ILO is typically higher than CC.** Differences up to 4 marks (2 x 2 marks) Unemployment (ILO) up to 2 marks: • Actively looking for a job and out of work in last four weeks (1) • ready to work in two (1) • Questionnaire/interview (1) • Survey by phone call/paper (1) • Internationally recognised (1) • age 16-65 (1) • Sample, and related problems (1) Claimant count up to 2 marks: • the number of people claiming/receiving (1) • JSA/dole/or unemployment related benefit (1) • Age range – 18-60/65 (1) • savings cap (1)	**(6)**

	• must be able to prove they are looking for work (1). • Register at unemployment offices (1) • Does not include those unemployed for more than 6 months (1) • Excludes those who have voluntarily left employment (1) Reward other valid explanations	

Question Number	Indicative Content	Mark
1(b)(ii)	KAA 8 marks 2 reasons up to 4 marks each (2 x 2 marks) 2 marks for the identification and 2 marks for the explanation of each reason. Reasons may include: • Rise in youth unemployment (including 16 and 17 year olds) • It has become increasingly difficult to claim JSA • Stigma of collecting the JSA means that the unemployed will only collect it if they really can't find a job, whereas those who can manage without JSA • Decrease in the value of JSA relative to wage changes In the LFS: • The underemployed might declare themselves unemployed on the LFS • Recession makes it more difficult for students to find part time work and so more likely to claim to be unemployed on LFS • Rise in students seeking employment following increase in tuition fees Also: award 2 marks for recognition of divergence between ILO and CC after 2009. Reward other valid explanations	**(8)**

Question Number	Indicative Content	Mark
1(b)(iii) ***QWC i-iii**	KAA 8 marks 2 factors up to 4 marks each (2 x 2 marks) 2 marks for the identification and 2 marks for the explanation of each factor. • Fall in UK domestic demand in the recession causing more unemployment generally • Decline in real incomes • Global recession resulting in falling exports • UK reliance on service sector which has a low propensity to export • Loss of UK competitiveness e.g. linked to a higher rate of inflation • The minimum wage being too high • Net immigration rates	

	• Exchange rate changes • Structural unemployment • Reduction in availability of credit • Tightening of fiscal policy Reward other valid explanations Also award up to 2 marks for use of data Evaluation 4 marks (1 x 4 or 2 x 2) factors might include • The relative impact of the factors • Timing of the factors and their expected persistence • Regional/sectoral/occupational differences • Inequality or equity issues **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing points with at least one evaluative point
Level 2	5-8	2 convincing explanations with no connections, or 1 convincing explanation with some good analysis but no evaluative point; 1 or 2 less-convincing explanation with some evaluation
Level 1	1-4	Identification of relevant points with or without brief evaluative keywords

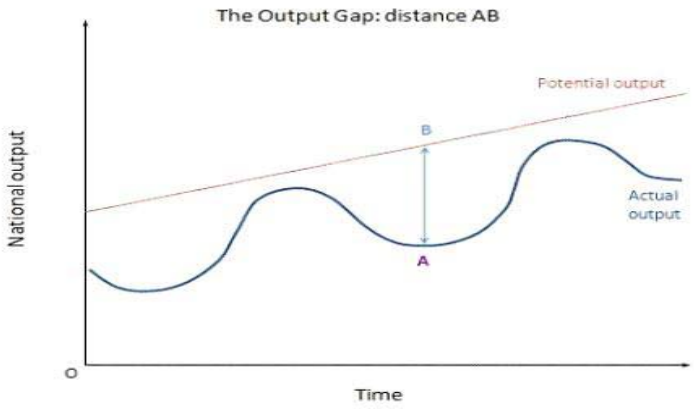
Question Number	Indicative Content	Mark
1(c) ***QWC** **i-iii**	KAA 18 Up to 6 marks • Identification of low and stable unemployment/full employment as a government objective (2) • Identification of any macroeconomic policy as fiscal, monetary and/or supply side (reward implicit understanding) (2) • Use of data indicating extent of unemployment (2) • AD/AS diagram showing rightward shift in AD and/or AS curve or equivalent verbal analysis of how price level and real output are affected or PPF diagram showing rightward shift in PPF and/or a movement towards PPF (4 marks). Diagram showing AD and/or AS shifts to the right; axes labelled (1), equilibria labelled (1), AD/AS lines labelled (1), correct shift (1). No marks for diagram if shift in wrong direction. Explanation of how the policies might reduce the level of unemployment	

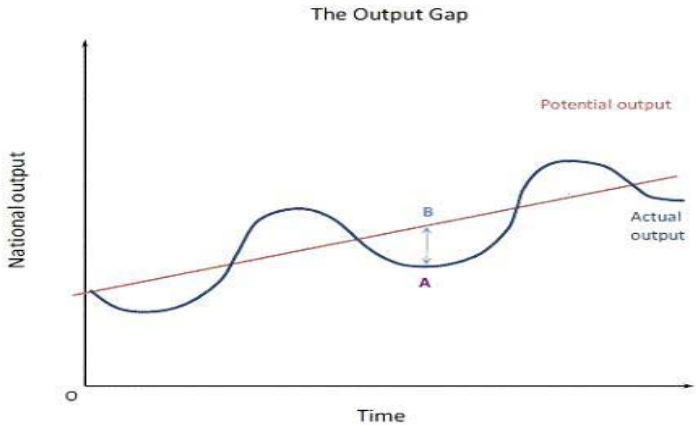
	in the UK 12 marks (3 x 4 marks); • Fiscal expansion through government spending increasing employment • Reduction in taxation rates through borrowing or policy financed through lowering immediate tax burden increasing AD • Reduction in interest rates (or increase in money supply) increasing borrowing and reducing debt payments • Measures to increase incentives such as reduced marginal tax rates; • Reduction in benefits. • Measures to increase competitiveness and productivity through outsourcing and tenders; • Privatisation; • Health care improvements; • Training and education. • Increase price flexibility and signalling in the market (ie reducing the minimum wage) Reward other valid explanations Evaluation 12 marks (3 x 4 marks, OR 2 x 6 marks, OR 6 + 4 + 2 marks) Comments might include reference to • Tax cuts ineffective if used to increase savings or repay debts • Cuts in Bank of England's interest rate ineffective if banks unwilling to lend or if banks do not reduce interest rates to customers • Identification of common elements of both policies e.g. cutting taxes as a demand management policy as well as improvement to incentives • Crowding out • Long term debt payments to repay will reduce future living standards • Time lag for supply side policies • Depends on the elasticity of the AS • Depends on magnitude of multiplier (i.e. increased savings ratio because of lack of confidence leading to lower multiplier) • Relative merits of policies which justifies prioritisation • Other things being equal **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

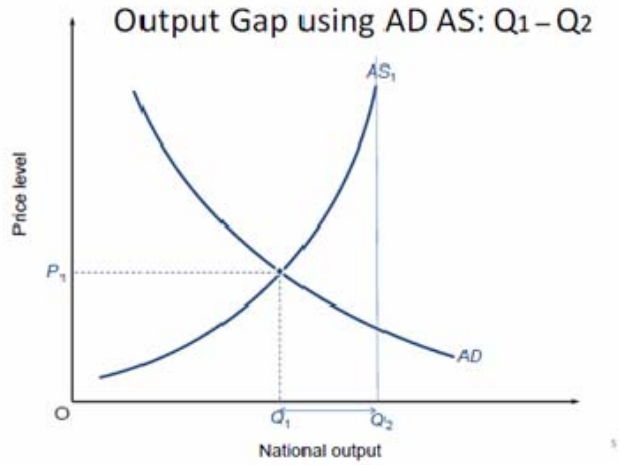
Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing policies with at least two evaluative points
Level 3	19-24	2 or 3 convincing policies with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing policies with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

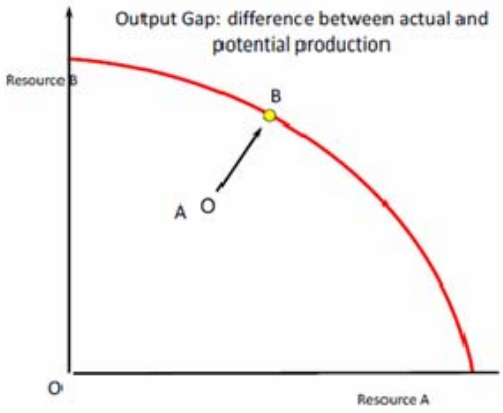
Question Number	Indicative Content	Mark
2(a)(i)	KAA 6 marks Definition up to 4 marks A recession is two consecutive quarters or 6 months (2) of negative growth or reduction in output (2) Use of data up to 2 marks e.g.: Q2 2008 to Q3 2009 six quarters of negative growth	**(6)**

Question Number	Indicative Content	Mark
2(a)(ii)	KAA 8: 2 marks for diagram; 2 marks for data; 4 for explanation Explanation of reasons for a negative output gap up to a maximum of 4 marks • The actual/current output (or GDP) is lower (2) than the UK's potential/trend output. (2) • Reward also the level of expenditure is lower (2) than the capacity of the economy to produce. (2) • It is characterised by a significant amount of unemployment (2) and idle capital (2) • N.B. Award 2 marks for a general definition of output gap: e.g. difference between actual output and potential output. Use of data up to 2 marks: real actual output fell significantly or fell for most of the period during 2008-9 (2) 2marks for correctly labelled diagram:	


The Output Gap: distance AB
Potential output
B
Actual output
A
National output
O
Time


The Output Gap
Potential output
B
Actual output
A
National output
O
Time


Output Gap using AD AS: Q1 – Q2
AS1
Price level
P1
AD
O
Q1
Q2
National output


Output Gap: difference between actual and potential production
Resource B
B
A
O
O
Resource A

(8)

Question Number	Indicative Content	Mark
2(a)(iii)	KAA 8 marks 2 factors related to Extract 1 up to 4 marks each (2 x 2 marks) 2 marks for the identification and 2 marks for the explanation of each factor – linked to effect on AD. • Fall in consumer confidence (2) from economic uncertainty of government fiscal tightening and fear of a double dip recession (2) • Recession (2) leading to rising unemployment/reducing consumption/fall in value of exports (2) • Fall in investment (2) from economic uncertainty of government fiscal tightening and fear of a double dip recession (2) • Cuts to Government sector spending (2) will lead to a fall in AD (2) and a further reduction through the multiplier effect resulting in further job cuts and AD falling further (2) • Increase in tax e.g. increase in VAT; increase in income tax (50% tax rate) • Depreciation in value of the pound (2); impact on exports & imports (2) • Rise in value of imports (2) from price rises of necessities with inelastic demand such as oil and food (2) • Increase in costs servicing household debt Evaluation 4 marks (1 x 4 or 2 x 2) factors might include • Extent of change depends on magnitude of multiplier (increased savings ratio because of lack of confidence) • Relative impact of each factor • Relative importance of each component (Consumption 65% approx) • Time lag (e.g. unemployment is a lagging indicator) • Effect of other factors counterbalancing or exacerbating the effect	**(12)**

Level	Mark	Descriptor
Level 3	9-12	1 convincing factor and diagram with at least one evaluative point
Level 2	5-8	2 convincing factor with no connections, or 1 convincing factor with some good analysis and diagram but no evaluative point; 1 or 2 less-convincing factor with some evaluation
Level 1	1-4	Identification of relevant factor with or without brief evaluative keywords

Question Number	Indicative Content	Mark
2(b)(i)	KAA 4 marks Explanation up to 2 marks that the value of imports (withdrawal) is greater than the value of exports (injection). Accept reference to outflows of money being greater than inflows. Use of data up to 2 marks e.g. current account balance £-36.4 billion or current account balance -2.5% of GDP for 2010 (2 marks)	**(4)**

Question Number	Indicative Content	Mark
2(b)(ii)	KAA 8 marks 2 problems up to 4 marks each (2 x 2 marks) 2 marks for the identification and 2 marks for the explanation of each problem. A persistent and increasing net leakage result in • Loss of output (growth) • Loss of jobs (unemployment) • Possibly rising household debt to fund purchases • Possibly a lack of investment as firms are concerned about the lack of UK non price competitiveness • Threat of cost push inflation from the increased price of imports (price of imports generated by a weakening currency).	**(8)**

Question Number	Indicative Content	Mark
2(b)(iii) ***QWC** **i-iii**	KAA 8 marks 2 causes up to 4 marks each (2 x 2 marks) 2 marks for the identification and 2 marks for the explanation of each cause. • Rises in oil prices and relatively inelastic demand and we are a net importer • World food prices and relatively inelastic demand and we are a net importer • Inflation relatively high reducing international competitiveness • UK manufacturers' non price competitiveness is too low (e.g. quality of UK goods) • Lack of domestic substitutes for some imported goods (line 14) e.g. we don't produce some of the goods we import. • 'Manufacturing base is so depleted' line 15 • Lack of confidence to invest because of the global financial situation • Lack of confidence to invest because of the belief that the exchange rate is temporary. Evaluation (1 x 4 or 2 x 2) • Relative contribution of each cause • Timing of each cause (SR/LR impact) • Government policies to remedy the cause over time • Comparison to other countries with stronger manufacturing base • Relative size of the deficit in comparison to GDP may not be the largest but in absolute terms it is the largest deficit **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	Convincing explanation of two causes with at least one evaluative point
Level 2	5-8	Convincing explanation of two causes with no evaluation, or 1 convincing explanation of a cause or either with some good analysis and 1 evaluative point. Less-convincing explanation of a cause with some evaluation
Level 1	1-4	Identification of relevant explanation with or without brief evaluative keywords

Question Number	Indicative Content	Mark
2(c) ***QWC** **i-iii**	KAA 18 marks Up to 6 marks • Explicit or implicit understanding of economic growth – a measure of the increase in either real GDP or real GDP per head or potential GDP(2) • Use of data(2) • Identification of economic growth as a government objective (2) • AD/AS diagram showing rightward shift in AD and/or AS curve or equivalent verbal analysis of how price level and real output are affected (4 marks). Diagram showing AD and/or AS shifts to the right; axes labelled (1), equilibria labelled (1), AD/AS lines labelled (1), correct shift (1). No marks for diagram if shift in wrong direction. • PPF diagram showing rightward shift in PPF and/or a movement towards PPF (4 marks). Marks awarded for showing axes labelled (1), equilibria labelled (1), PPF lines labelled (1), correct shift/movement (1). No marks for diagram if shift/movement in wrong direction. Explanation of how growth might benefit the economy 12 marks (3 x 4 marks); • Increased tax revenues for the government which may be used to improve public services or redistribute incomes • Higher profits for companies which may be used to improve quality products or to produce new products • Consumers can afford to buy more goods and services and/or have more leisure time • More employment opportunities/lower unemployment • If there is export –led growth, then the current account of the Balance of Payments would improve • Real economic growth increases LRAS and could lower inflation Evaluation 12 marks (3 x 4 marks, OR 2 x 6 marks, OR 6 + 4 + 2 marks); Comments might include reference to • Companies may not invest but distribute profits to shareholders • Consumers might spend extra income on imports	

	• Growth might involve depletion of natural resources • External costs of growth • Greater inequality • Lack of sustainability • Technological unemployment • Short run/Long run effects • Growth could cause a deterioration in the Balance of payments since Britain has a high marginal propensity to import • Growth from supply side improvements may reduce inflation **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
Level 4	25-30	3 convincing benefits with at least 2 evaluative points (an evaluation points is worth up to a maximum of 6 marks)
Level 3	19-24	2 or 3 convincing benefits with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing benefits with no evaluative point; 1 or 2 less-convincing benefits with some evaluation
Level 1	1-6	Identification of relevant points with or without brief evaluative keywords

	Knowledge	Application	Analysis	Evaluation	Total
Question 1					
ai	2	2			4
aii	2	2	4		8
aiii	2	2	4	4	12
bi	4	2			6
bii	2	4	2		8
biii	2	2	4	4	12
c	6	6	6	12	30
Total	20	20	20	20	80
Question 2					
ai	2	2	2		6
aii	2	4	2		8
aiii	2	2	4	4	12
bi	4				4
bii	2	4	2		8
biii	2	2	4	4	12
c	6	6	6	12	30
Total	20	20	20	20	80

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Centre Number | Candidate Number

Edexcel GCE

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Wednesday 18 January 2012 – Morning
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. 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 Productivity, Investment, Trade and Employment

Figure 1 Annual average international labour productivity growth, %

	1995 – 2007	2007 – 2009
United States of America (US)	2.1	2.1
United Kingdom (UK)	2.2	-0.7
European Union (EU)	1.5	-0.5

(Source: http://www.mckinsey.com/mgi/publications/UK_report/pdfs/MGI_UK_growth_and_renewal_full_report.pdf)

Figure 2 UK Gross Investment and GDP Growth (percentage change over previous year), 2001–2009

Year	Gross investment	GDP Growth
2001	2.6	2.5
2002	3.6	2.1
2003	1.1	2.8
2004	5.1	3.0
2005	2.4	2.2
2006	6.4	2.8
2007	7.8	2.7
2008	–5.0	–0.1
2009	–15.0	–4.9

(Source: © Crown Copyright 2010/HMSO)

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Extract 1 Trade risks are main threat to UK Economy, says Bank

According to the Governor of the Bank of England, Mervyn King, the biggest risk to growth in the UK is that if the economies of its trading partners suffer badly, demand for UK exports will slow and will make it difficult for the nation to undertake a rebalancing of its economy. Mr King said "the biggest risk that we face is bad news on the world economy and in particular in the euro area". He noted that more than 60% of UK exports were to the eurozone - including 7% to Ireland alone.

Mr King went on to say that the central issue facing the UK economy is to reduce its dependence on credit-fuelled household consumption and on the public sector, replacing it with demand for exported goods and services and increased investment.

Nearly three years after a 25% drop in the value of sterling, there has been little improvement in Britain's trade balance.

(Source: adapted from the Financial Times © The Financial Times Limited 2010 "Trade risks are main threat to UK, says Bank" By Norma Cohen and Daniel Pimlott November 10 2010 http://www.ft.com/cms/s/0/e6a628a8-ecbf-11df-88eb-00144feab49a.html#)

Extract 2 Latest figures show the majority of claimants being found fit for work

The conditions for people to receive Job Seeker's Allowance have become more and more difficult. Some economists see a link between this and the increase in people claiming long term sickness benefit, or incapacity benefit (IB) over the same period. This increase could well be concealing many long term unemployed.

The Government has therefore started reassessing those on the old style IB for a replacement benefit, the Employment and Support Allowance (ESA) programme. This will be completed in 2011. According to official statistics from a pilot study, three-quarters of people applying for the new ESA were either found to be fit for work or withdrew their benefit claim before they completed a medical assessment.

The Employment Minister, Chris Grayling, commented that with over two million people trapped on incapacity benefits, this pilot study underlined how important it is to make sure that everyone who has the potential to work gets the right help to move off benefits and into a job. He also expressed his view that the medical assessment should be designed fairly and explained that an independent review is being undertaken with a number of charities representing disabled people and those with mental health issues.

The following day the Daily Mail's headline was "75% of incapacity claimants are fit to work" and the paper estimated this reform would slash the £12.5 billion spent on incapacity benefits a year to just over £4 billion.

(Source: © Crown copyright and '75% of incapacity claimants are fit to work', Gerri Peev © Daily Mail 27 October 2010)

(a) (i) With reference to Figure 1, what is meant by 'labour productivity'?

(4)

(ii) Explain **two** possible reasons why UK labour productivity declined during the period 2007-2009 (Figure 1).

(8)

(iii) With reference to the data, evaluate the effects of declining productivity on the UK economy.

(12)

(b) (i) With reference to Extract 1, explain what is likely to be 'the biggest risk to growth in the UK.' (Lines 1 -2)

(6)

(ii) Explain **two** factors that might lead to an increase in investment in the UK.

(8)

*(iii) With reference to Figure 2, discuss the significance of investment for economic growth. Illustrate your answer with an aggregate demand and supply diagram.

(12)

*(c) Assess the likely impact of UK government labour market policies on any **three** macroeconomic objectives. Refer to the information provided and to your own knowledge.

(30)

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(4)

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(8)

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P 4 0 0 9 2 R A 0 8 3 2

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(30)

P 4 0 0 9 2 R A 0 1 4 3 2

(Total for Question 1 = 80 marks)

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

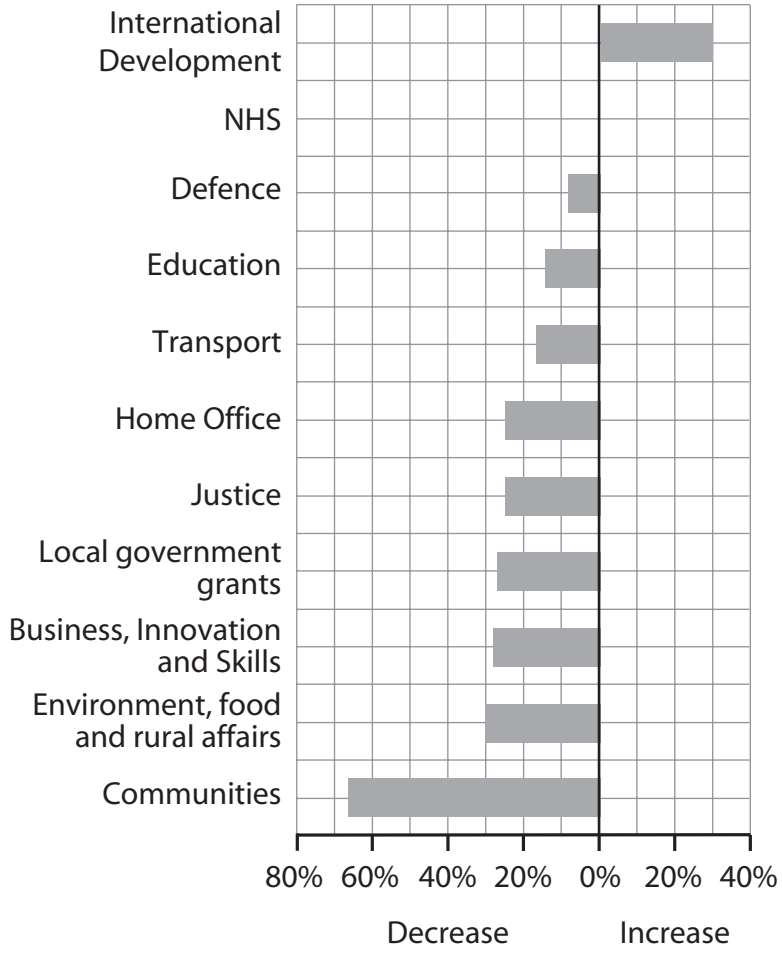
2 Public Sector cuts, unemployment and inflation targets

Extract 1 Cutting back the state

The Chancellor of the Exchequer, George Osborne, insisted that harsh medicine was vital to cut Britain's huge budget deficit, expected to be 10% of GDP in 2010–11. Total cuts in public sector spending of £81 billion are to be made by 2014–15. Nevertheless, total spending is planned to be 6% higher in cash terms in 2014–15 than 2010–11, but in real terms to be 3% lower. Some spending is beyond the Chancellor's control: debt interest is likely to rise from £43 billion this year to £63 billion by 2014–15 as a result of the surge in government borrowing.

As well as efficiency savings, one obvious way to reduce costs is to keep pay down. The government has already announced a two-year pay freeze for public-sector staff. State employers could carry on in this spirit after that, pointing out that the more pay can be kept down, the fewer the job losses. But job losses there will be, amounting to probably about half a million (out of a public sector workforce of about 6 million) by the end of 2014.

Figure 1 Planned real percentage changes in UK public expenditure by government department between the fiscal years 2010–11 and 2014–15



(Source for figure 1 and extract 1: © The Economist Newspaper, Oct 21st 2010)

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Extract 2 The inflation overshoot continues

For the fourth time this year, the Governor of the Bank of England, Mervyn King, has had to write to the Chancellor of the Exchequer explaining why inflation is above 3%. According to the Bank's own forecast published in its Inflation Report on November 10th 2010, Mr King is likely to be writing yet more letters in 2011 to George Osborne at the Treasury.

Figures out today from the Office for National Statistics showed that consumer prices rose by 3.2% in the year to October 2010. The new numbers triggered the letter, which the Governor has to write every three months if inflation remains more than a percentage point above (or below) the 2% target. It marked the ninth since the Bank of England's Monetary Policy Committee was given operational control over monetary policy in 1997. Since the spring of 2007, inflation has been above the 2% target in all but nine of the past 54 months.

Britain is unusual in facing high inflation. Consumer prices in the Euro zone rose by 1.9% in the year to October 2010 and in the USA annual inflation was 1.1% in September 2010.

In his letter to the Chancellor, Mr King struck what has become a familiar note, by drawing a distinction between temporary upward and long term downward pressures on inflation. The inflation overshoot, he said, largely reflected a number of temporary factors, including the restoration of the main rate of VAT from its emergency rate of 15% during the recession to 17.5% in January 2010, past rises in oil prices and the continued effects of higher import prices resulting from the big 25% fall in sterling from mid-2007. These factors were offsetting the downward effects from spare capacity caused by the recession.

However, the temporary effects keep on coming. World food prices have risen by 31.5% in the past year. On January 4th 2011 the standard rate of VAT will rise again, to 20% as part of the coalition government's budget deficit reduction strategy.

Mr King argued that once these further temporary effects ended, inflation would fall back towards the target, due to spare capacity in the economy. He insisted that "the depth of the recession means that a margin of spare capacity is likely to persist for some while". However, there is considerable uncertainty about just how much spare capacity there is in the economy.

The main danger from the persistence of inflation overshoots is that people start to expect higher inflation and to demand higher wages. Mr King was concerned that this would make it "more costly to bring inflation down".

(Source: © *The Economist Newspaper*, Nov 16th 2010)

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(a) (i) With reference to Extract 1, what is meant by a "budget deficit" (line 2)?

(4)

(ii) With reference to Extract 1, explain the likely impact of a reduction in the budget deficit on the circular flow of income.

(8)

(iii) Using an aggregate demand and aggregate supply diagram, evaluate the effect on output of the half a million public sector job cuts (Extract 1, Line 12).

(12)

(b) (i) With reference to Extract 2, explain what has happened to "spare capacity" (line 29) in the context of the UK economy.

(6)

(ii) With reference to Extract 2, analyse **two** of the causes of inflationary pressure that the Governor views as "temporary".

(8)

*(iii) In light of the information provided, assess the case for an increase in the base interest rate set by the Monetary Policy Committee.

(12)

*(c) With reference to Extract 2, evaluate the likely impact of higher inflation on **three** macroeconomic objectives.

(30)

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(4)

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*(c) With reference to Extract 2, evaluate the likely impact of higher inflation on **three** macroeconomic objectives.

(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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Results Mark Scheme
January 2012

GCE

GCE Economics (6EC02/01)

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

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Question Number	Answer	Mark
1(a)(i)	KAA 4 marks Output per worker or output per hour worked (2) measured either in volume or value; or output per unit of labour (2) If refers only to efficiency or lower costs then only 1 mark Use of data. Only 1 data reference needed for 2 marks. (2) N.B. No marks for data reference if definition is incorrect.	**(4)**

Question Number	Answer	Mark
1(a)(ii)	KAA 8 marks 4 marks per reason • Fall in demand leading to reduced value of work per employee • Fall in demand leading to reduced volume of work per employee • Labour costs rising faster than labour output (eg pay rise) • Employers holding on to staff hoping the recession will end (to avoid redundancy, recruitment and training costs) • The high value industries in the UK were particularly hard hit (financial services) • Lack of investment will contribute to low labour productivity • Reduced training opportunities • Accept minimum wage increases prevented wages falling as far as they should • Reduction in incentives to work for those in work e.g. rise in income tax/NIC • Demotivation e.g. resulting from job insecurity	**(8)**

Question Number	Answer	Mark
1(a)(iii)	KAA 8 marks Maximum 6 out of 8 marks if there is no data reference Relevant data reference: e.g. UK productivity; UK growth; or reference from Extracts 1 or 2 (2 marks) Loss of international competitiveness or rising costs of UK goods relative to foreign goods (2) leading to • Reduction in exports (2) and • Increase in imports (2) • Leading to a worsening of the current account deficit (2) Reward other valid explanations e.g. reduction in economic growth; increased unemployment; cost push inflation: up to 6 marks. Award up to 2 marks for a diagram if it develops the analysis. Evaluation 4 marks (1 x 4 or 2 x 2) factors might include • No great change in the short run but more significant in the long run • The size of the fall in productivity • The importance of non price factors (eg quality or branding) • Significance of gradient of AS curve • Impact will be greater on US trade component than on EU component • EU a more significant (approx. 60% of exports) than US (approx. 15%)	**(12)**

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Level	Mark	Descriptor
Level 3	9-12	2 convincing effects with at least one evaluative point
Level 2	5-8	2 convincing effects with no connections, or 1 convincing effect with some good analysis but no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-4	Identification of relevant effect with or without brief evaluative keywords

Question Number	Answer	Mark
1(b)(i)	KAA 6 marks Maximum 4 out of 6 marks if no data reference. Use of data: e.g. 60% of UK exports to euro zone or direct reference to Extract 1 (2) Up to 4 marks for Fall in Aggregate Demand (2) from a reduction in exports (2) of British goods and services causing a fall in UK growth AD/AS diagram correctly labelled showing AD moving left (2). Allow: 'Need to replace domestic 'credit-fuelled' consumption'(2) and public expenditure (2). Accept also a fall in investment (2). Reward further analysis of falling confidence as a result of negative economic growth in UK (2)	**(6)**

Question Number	Answer	Mark
1(b)(ii)	KAA 8 marks Award two factors only (2 x 4 marks) Two factors identified (2 marks each) and explained (2 marks each) **Factors may include:** • Increase in business confidence or start of the recovery • Lower interest rates for borrowers • Greater willingness of banks to lend to business/credit easing • Government incentives such as a reduction in corporation tax or tax breaks • Subsidies for investment	**(8)**

Question Number	Answer	Mark
1(b)(iii)*	KAA 8 marks Up to 2 marks for use of data reference from Figure 2 showing positive correlation between investment and growth Up to 4 marks for diagram If investment increases growth then: Diagram AD and/or AS shifts to the right; correct movement (1), lines labelled (1), axes labelled (1), equilibria labelled (1). Note diagrams where the movement is incorrect receive no marks. N.B. Accept diagram and analysis based on a fall in investment Up to 2 marks for the transmission mechanism explained o AD: investment as an injection into circular flow (2). Multiplier (2) o AS: Significance of investment for productive capacity. This may include an explanation of an outward shift of the PPF. Evaluation 4 marks (1 x 4 or 2 x 2) • Depends on the effects of other factors in the economy (consumer confidence and consumer debt) • Knowledge that investment is small but significant component of AD (about 15%) • New machinery can give a competitive edge if old stock is replaced • Enables development of new companies and even industries • Britain needs high-technology industry to compete • Suggests long term commitment to the growth of the firm and the economy • Correlation might be caused by other factors/ data might be coincidental **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing points with at least one evaluative point
Level 2	5-8	2 convincing points with no further analysis or explanation, or 1 convincing point with some good analysis but no evaluative point; 1 or 2 less-convincing point with some evaluation
Level 1	1-4	Identification of relevant points with or without brief evaluative keywords

Question Number	Answer	Mark
1(c)*	KAA 18 marks Identification of 3 macroeconomic objectives 6 marks (3 x 2marks) • Economic Growth • Control of inflation • Reduction in unemployment • Making the distribution of income more equal • Accept reduction of the national debt or balancing the budget • Restoration of equilibrium in the balance of payments • Protection of the environment Explanation of how the macroeconomic objective might be affected 12 marks (3 x 4 marks); • As some former IB claimants find jobs and the productive potential of the economy increases (AS shift to right or PPF shifts to right – accept also an outward movement towards the PPF) increasing growth • As former IB claimants enter the job market deflationary effect on inflation target • Official numbers of unemployment may increase as some former IB claimants qualify for JSA • Many former IB claimants lose their income, many may not be eligible for JSA and so income inequality increases • Reduction in overall benefit payments leading to a reduction in the fiscal deficit and national debt. Reward explanation of the effect of other policies such as: • Minimum wage • Incentives to work • Changing employers' NI contributions Reward use of diagrams (maximum of 2 marks each per objective) Maximum of 8 marks out of 12 (i.e. 2 x 4 marks) if only 1 policy discussed. Evaluation 12 marks (2 x 6 marks or 3 x 4 marks); Comments might include reference to • Need to invest in human capital to restore employability • Availability of jobs in the economy when is unemployment already high • Difference in indicators measurements (JSA vs ILO) • Extent of shifts in AS curves or PPF • Time lags – (eg length of time for former claimants to find jobs) • Short run and long run impact on the objectives • Critical consideration of the effectiveness of policies • Social consequences of hardship caused • Potential increase in black economy (cash in hand work) **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

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Level 2	7-18	2 or 3 convincing effects with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant effects with or without brief evaluative keywords

Question Number	Answer	Mark
2(a)(i)	KAA 4 marks Government spending is greater than the revenue (accept tax) it receives (2) Use of data or relevant reference to the article (2). No data marks if definition is incorrect.	**(4)**

Question Number	Answer	Mark
2(a)(ii)	KAA 8 Up to 2 marks for use of data in Extract 1.e.g. huge budget deficit is to be reduced in real terms by 3% by 2014-15 Up to 2 marks for the following • definition of the circular flow of income as a model of the economy which shows the movement of goods and services between households and firms, and their corresponding payments in money terms (2 marks) • OR diagrammatic representation of circular flow of income (2 marks) • OR If the candidate's answer only states that injections are I+G+X and withdrawals are S+T+M then award (2 marks). Up to 4 marks for explanation of the reasoning: e.g. • A reduction in the budget deficit is a reduction in net injections (2) • which results in a reduction in the total spending in the economy/money flowing around the circular flow (2)	**(8)**

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Question Number	Answer	Mark
2(a)(iii)	KAA 8 marks Up to 4 marks for the diagram AD shifts to the left; correct movement (1), lines labelled (1), axes labelled (1), equilibria labelled (1). Note diagrams where the movement is incorrect receive no marks. Up to 4 marks for an explanation of transmission mechanism: Less employment leads to less government expenditure and/or consumption and/or less investment (2), falling AD leading to less output (2). The following analysis with accompanying diagram could be awarded all KAA marks: If AS is shifted to left on the basis that productivity will fall if (maximum of 2 marks): • quality of health and education fall • workers leave the workforce • deteriorating human capital resulting from long term unemployment and therefore reducing the PPF or full employment output (2) Evaluation 4 marks (1 x 4 or 2 x 2) factors might include • Rise in unemployment leads to a rise in benefits (G) and so automatically stabilises • Smaller change in the short run but more significant in the long run • Size of the multiplier • Large impact as unemployment already high so many won't be able to get jobs immediately • Effect of other factors counterbalancing or exacerbating the effect	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing points with at least one evaluative point
Level 2	5-8	2 convincing points with no further analysis or explanation, or 1 convincing point with some good analysis but no evaluative point; 1 or 2 less-convincing point with some evaluation
Level 1	1-4	Identification of relevant points with or without brief evaluative keywords

Question Number	Answer	Mark
2(b)(i)	KAA 6 marks Definition (2 marks) A situation where there are unemployed resources in the economy. Accept also negative output gap. Explanation (maximum 4 marks) that there is significant and persistent spare capacity that might take the form of: • Recession (2) • Unemployment (2) • underemployed labour (2) • machinery lying idle or not used to its maximum (2) • use of PPF diagram or AD/AS diagram or output gap diagram (2) • Fall in rate of inflation with reference to Phillips Curve (2) • use of information provided (2)	**(6)**

Question Number	Answer	Mark
2(b)(ii)	KAA 8 marks Reward identification of up to 2 Factors in Extract 2 with 2 marks each (2 x 2 mark) • VAT 15% to 17.5% in January 2010 and/or 17.5% to 20% in January 2011 • Rises in oil prices • Effects of higher import prices resulting from the big 25% fall in sterling from mid-2007. • World food prices have been rising sharply, by 8% in just the past month and 31.5% in the past year • Inflationary expectations are higher Explanation of transmission mechanism for each factor - up to 2 marks for each factor's explanation (2 x 2 marks) e.g.: • How increase in VAT affects CPI inflation (2) • Oil as a cost of production relevant to most goods and services (2) • cost push inflation shifting AS curve to left (2) increasing price level (2) • diagram without explanation (AS curve and increased price level, but must be correctly labelled) (2) Also reward comment such as VAT 17.5% to 20% the increase is expected to be passed through to prices fully whereas only about half of the earlier cut and ensuing rise went through to prices (2)	**(8)**

Question Number	Answer	Mark
2(b)(iii)*	KAA 8 marks 2 reasons (2 x 4 marks) • Inflation is above the MPC's target and tolerance • Important to stop inflationary expectations taking hold and further fuelling inflation • Lowering relative inflation should increase international competitiveness • Stronger pound would reduce impact of cost push inflation 2 marks could be awarded for a diagram which develops the analysis Evaluation 4 marks (2 x 2 marks or 1 x 4 marks) • Greater concern about potential deflationary spiral if consumption collapses • Most factors are temporary • Unions not powerful enough to create wage price spiral • Raising interest would strengthen sterling and reduce exports' competitiveness and further weaken AD • Significance of gradient of curves **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

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Level	Mark	Descriptor
Level 3	9-12	2 convincing points with at least one evaluative point
Level 2	5-8	2 convincing points with no further analysis or explanation, or 1 convincing point with some good analysis but no evaluative point; 1 or 2 less-convincing point with some evaluation
Level 1	1-4	Identification of relevant points with or without brief evaluative keywords

Question Number	Answer	Mark
2(c)	KAA 18 marks Identification of 3 macroeconomic objectives 6 marks (3 x 2 marks) • Economic Growth • Reduction in unemployment • Making the distribution of income more equal • Accept reduction of the national debt or balancing the budget • Restoration of equilibrium in the balance of payments • Protection of the environment • Control of inflation Explanation of how the macroeconomic objective might be affected 12 marks (3 x 4 marks); • May reduce growth owing to costs of inflation • Unemployment may rise through increased inefficiency and stagflation • Reduction in purchasing power and real incomes • A higher rate of inflation associated with increasing AD may have a detrimental impact on the environment • Effect on those who have fixed incomes (not protected by inflation) who are often the poorest • May make the national debt smaller in real terms • Reduction in competitiveness of British goods worsens balance of payments deficit • Possible beneficial effect on the environment as growth slows • Self reinforcing effect on inflation through expectations- higher inflation as consumers get used to higher levels of inflation they will demand higher wages to protect buying power of their incomes • Loss of business and consumer confidence Evaluation 12 marks (2 x 6 marks or 3 x 4 marks); Comments might include reference to • Inflation currently not that high so impact on objectives not very large • Growth already low so slightly higher inflation is worth the risk to avoid deflation or depression • Possible beneficial effect on the environment as growth slows • Inflation may not translate through to higher wages and unemployment as workforce have little union power • Impact deepens on relative inflation rates • National debt being made smaller may be limited by the depreciation of the exchange rate brought on by sustained inflation • Other factors may have a larger effect the exchange rates or other macro objectives (ceteris paribus) • Explanation of it being more costly to bring inflation down -interest rates may have to be higher for longer (or QE reversed more rapidly) in order to convince the workforce that the government's policy to reduce inflation is credible	

	Quality of written communications will be assessed in this question based on the candidate's ability: • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing effects with at least two evaluative points (an evaluation point is worth up to a maximum of 6 marks)
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Level 2	7-18	2 or 3 convincing effects with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant effects with or without brief evaluative keywords

	Knowledge	Application	Analysis	Evaluation	Total
Question 1					
ai	2	2			4
aii	2	2	4		8
aiii	2	2	4	4	12
bi	4	2			6
bii	2	4	2		8
biii	2	2	4	4	12
c	6	6	6	12	30
Total	20	20	20	20	80
Question 2					
ai	2	2			4
aii	2	2	4		8
aiii	2	2	4	4	12
bi	4	2			6
bii	2	4	2		8
biii	2	2	4	4	12
c	6	6	6	12	30
Total	20	20	20	20	80

Write your name here

Surname	Other names

Centre Number | Candidate Number

Edexcel GCE

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Friday 27 May 2011 – Morning
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. 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.

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.

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

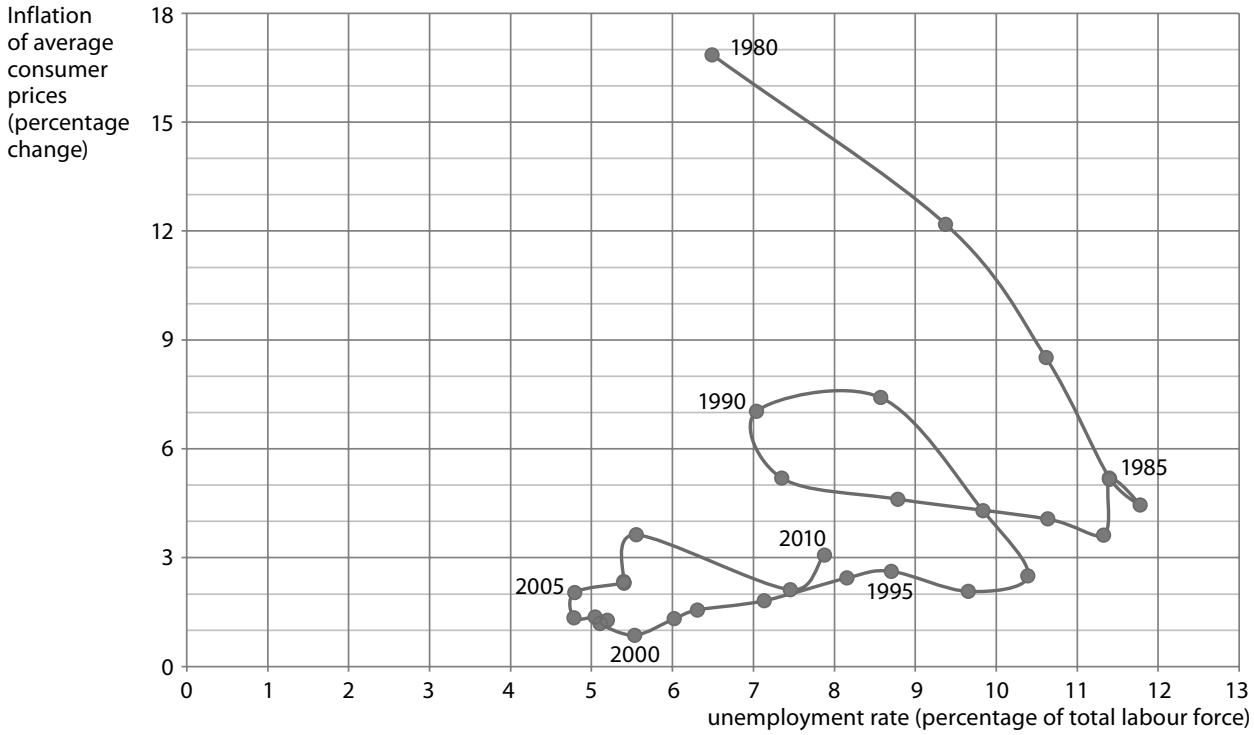
Extract 2 Unemployment Headlines from the Guardian, March 2010

- 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

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

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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

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(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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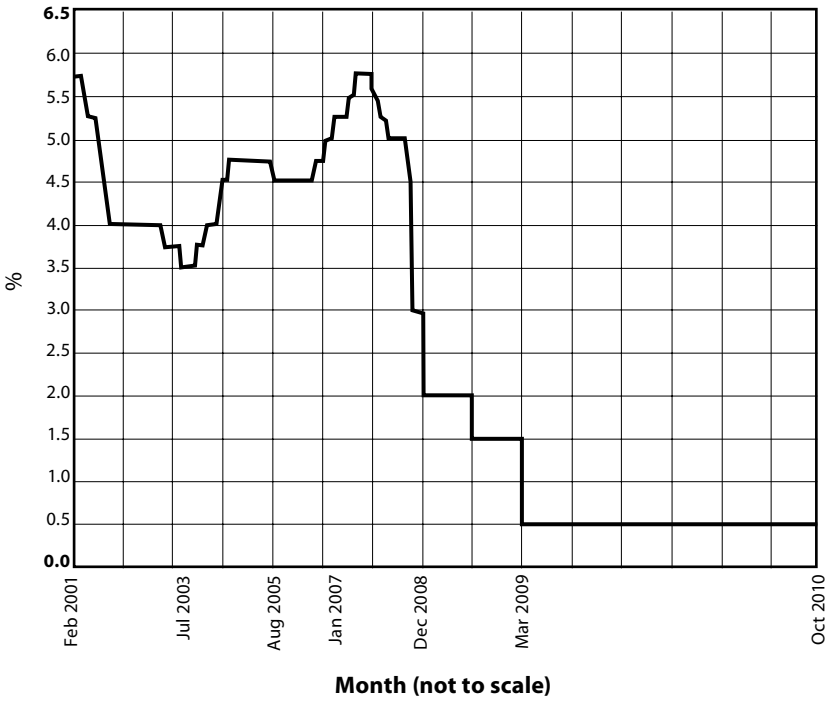
(Total for Question 1 = 80 marks)

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

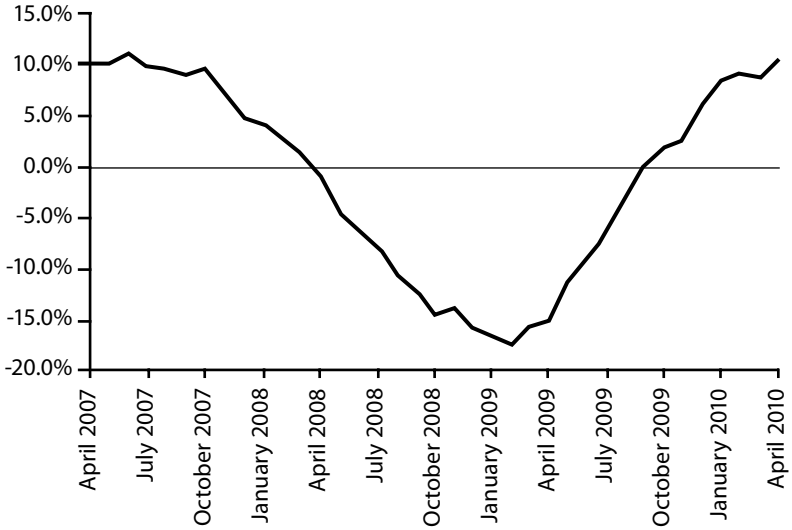
2 Interest Rates, House Prices, Savings and Growth

Figure 1 UK base rate of interest, 2001–2010



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

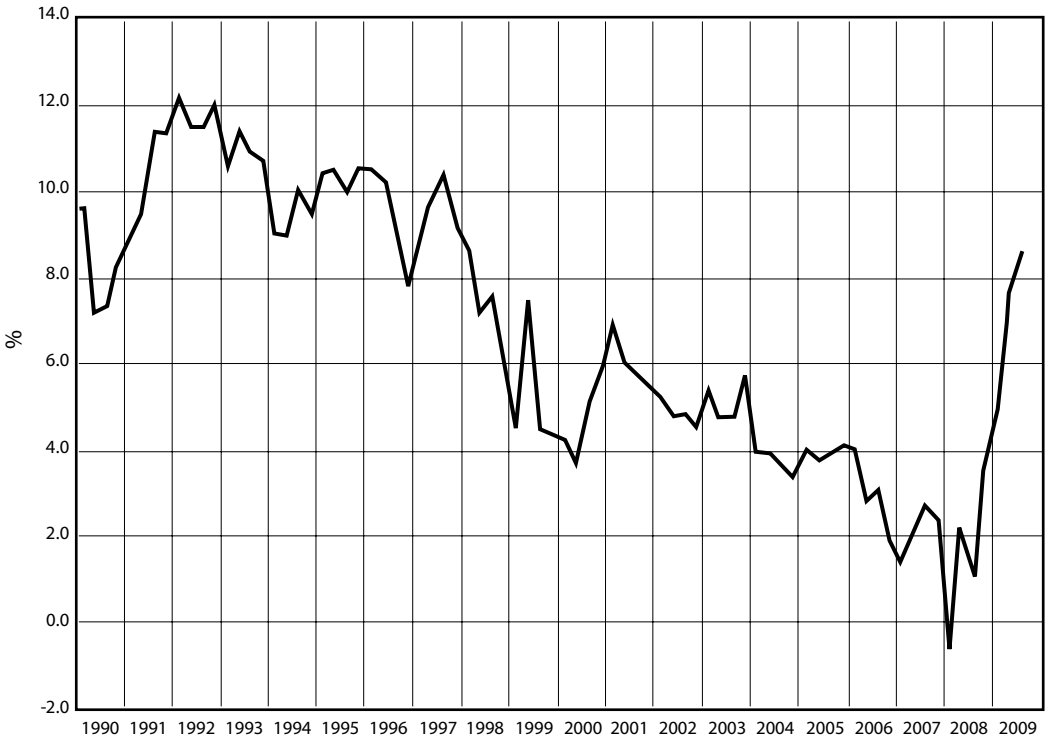
Figure 2 Quarterly percentage change in UK house prices, April 2007 to April 2010



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

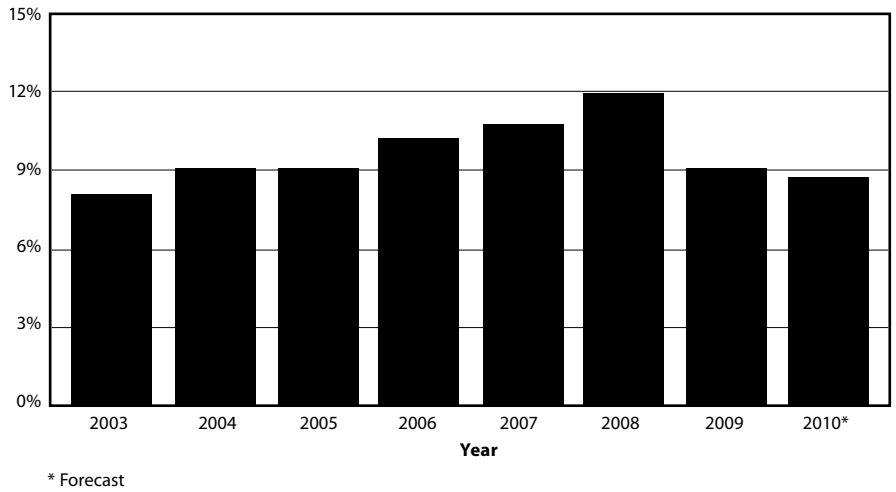
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Figure 3 UK Household Savings Ratio
(percentage of disposable income that is saved, using quarterly data)



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

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(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)

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(6)

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QUESTION 2 CONTINUES ON THE NEXT PAGE

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(10)

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(12)

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(30)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

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Mark Scheme (Results)

June 2011

GCE Economics
(6EC02) Paper 01

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You can also telephone 0844 372 2187 to speak to a member of our subject advisor team.

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Question Number	Answer	Mark
1(a)(i)	2 of the following reasons (2 + 2 marks) and 2 marks for 1 example From figure 1. Ensure that inflation is accurately measured (2 marks) Avoiding potential biases that might develop over time such as • the development of new goods and services (2 marks) • the change in tastes (2 marks) • the switching away from goods and services that have risen in price (2 marks) Ensures long term trends are reflected (2 marks) Sound definition of CPI (2 marks) Maximum 4 marks if no example of a trend or change from fig 1	**(6)**

Question Number	Answer	Mark
1(a)(ii)	KAA 10 marks Connection between oil and aggregate supply e.g. oil is general production cost which increases when oil price rises(2 marks) AD/AS diagram showing leftwards/upwards shift in aggregate supply (4 marks max), made up from: axes labelled (1 mark), equilibria labelled (1 mark), AD/AS lines labelled (1 mark) and correct shift of AS to left (1 mark). (Note: no marks to be awarded for the diagram if the shift is incorrect or if AD/AS are wrong way round or labelled incorrectly even if axes are labelled correctly) Fall in real output described (2 marks) and rise in price level (2 marks) described. Accept also the explanation that the total value of an oil importing country's imports might rise and so AD shift to the left. Above point is not really valid in the context of extract 1 -i.e. inflation above target so only half marks should be given for analysis (1 marks). AD/AS diagram showing leftwards/downwards shift in aggregate demand (2 marks Max), made up from: axes and equilibria (1 mark), AD/AS lines and correct shift of AD to the left (1 mark). Fall in real output described (1 mark) and fall in price level described (1 marks) in writing.	**(10)**

Question Number	Answer	Mark
1(a)(iii)	KAA 8 marks (maximum 6 marks for KAA if data NOT used) Two points from the Extracts 1 or 2 or Figure 3. (2 x 4 marks) Identify each point (2 marks) and further explanation of how this factor **might influence the price level**, accept use of AD/AS diagram (2 marks) From Extracts 1 or 2 or Figure 3 • Expectation that inflation will fall below target (line 8) • Rise in Vat to 17.5% • a sharp increase in oil prices • sharp depreciation of sterling (or exchange rates) • fall in consumer spending • fall in investment spending • the build-up of spare capacity in the economy as factories and equipment lie idle • unemployment or employment level changing Evaluation 4 marks (1 x 4 marks or 2 x 2 marks). Factors might include: • Relative significance/importance of two factors • Average earnings in 2009 are roughly in line with target inflation of 2% (Figure 2) • Confidence levels (concern over threat of double dip recession) • Concern still over extent of bad debts • Global recovery seems to be underway • Expansive fiscal policy by the government is still being implemented and full effects are yet to be seen • Stock market has risen very rapidly since QE started suggesting an asset price bubble (financial markets) • Interest rates are already at a historical low • Uncertainty over the full effect of Quantitative Easing • Clearing Banks are not passing on the lower rate • Britain seems to be one of the last countries to be emerging from the recession • Elasticity of AS • reliability of statistics: many are revised later such as GDP • Unemployment is a lagging indicator and may, therefore, be of little use • Reference to conflicting unemployment data • Oil prices are very volatile: increase in price might be temporary • Difficulty of estimating amount of spare capacity in the economy	**(12)**

Question Number	Answer	Mark
1(b)(i)	Inverse or negative relationship or trade off or if one is high the other is low, (2 marks) Explanation of the reason why this might be the case (2 x 2 or 1 x 4 marks) such as • when nearing full employment or capacity the economy begins to overheat and prices rise (or cost push inflation from wage-price spiral) • Keynesian AS curve is upward sloping • use of an AD/AS diagram or Phillips curve (up to 2 marks for diagrams) • Phillips Curve explained • reverse analysis i.e. if unemployment is rising, then workers have less bargaining power and earnings growth will be slower • incentive effect Alternatively, there is no relationship (2 marks) Explanation of the reason why this might be the case (2 x 2 or 1 x 4 marks) such as • If no relationship explain that the Phillips curve is unrealistic • Any plausible analysis	**(6)**

Question Number	Answer	Mark
1(b)(ii)	EITHER If inverse relationship (Phillips curve) is supported, explain identification of curve or trade off (2 marks) using data (2 marks) such as • Inverse 1980 to 1985 • Inverse 1989 to 1993 • Inverse 1999/2000 to 2009 OR If relationship is denied, explain that points are random or don't follow a pattern (2 marks) using data (2 marks) such as • 1989 to 1993 at a different angle from 1993 to 1999 • 1999/2000 to 2009 at a different angle from 1993 to 1999 • Cluster of points in 2000 to 2008 Accept answers supporting a positive or direct relationship e.g. 1993 to 1999 Award Candidates 4 marks if they point out the question is about earnings growth and unemployment whereas the data is on price inflation	**(4)**

Question Number	Answer	Mark
1(c)	KAA 8 marks Either meaning of a sharp depreciation of the pound or definition of current account (max of 2 marks) Possible definitions include: • a pound that is falling or has fallen in value against another major currency • a pound that buys less foreign currency than it used to • accept current account as imports & exports Explanation (2 x 4 marks). These might include: • Exporters will be able to sell their goods more cheaply (2) and so increase their total revenue or total exports rise (2) • Imports into the UK become more expensive (2) so less are demanded at the higher price and there is a fall in expenditure on imports (2) Evaluation 4 marks (1 x 4 marks or 2 x 2 marks). Comments might include reference to • In the short run manufacturing orders will not change as they are struck at a fixed price for a number of months, but in the long run change should take effect • Recognition that manufacturing exports account for a sizeable amount (approximately half) of UK's exports • Supply of UK exports may be inelastic • Price elasticities of demand for imports/exports • Industries have different elasticities of demand and supply • Fluctuations in the value of the pound may undermine long term customer and supplier relationships • Extent of the depreciation • Increase of cost from rising import costs (such as oil) and the detrimental effect on domestic demand for manufacturers' products • Manufacturing skills have been lost and therefore it will not be easy for the sector to grow quickly • In some industries (where low cost is important) British manufacturers are unable to compete unless the pound falls dramatically • Some industries will be unaffected because they have relatively few substitutes • investment decisions and flows • relative importance of trade to manufacturing sector **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument	

	• To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing points with at least one evaluative point
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Level 1	1-4	Identification of relevant points with or without brief evaluative keywords

Question Number	Answer	Mark
1(d)	KAA 18 marks Definitions and/or diagram up to 6 marks for: • Fiscal policy – the government's manipulation of its spending and taxation in order to affect aggregate demand (2 marks) • Supply-side policy – actions by government designed to promote market forces in order to increase economic growth or shift AS/PPF curve out (2 marks) • Rate of unemployment – the percentage of the workforce that is not currently employed (2 marks) • Reward Implicit understanding of definitions • Reference to data (2 marks) – implicit or explicit • 4 marks for any appropriate diagram: made up from: axes labelled (1 mark), equilibria labelled (1 mark), line(s) labelled (1 mark) and correct shift (1 mark). Explanations of at least two policies (up to a maximum of 12 marks); of which up to 6 marks each for two policies explained in depth, or up to 4 marks for three policies explained clearly. **Max 8 marks** if only two fiscal OR two supply side policies explained. Policies might include: • Reducing income tax • Increasing government spending • Increasing the national debt to fund the expansion in spending • Competition policy • Education and training • Reducing VAT or Corporation tax • Increasing subsidies or tax breaks, such as for capital investment or R&D Evaluation 12 marks (3 x 4 marks or 2 x 6 marks) • difficulty of keeping the growth of demand at the right level owing to time lags • difficulty of keeping the growth of demand at the right level owing to inaccurate data • concern about the ability of the government to repay its debt if it gets	

	too large • crowding out of the private sector undermining the net impact of the investment • credibility of the Phillips curve trade off • significance of elasticities of AS or AD explained • magnitude of boost • size of the multiplier • conflict of objectives e.g. possible inflation with fiscal • evaluation of supply side policies, e.g. more uneven distribution of income **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
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Level 2	7-18	2 or 3 convincing effects with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant effects with or without brief evaluative keywords

Question Number	Answer	Mark
2(a)(i)	Up to 2 marks for definition or explanation • cost of borrowing • price of money • income from savings deposited in a bank • return on deposits in high street banks • the interest payments on mortgages or credit cards or an overdraft • return on private loans made • Bank of England rate (not target rate) One reference to data from Figure 1 (2 marks)	**(4)**

Question Number	Answer	Mark
2(a)(ii)	KAA 6marks Definition of investment is an increase in the capital stock or the buying of capital goods (2 marks). Accept the buying of a factor of production that produces other goods and services Up to 6 marks for explanations e.g. 4 + 2 or 3 + 3, also reward diagrammatic analysis • Fall in interest rates reduces the cost of borrowing (2 marks) and so makes investment cheaper leading to more investment (2 marks) **OR** Rise in interest rates increases the cost of borrowing (2 marks) and so makes investment more expensive leading to less investment (2 marks) • Fall in interest rates leads to rise in consumption and therefore investment OR REVERSE(4 marks) • Rise in interest rates leads to the incentive for firms to save (2 marks) and therefore a fall in investment OR REVERSE (2 marks) • Reward other influences e.g. confidence, access to finance	**(6)**

Question Number	Answer	Mark
2(a)(iii)	KAA 8 marks Reference to data (2 marks) in Figure 2 e.g. house prices fell between April 2008 – July 2009 Note the title of the graph, allow any reasonable use of data, quarterly or annually. Maximum 6 marks for KAA if no data reference Other 6 marks awarded as follows: identification of negative wealth effect (2); explanation and analysis (4): e.g. fall in confidence; lower consumption; fall or less rapid rise in AD; resulting in fall in real output or slower rate of economic growth. Fall in prices so easier access for first time buyers/extension of demand. Maximum 4 marks unless developed into macroeconomic perspective. Credit answers analyse wider effects on the economy: e.g. impact on current account of balance of payments; or for impact on the price level; or for impact on unemployment. Explanation of transmission mechanism through to consumption or use of a graph to explain the slowing of growth or fall in output (4 marks) Credit effect of negative equity Evaluation 4 marks (1 x 4 marks or 2 x 2 marks). Factors might include: • Houses are a significant component of wealth and effect a large proportion of households in the UK which will therefore have a **major effect** in slowing down the recovery • Significance of elasticity of AS curve • Consumption is approximately 2/3 of aggregate demand which implies a strong inter-relationship • A fall might have a very large impact (more so than a slow down) and with bankruptcies/defaulting could lead to a large increase in supply and a further fall in house prices (and therefore AD) • Wealth effects take some time to trigger spending changes • Other factors may be more important in generating confidence such as the strength of the global economy's recovery • Regional differences in impact	**(12)**

Question Number	Answer	Mark
2(b)(i)	Candidates can give reasons for the fall and/or reasons for the rise in the household savings ratio. Mark as follows: 2 + 2 or 3 + 1 (1 mark identify + 1 or 2 for development.) • Degree of job security/ confidence • changes in house prices and/or share prices • interest rates paid by banks	**(6)**

	• savings schemes e.g ISAs; index-linked savings certificates • changes in incomes • credit should also be given for convincing points made about an ageing population requiring increased savings in the longer term as a result of the level of welfare benefit provided. 2 for reference to data	

Question Number	Answer	Mark
2(b)(ii)	KAA 10 marks Note that the definition of the rate of savings is given in Figure 3 so no marks are to be awarded for it. AD/AS diagram showing leftwards/downwards shift in aggregate demand (4 marks), made up from axes labelled (1 mark), equilibria labelled (1 mark), AD/AS labelled (1 mark), and correct movement of AD to the left (1 mark). (Note: no marks to be awarded for the diagram if the AD shift is incorrect or if AD/AS are wrong way round or labelled incorrectly even if axes are labelled correctly; max 3 marks if AS shifted but not valid explanation) Reference to Figure 3 (2 marks) State fall in price level (2 marks) and state fall in real output (2 marks).	**(10)**

Question Number	Answer	Mark
2(b)(iii)	KAA 8 marks Data reference to Figure 4 (2 marks) Maximum of 6 KAA if no reference to data Two factors identified and explained (4 + 2 or 3 + 3); • Government policy (2 policies could be 2 factors) • Higher investment (both foreign direct investment and domestic investment) • High levels of savings should lead to a fall in the cost of borrowing for industry • Innovation and/or the importing of new technology • Increase in human capital • Acceleration of migration from low value added sectors (such as agriculture) to high value added sectors (manufacturing) • Increase in efficiency and productivity • Inflation kept low • Export led growth • Weak or low valued currency encourages demand for exports • Availability of a cheap source of skilled labour • Access to cheap raw materials Reward use of diagrams in explanations; AD/AS or circular flow of income Also reward definition of economic growth (2 marks) e.g. an increase in either real and/or potential output (GDP)	**(12)**

	Evaluation 4 marks (1 x 4 marks or 2 x 2 marks). Factors might include: • consider time lag involved in investment • the problem of rapidly rising wages in China • prioritisation of factors • the effect on the price level and output is determined by the relative elasticity of the AD and AS curves • the state of the global economy and the Chinese government's drive to increase domestic consumption to replace faltering export demand • Scale of each factor • Rise of competitor nations	

Question Number	Answer	Mark
2(c)	KAA 18 marks Objectives and/or diagram up to 6 marks for: • Definition of macroeconomic objectives as the main aims of the government to achieve improved economic welfare (for all the population) (2 marks) • Definition of Growth as an increase in either real and/or potential output (GDP) (2 marks) • Identification of any 2 other macroeconomic objectives that are adversely affected (2 marks maximum) such as o Control of inflation (or price stability) o A fair or equitable distribution of income and wealth o An external policy objective such as satisfactory balance of payments (e.g. restoration of equilibrium or reduction of the deficit) o Protection of the environment • 4 marks for any appropriate diagram: made up from: axes labelled (1 mark), equilibria labelled (1 mark), line(s) labelled (1 mark) and correct shift (1 mark). Explanation of at least two effects (up to a maximum of 12 marks); of which, up to 6 marks each for two effects explained in depth, or up to 4 marks for three effects explained clearly. • Inflation rising as full capacity is approached • Balance of payments position may deteriorate as incomes rise and more imports are demanded • Growth should result in a higher average standard of living, but may not deliver a more fair or equitable distribution of income and wealth as the rich tend to get rich faster than the poor do • Increased growth tends to lead to a deterioration of the environment from congestion and pollution Examples of recent evidence should be credited Evaluation 12 marks (3 x 4 marks or 2 x 6 marks) • significance of stage in trade cycle which the country is in and implications for elasticity of AS curve;	**(30)**

	• If it is supply side growth (rather than demand-side) then fewer conflicts with other objectives • Initial state and stability of inflation/deflation • The rate of actually growth in comparison to the growth of the productive capacity • Proximity to full employment (full output) • Full employment (or low unemployment) shouldn't conflict • Short run unemployment from introduction of new technology • An increase in AS tends to happen in the longer run • Extent of domestic economy's capacity to meet rising demand (i.e. if economy can supply most wants) • Extent of the country's international competitiveness • Redistributive policies of the political part in power • Extent of the effectiveness of environmental policies • Extent to which the growth is in tertiary sector or in primary and secondary sectors • Balance of payments position may improve if it is export-led growth • Balance of payments position may improve if growth if generated through an increase in productivity (such as through investment) resulting in a shift in AS to the right • Growth may lead to higher government revenues and scope to improve public transport as well as tax polluting old technologies • Developed economies may employ green technology **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing effects with at least two evaluative points (an evaluation point is worth up to a maximum of 6 marks)
Level 3	19-24	2 or 3 convincing effects with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing effects with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant effects with or without brief evaluative keywords

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Edexcel GCE

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Wednesday 19 January 2011 – Morning
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. 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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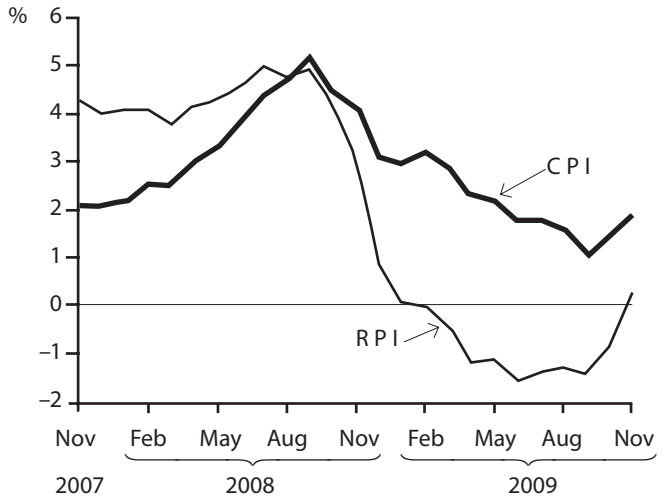
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Answer EITHER Question 1 or Question 2.

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

1 Inflation and growth

Figure 1 Rates of Inflation in the UK, year on year percentage changes



Source: http://www.statistics.gov.uk/pdfdir/cpi1209.pdf produced on 15th December 2009.

Figure 2 Annual percentage change in Gross Domestic Product (GDP) at constant prices

				Forecast
Country	2007	2008	2009	2010
Germany	2.5	1.2	-5.0	1.2
United Kingdom	2.6	0.5	-4.9	1.3
United States	2.1	0.4	-2.4	3.1
Developing Economies	8.3	6.1	2.4	6.3

Source: www.imf.org (World Economic Outlook Database April 2010).

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Extract 1 Recession to cause permanent damage

The effects of the 2008-09 financial crisis and recession (at least two consecutive quarters of negative growth) has similarities to the recessions of the 1920s, 1980s and 1990s: global output is on a persistently lower path than expected before the crisis; public finances are severely weakened; long term unemployment has increased and income inequality has risen.

Research by the International Monetary Fund (IMF) into previous recessions found three major forces which tended to prevent economies rebounding to their pre-crisis trends of output.

First, for a period of time after the recession there is likely to be high unemployment and misallocations of resources in several sectors of the economy. An example is residential construction. If unemployment remains high for some time, former employees may lose skills and the discipline of working.

Second, part of the capital stock is destroyed as some plant and equipment is scrapped prematurely. Other companies struggle to invest in viable and innovative projects because banks restrict credit to protect their finances.

Third, productivity falls because there is 'less innovation, as research and development spending tends to be scaled back in bad times', the IMF says.

Source: adapted from *The Financial Times*, the article 'Recession to leave permanent scars' by Chris Giles, 24th November 2009.

(a) (i) With reference to Figure 1, explain what happened to the price level in the period shown.

(6)

(ii) With reference to Figure 1, and your own knowledge, to what extent has monetary policy, as conducted by the Monetary Policy Committee, been a success?

(12)

(b) With reference to Figure 2,

(i) Explain what is meant by a **fall** in *Gross Domestic Product at constant prices*.

(4)

*(ii) Discuss **two** problems of comparing the economic growth of the UK and developing economies using GDP as a measure.

(12)

(iii) Analyse **two** possible implications for macroeconomic policy of inaccurate forecasts of GDP growth data.

(8)

(c) With reference to Extract 1, analyse the possible impact on the distribution of income of negative economic growth.

(8)

*(d) Assess the effectiveness of supply-side measures that the government could use to deal with the problems outlined in paragraphs 3, 4 and 5 of Extract 1.

(30)

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(a) (i) With reference to Figure 1, explain what happened to the price level in the period shown.

(6)

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(ii) With reference to Figure 1, and your own knowledge, to what extent has monetary policy, as conducted by the Monetary Policy Committee, been a success?

(12)

M 3 8 5 2 1 R A 0 6 3 2

(b) With reference to Figure 2,

(i) Explain what is meant by a **fall** in *Gross Domestic Product at constant prices*.

(4)

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(12)

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(iii) Analyse **two** possible implications for macroeconomic policy of inaccurate forecasts of GDP growth data.

(8)

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(8)

*(d) Assess the effectiveness of supply-side measures that the government could use to deal with the problems outlined in paragraphs 3, 4 and 5 of Extract 1.

(30)

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M 3 8 5 2 1 R A 0 1 4 3 2

(Total for Question 1 = 80 marks)

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

2 Public finances

Extract 1 Some initial reactions to the 2009 Pre-Budget Report

No Chancellor would wish to publish a forecast showing that the government will need to borrow £178 billion in 2009/10. But when you consider that the economy has shrunk more in the last six months than the Chancellor, Alistair Darling, predicted in Spring 2009, an increase of just £3 billion in the forecast deficit from £175 billion actually looks like good news.

Far from reducing the fiscal deficit immediately, the Chancellor has actually announced a modest increase in the fiscal deficit over the next three years. The Chancellor increased planned spending by around £15 billion in total over 2011/12 and 2012/13, while recovering only £9 billion through new tax increases.

The Chancellor said that the extra spending would allow modest real increases in spending on 'frontline' schools and no real cuts in the 'frontline' National Health Service plus no cuts in police numbers. But this will leave remaining public services, such as housing, transport and higher education, facing severe real cuts. By 2015, the planned spending increases become less generous while the planned tax increases continue to bring in more revenue.

Source: adapted from The Institute for Fiscal Studies, the article 'Some initial reactions to the 2009 Pre-Budget Report', 9th December 2009 http://www.ifs.org.uk/pr/pbr09.pdf.

Figure 1 Changes in UK GDP and Components of Aggregate Demand in real terms (£ millions)

	2008	2009	Percentage Change
Consumption	852,918	826,436	–3%
Investment	232,202	199,962	–14%
Government Spending	282,681	288,133	2%
Stocks	866	–15,644	–1906%
Exports	361,535	321,155	–11%
Imports	401,137	349,189	–13%
Exports–Imports	–39,602	–28,034	29%
GDP	1,330,088	1,266,533	–5%

Source: adapted from http://www.bankofengland.co.uk/publications/inflationreport/ir09nov.pdf and data from Daiwa Capital Markets, 6th January 2010.

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Figure 2 Value of £1 sterling, expressed in Euros and Dollars, annual averages

	EURO	US$
2004	1.43	1.90
2005	1.46	1.74
2006	1.48	1.95
2007	1.41	2.01
2008	1.15	1.52
2009	1.10	1.62

Source: adapted from Yahoo Finance.

(a) (i) With reference to the information in Extract 1, explain what is meant by 'a modest increase in the fiscal deficit' (line 7).

(6)

(ii) Illustrating your answer with an aggregate demand and aggregate supply diagram, evaluate the likely effect of an increase in the fiscal deficit on the level of real output and on the price level. Refer to the multiplier effect in your answer.

(16)

(b) (i) Explain the impact on aggregate demand of the fall in the size of the current account deficit in 2009, as represented in Figure 1 by 'Exports – Imports'.

(6)

*(ii) With reference to Figure 1, discuss **two** likely reasons for the fall in consumer expenditure in 2009.

(14)

(c) (i) With reference to Figure 2, explain the term *exchange rate*.

(4)

(ii) Using the data in Figure 2, calculate the percentage change in the value of the pound against the Euro between 2004 and 2009.

(4)

*(d) Evaluate the likely effects on the UK's current account of the balance of payments of changes in consumption, investment and the exchange rate of the pound sterling (£), as shown in Figures 1 and 2.

(30)

(a) (i) With reference to the information in Extract 1, explain what is meant by 'a modest increase in the fiscal deficit' (line 7).

(6)

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(ii) Illustrating your answer with an aggregate demand and aggregate supply diagram, evaluate the likely effect of an increase in the fiscal deficit on the level of real output and on the price level. Refer to the multiplier effect in your answer.

(16)

M 3 8 5 2 1 R A 0 2 0 3 2

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M 3 8 5 2 1 R A 0 2 4 3 2

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*(d) Evaluate the likely effects on the UK's current account of the balance of payments of changes in consumption, investment and the exchange rate of the pound sterling (£), as shown in Figures 1 and 2.

(30)

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M 3 8 5 2 1 R A 0 2 8 3 2

(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

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M 3 8 5 2 1 R A 0 3 2 3 2

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GCE

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Paper 01

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January 2011

Publications Code US026254

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Question Number	Answer	Mark
1(a)(i)	Definition of inflation **(2 marks)**: an increase in the cost of living or average/general price level, or a fall in the purchasing power of £1 Definition of deflation **(2 marks)**: a decrease in the cost of living or average price level, or a rise in the purchasing power of £1. Outlining the difference between CPI and RPI methods of measuring inflation, such as the RPI including mortgage payments **(2 marks)** Explain trend with reference to data **(2 marks)** • Inflation peaked Q3 2008 **(2 marks)** • CPI prices rose faster before Q3 2008 and then rose at a slower rate thereafter **(2 marks)** • RPI prices rose slowly up to Q3 2008 an then rose less quickly after that, eventually falling reference to deflation **(2 marks)**. Accept comments on the differences between the CPI and RPI rates in Figure 1 in terms of • the overall level **(2 marks)** • volatility **(2 marks)** **Maximum 4 marks** with no reference to the data	**(6)**

Question Number	Answer	Mark
1(a)(ii)	Some criteria that indicates success 2 x 4 marks. Identify each criterion that might indicate success **(2 marks)** and further explanation or reference to data **(2 marks)** • Named target has been clear 2% inflation (+/- 1%) • Transparency and openness maintained (open letters to chancellor in 2007) • MPC remains independent with control of interest rates and free of political interference • These led to reduced inflationary expectations which is self fulfilling to some extent • Looking at Figure 1 generally in tolerance over the decade • Looking at Figure 1 technically no deflation in 2009 • Credit for how monetary policy committee use interest rates • Reward discussion of more recent problems Give credit for candidates who say why target was missed Evaluation (1 x 4 marks or 2 x 2 marks). Factors might include: • Fluctuating state of the economy had inevitable effect on inflation • Changed target to CPI which was more stable than RPI possibly because of absence of volatile housing market and mortgage interest payments • Uncertainty of effect of Quantitative Easing	

	• Looking at Figure 1, out of tolerance in 2007 but not out of control • Looking at Figure 1, vicious cycle of deflation seems to have been avoided in 2009	**(12)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing criteria with at least one evaluative point
Level 2	5-8	2 convincing criteria with no further analysis or explanation, or 1 convincing criterion with some good analysis but no evaluative point; 1 or 2 less-convincing criterion with some evaluation
Level 1	1-4	Identification of relevant criterion with or without brief evaluative keywords

Question Number	Answer	Mark
1(b)(i)	Up to 2 marks for definition A contraction, decrease, or reduction (accept recession) **(1 mark)** in the volume or after discounting the effect of inflation **(1 mark)** of output or goods and services produced in a country (1 mark). Allow potential output. Up to 2 marks for use of data for example Germany -5.0%, U.K. -4.9%, or US -2.4% in 2009	**(4)**

Question Number	Answer	Mark
1(b)(ii)	Award two problems only Two problems identified **(1 mark each)** and explained **(1 mark each)** and applied **(2 marks each)** Problems of comparison may include: • Subsistence, barter and the black economy undervaluing the real output • Currency values and effectively calculating an accurate purchasing power parity • Spending on investment may increase future welfare at the expense of current welfare • Size of the public sector which might or might not improve welfare • Quality of life issues such as spending on education or health which is difficult to measure the impact • Population growth in developing countries may account for most growth in GDP Evaluation (1 x 4 marks or 2 x 2 marks). Factors might include: • Prioritisation with justification • Problems of comparison over time • Other measures might be better e.g. HDI, real, per capita (each method is a different point) • GDP per capita may not grow • Benefits of using GDP for comparison – standard measure, well understood	**(12)**

Question Number	Answer	Mark
1(b)(iii)	2 implications x 4 marks 2 marks for each problem or outcome and explanation of the consequence. Up to 2 marks for policy affected If growth data are inaccurate and real growth lower than data measured, output gap could be larger and unemployment may rise faster than expected **(2 mark)** • this could lead to financial crowding out (a larger budget deficit) and fiscal policy could be tighter in the future **(2 marks)** • supply side policy may also need to be increased to increase retraining of workforce **(2 marks)** If growth data are inaccurate and real growth higher than data measured, the output gap could be smaller and output could be closer to full employment. **(2 marks)** • the government could adopt an excessive expansionary fiscal policy which leads to fiscal policy being tighter in the future **(2 marks)** • supply side policy may also need to be expanded to maintain growth (ie full employment) if capacity has been reached **(2 marks)** • the MPC mighty need to increase interest rates **(2 marks)** Do not award the same point in reverse Additional use of data **(2 marks)**	**(8)**

Question Number	Answer	Mark
1(c)	Reward identification that income is less equal **(2 marks)**. Maximum marks could be obtained for 2 implications done well or 3 implications less well. For each likely cause (2 x 4 marks or 3 x 2 marks); Identify each possible cause **(2 marks each, or 1 mark if not fully convincing)** and a further 2 marks for the explanation of the connection: • Increased unemployment of low income workers • High income workers are more likely to have higher unearned income from wealth • Change in tax revenue (direct and indirect) • Credit that different groups are affected in different ways • Depends on the top rate of income tax or corporation tax • Depends on size of benefits of pensioners or low income households	**(8)**

Question Number	Answer	Mark
1(d)	KAA 18 marks **Up to 6 marks** for definitions: Definition and outline of the nature of supply side policies • Accept rightward shift of the aggregate supply curve or similar definition **(2 marks)** • a diagram showing rightward shift of AS curve; axes labelled(1), equilibria labelled(1), AD/AS lines labelled(1), correct shift (AS to right)(1). No marks for diagram if shift in wrong direction. Alternatively reward explanation in words demonstrating the impact on the price level and real output **(4 marks)**. Possible definitions include either: • a change in the capital stock to offset depreciation **(2 marks)** • or productivity is the output per worker, machine, operational unit or per unit of inputs **(2 marks)** • or supply-side measures as those aimed at increasing productivity and/or competition in the product market **(2 marks)**. Allow policies aimed at shifting AS to the right **(2 marks)**. Explanation and analysis of at least two policies **(12 marks)**; of which, up to 6 marks each for two policies explained in depth with examples, or up to 4 marks for three policies explained clearly. 2 marks for identifying each policy and up to a further 4 for development Policies might include: • Increase accessibility and flexibility of the education system for adults and those in work to increase and update their skills • Subsidise firms to take on school leavers and graduates to enable them to get work experience and useful skills (New deal, Sure Start, modern apprenticeships) • Provide training and subsidise work placements for potentially long term unemployed • Offer subsidies or tax breaks for investment in long term capital projects • Implement schemes to offer businesses extra credit to cover overdraft payments in the short run • Offer subsidies or tax breaks for investment in research and development • Other recent policy developments e.g. trade union reform, attract skilled immigrants • Reduction in Corporation tax • Privatisation and deregulation Evaluation **(12 marks)**; of which award two very well developed points (6 marks each) or three factors clearly given (up to 4 marks each). Factors comments might include reference to • Significance of elasticities of AD and AS curves • Extent of shifts in AS curves • Time lags • Short run and long run impact	

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing measures with at least two evaluative points (an evaluation point is worth up to a maximum of 6 marks)
Level 3	19-24	2 or 3 convincing measures with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing measures with no evaluative point; 1 or 2 less-convincing measures with some evaluation
Level 1	1-6	Identification of relevant measures with or without brief evaluative keywords

	• Critical consideration of the effectiveness of policies • Other factors might be more significant in promoting productivity e.g. management methods • Cost implications of these policies **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	

Question Number	Answer	Mark
2(a)(i)	2 marks for definition of deficit, 2 marks for reference to increase • Government spending is more than revenue/taxation **(4 marks)** • Government spending is too high, it has overspent, or government has to borrow **(2 marks)** • Explanation of modest **(2 marks)** Reference to data **(2 marks)** e.g. £178 billion in 2009/10 or he increased planned spending by around £15 billion in total over 2011/12 and 2012/13, while recovering only £9 billion through new tax increases.	**(6)**

Question Number	Answer	Mark
2(a)(ii)	KAA 12 marks. Up to 8 marks • Appropriate AD/AS diagram showing enlarged shift or second shift of AD **(4 marks)**; axes labelled(1), equilibria labelled(1), correct shift (AD to right)(1), enlarged shift or second shift of AD to the right (1). • Written explanation of effect on price level **(2 marks**) and output **(2 marks)** • Definition of an injection: an addition to the level of I+G+X demand in the circular flow e.g. an increase in government spending **(2 marks)**. • Initial impact on the level of AD without graph **(2 marks)** Up to 4 marks for 2 x 2 marks for the following points; • Definition of the multiplier as the number of times a rise in income exceeds the rise in injections that caused it. It measures the more than proportionate increase in the circular flow of income **(2 marks)**. • Rise in incomes of those affected **(2 marks)**. • These people in turn increase their consumption **(2 marks)** • and the extended repercussions result as the increase in demand goes round the circular flow **(2 marks)** • the process fades due to withdrawals (S,T,M) at each stage **(2 marks)** Evaluation 2 x 2 marks or 1 x 4 marks. Points may include • the magnitude of multiplier effect • changes over time • magnitude of the injection • other things are not equal e.g. confidence might change • fall in one of the other components of AD impact on price level depends on elasticity of AS curve	**(16)**

Question Number	Answer	Mark
2(b)(i)	Definition up to 2 marks • Identification of exports as an injection and/or imports as a withdrawal **(2 marks)** • Define circular flow of income as the flow of goods and services between households and firms and their corresponding payments in money terms. **(2 marks)** • Accept AD shift to the right or when taken in the context of a other components of AD decreasing, then award a shift to the left that is not as great because of the more positive impact **(2 marks)** Explanation up to 4 marks • Imports have fallen faster than exports **(2 marks)** • Identify it as a reduction in the size of withdrawal or a net injection on previous year **(2 marks)** Use of data up to 2 marks, such as the correct comparison of absolute figures or percentage changes for Exports and Imports, or Export-Imports.	**(6)**

Question Number	Answer	Mark
2(b)(ii)	For each likely cause (2 x 4 marks); Identify each possible cause (1 mark each) and 3 marks for the explanation or analysis of the cause; • Unemployment and the fall in incomes; or fear of unemployment • Fall in real wages • Fall in expected incomes • Higher savings ratios • Negative wealth effect associated with falling asset prices • Restrictions on the availability of credit after a period of relatively easy credit • Higher tax rates (e.g. VAT) No marks are to be awarded if reference is made to trade or the balance of payments as this indicates a fundamental misunderstanding Up to 2 marks for reference to the data Evaluation (1 x 4 marks or 2 x 2 marks) • Claimant Count Unemployment rose by 50% in the previous 18 months • Restriction on the availability of credit after a period of relatively easy availability (approximately 10 million households had mortgages and the average mortgage was £70,000) • Higher savings ratios as a result of uncertainty about the future from approximately 18 million of the 25 million households who are owner occupiers and whose asset prices have fallen • Short-run/long-run: fall in consumption might only be temporary if economic recovery is maintained. • Prioritisation: eg most significant reason is uncertainty associated with fear of unemployment and fall in income. • Consumption may not have fallen as much in real terms if product price deflation **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately • To use grammar, spelling and punctuation appropriately	**(14)**

Level	Mark	Descriptor
Level 3	9-12	2 convincing reasons with at least one evaluative point
Level 2	5-8	2 convincing reasons with no further analysis or explanation, or 1 convincing reason with some good analysis but no evaluative point; 1 or 2 less-convincing reason with some evaluation
Level 1	1-4	Identification of relevant criterion with or without brief evaluative keywords

Question Number	Answer	Mark
2(c)(i)	The price of one currency expressed in terms of another **(2 marks)** or the amount of one currency that can be bought with a unit of another currency **(2 marks)** Use of data **(2 marks)** eg £1 would have bought 1.41 euros in 2007	**(4)**

Question Number	Answer	Mark
2(c)(ii)	Award 4 marks for the correct answer regardless of whether working shown. ((1.10-1.43)/1.43)x 100 = -23.1% **(4 marks)** Accept figures between -23% and -23.1% For incorrect answers marks can be awarded for the following ((New Year – Old Year)/ Old Year) x 100 **(1 mark)** ((1.10-1.43)/1.43) x 100 = wrong answer **(2 marks)** (1.10-1.43) = -0.33 **(1 mark)** (1.10/1.43) x 100 **(1 mark)** 0.33/1.43 = -0.23077 **(1 mark)** -0.23077 x 100 = - 23.1% **(1 mark)** Both minus sign (or statement that 'the exchange rate fell by…') and percentage are required for this mark	**(4)**

Question Number	Answer	Mark
2(d)	KAA 18 marks **6 marks for definition and 12 marks for explanation – allow up to 14 for explanation if definition earns only 4.** Definition of current account of the balance of payments in simple terms of imports and exports **(2 marks)** and then some explanation of components of the balance of payments, such as trade in goods **(2 marks)**, trade in services **(2 marks)** etc. Explanation of at least two consequences **(12 marks or 14marks if definition only 4 marks or less)**; of which, up to 6 marks each for two consequences explained in depth with examples, or up to 4 marks for three consequences explained clearly. Consequences might be the effect on: • Effects of falling consumption - on imports - Possible effects on exports • Fall in investment - Fall in productivity and resultant loss of competitiveness • Fall in value of £ - improved competitiveness - accept an increase in the value of £ if reference is made to $ exchange rate 2008-9 and reduced competitiveness Evaluation **(12 marks)**; of which award two very well developed points (6 marks each) or three consequences clearly given (up to 4 marks each). Evaluative comments might include reference to • Relative size of each effect. • Different effects on imports of different goods (e.g. elasticity) • Short run effects on investments might be lower than long run • Significance of elasticities (short run/long run) • Relative importance of EU and US. **Quality of written communications will be assessed in this question based on the candidate's ability:** • To present an argument and conclude on the basis of that argument • To organise information clearly and coherently • To use economic vocabulary appropriately To use grammar, spelling and punctuation appropriately	**(30)**

Level	Mark	Descriptor
Level 4	25-30	2 or 3 convincing effects with at least two evaluative points (an evaluation point is worth up to a maximum of 6 marks
Level 3	19-24	2 or 3 convincing effects with at least one evaluative point (mark cap to 18 if no evaluation)
Level 2	7-18	2 or 3 convincing effects with no evaluative point; 1 or 2 less-convincing effects with some evaluation
Level 1	1-6	Identification of relevant effects with or without brief evaluative keywords

	Knowledge	Application	Analysis	Evaluation	Total
Question 1					
ai	4	2			6
aii	2	2	4	4	12
bi	2	2			4
bii	2	4	2	4	12
biii	2	2	4		8
c	2	2	4		8
d	6	6	6	12	30
Total	20	20	20	20	80
Question 2					
ai	4	2			6
aii	4	4	4	4	16
bi	2	2	2		6
bii*	2	2	6	4	14
ci	2	2			4
cii		2	2		4
d	6	6	6	12	30
Total	20	20	20	20	80

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Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Monday 7 June 2010 – 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. 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 Economic Growth and Unemployment

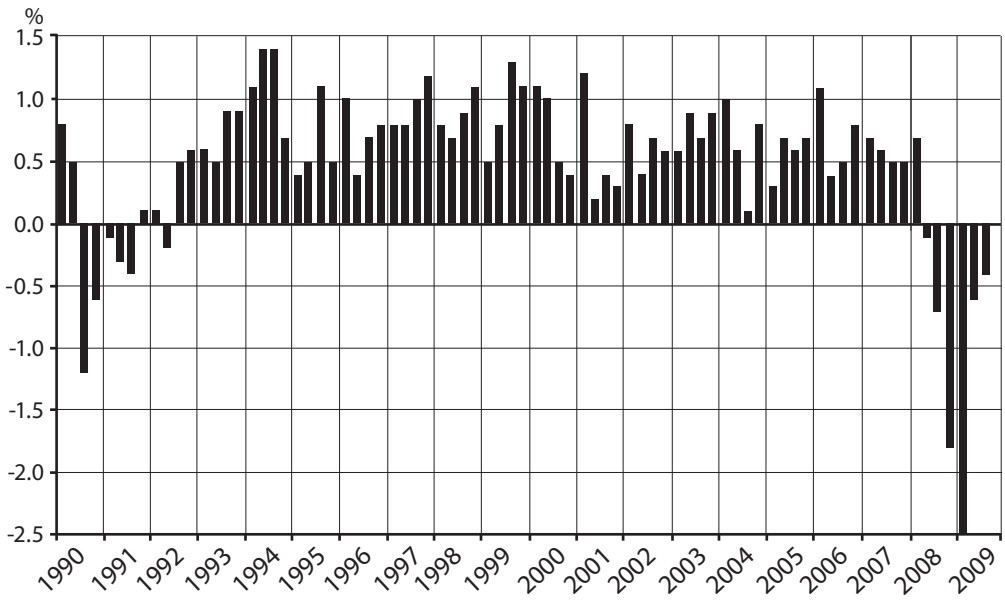
Extract 1 The World Economy – a glimmer of hope?

The worst of the economic downturn is over only in the sense that the pace of global decline has peaked. Thanks to expansionary – and unsustainable – fiscal and monetary policies, output growth will eventually become positive again. However, growth, when it comes, will be too feeble to stop unemployment and spare capacity rising. The increasing output gap will keep many individuals and firms dependant on the government.

Consider what that means. Much of the rich world will see unemployment rates that reach double figures, and then stay there. Inflation will become negative thanks to falling fuel costs and record economic spare capacity, pushing down prices and wages. Government borrowing will soar because of falling growth, prolonged fiscal spending and the growing costs of bailing out the banks and other firms. Continuing high unemployment, years of falling investment and higher government borrowing will limit economies' underlying potential. It is clear that rates of economic growth will be lower than the long-term trend for years to come.

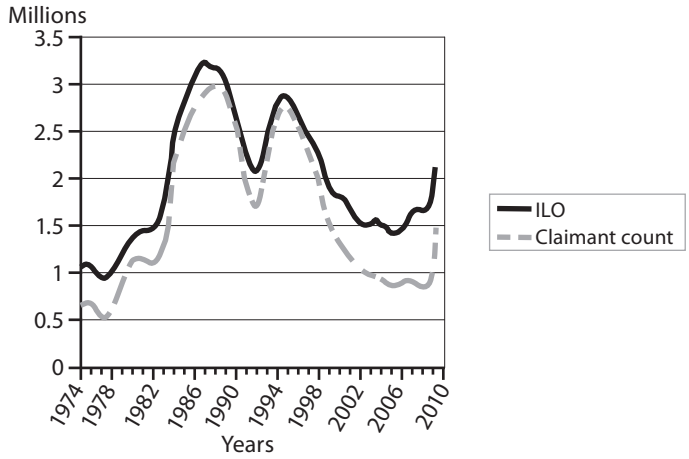
Source: adapted from *The Economist* 24 April 2009
http://www.economist.com/opinion/displaystory.cfm?story_id=13527685.

Figure 1 UK Growth rates at a 30-year low



Source: statistics.gov.uk

Figure 2 Unemployment: ILO and the Claimant Count



Source: www.statistics.gov.uk

Extract 2 Unemployment: ILO and the Claimant Count

ILO unemployment is now 6.7% (2.1 million). In some regions it is much higher, for example the West Midlands (8.4%) and the North East of England (8.3%). While ILO unemployment is still much lower, so far, than in the recent recessions of the 1980s and 1990s, it is forecast that the level will go above 3 million in 2010. The employment rate for people of working age is 73.8% as measured by the International Labour Organisation (ILO). 5

The claimant count has now increased continuously for 14 months. The claimant count rate in March 2009 was 4.5% (1.5 million), up 0.2% on the previous month and 2.1% higher than in March 2008.

Source: adapted from 'First Release labour market statistics' April 2009 ONS

Figure 3 Total immigration into the UK 1998 to 2007

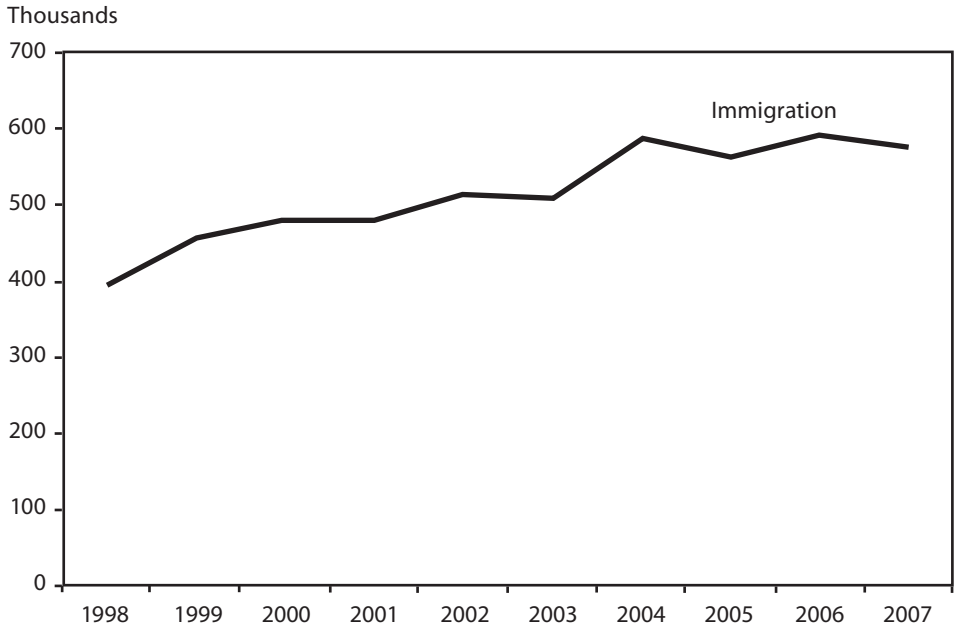
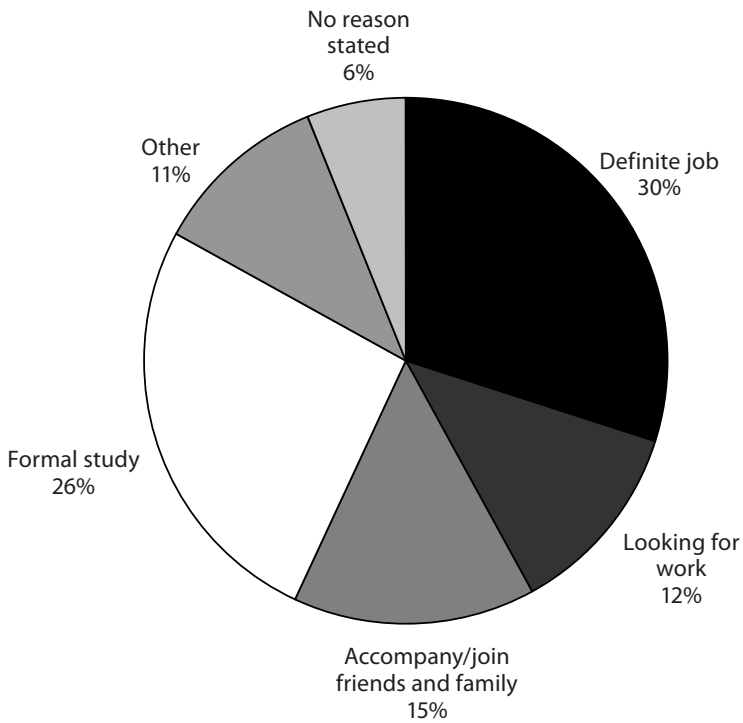


Figure 4 Estimates for the main reason for immigration to the UK, 2007



Source: http://www.statistics.gov.uk/pdfdir/tim1108/pdf

M 3 5 0 0 6 A 0 4 3 2

(a) With reference to Figure 1 and Extract 1,

(i) explain what is meant by an 'output gap' (*Extract 1, line 5*).

(4)

(ii) distinguish between *fiscal policy* and *monetary policy*.

(6)

*(iii) discuss the likely effectiveness of 'expansionary... fiscal and monetary policies' (*Extract 1, lines 2 to 3*) as means of closing the output gap.

(16)

(b) (i) Explain the methods used to obtain measures of *ILO unemployment* and the *claimant count*.

(4)

(ii) Explain why ILO unemployment is still expected to rise above 3 million even though 'the worst of the economic downturn is over' (*Extract 1, line 1*).

(6)

(c) With reference to Figure 3 and Figure 4, assess the significance of immigration for employment and unemployment.

(14)

*(d) Evaluate the likely effects of a recession (negative economic growth) on the UK economy.

(30)

(a) With reference to Figure 1 and Extract 1,

(i) explain what is meant by an 'output gap' (*Extract 1, line 5*).

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(14)

*(d) Evaluate the likely effects of a recession (negative economic growth) on the UK economy.

(30)

(Total for Question 1 = 80 marks)

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

2 Monetary Policy

Extract 1 MPC agreement on rates freeze

All nine members of the Bank of England's Monetary Policy Committee (MPC) voted in favour of freezing interest rates at an historic low of 0.5 per cent, according to the minutes of their April 2009 meeting. The MPC has aggressively cut the cost of borrowing from 5 per cent to 0.5 per cent since October 2008 in an effort to stimulate UK economic growth.

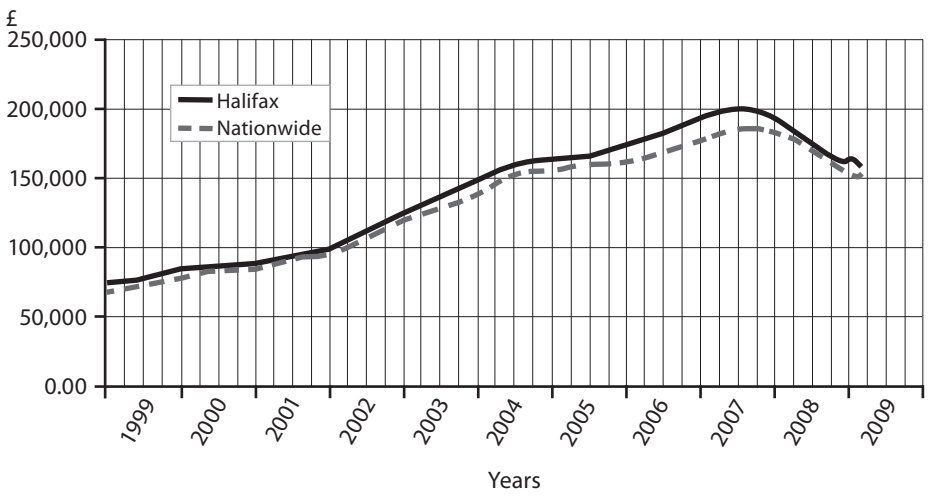
Policy makers noted that the prospect of households holding back on spending was probably the biggest risk to an economic recovery. Household consumption fell by 1 per cent in the fourth quarter of 2008 and the ratio of savings to disposable income was higher than expected.

Since then, developments in household spending have been more encouraging. Data on retail sales and car registrations have suggested a slowdown in the rate of decline of consumption. There are indications that confidence and affordability in the housing market are improving, although from very low levels, in the first quarter of 2009. Nevertheless, it is too soon to be sure whether a more significant recovery in consumers' expenditure is in prospect.

The Committee noted that consumer price inflation had risen to 3.2 per cent in February, higher than expected and above the MPC's own target. Despite this, the Committee continued to hold the view that inflation would fall back below its 2 per cent target by the second half of the year.

Source: adapted from *The Times* Online April 22, 2009.

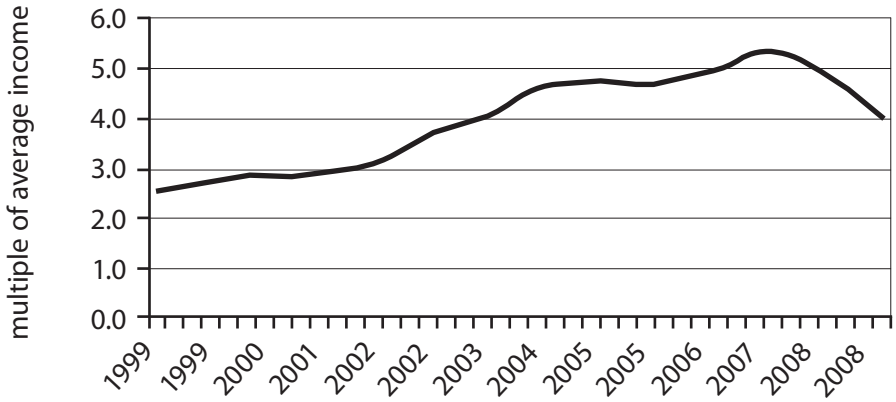
Figure 1: UK average house prices indicated by two large mortgage lenders, by quarter, 1999–2009



Source: Halifax/Nationwide

M 3 5 0 0 6 A 0 1 8 3 2

Figure 2: Average house prices (bought by first-time buyers) as a multiple of average income, by quarter



Source: http://www.nationwide.co.uk/hpi/historical.htm

With reference to Extract 1,

(a) (i) explain how Consumer Price Inflation (CPI) is measured. Refer to weights in your answer.

(4)

(ii) explain **two** reasons why the government has a low rate of inflation as a macroeconomic objective.

(8)

(iii) examine how interest rate decisions may be used to achieve the government's inflation target.

(14)

With reference to Figures 1 and 2,

(b) (i) identify changes in house prices and affordability of houses in the UK since 2005.

(4)

(ii) define the term *wealth effect*.

(4)

*(iii) assess the likely effects on real output and the general price level of changes in house prices since mid-2007. Use an aggregate demand and supply diagram to support your answer.

(16)

*(c) Evaluate three ways in which economic policy can be used to 'stimulate UK economic growth' (*Extract 1, lines 4 to 5*).

(30)

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(a) (i) explain how Consumer Price Inflation (CPI) is measured. Refer to weights in your answer.

(4)

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(8)

Reason one

Reason two

(iii) examine how interest rate decisions may be used to achieve the government's inflation target.

(14)

(b) With reference to Figures 1 and 2,

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(4)

(ii) define the term *wealth effect*.

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(16)

*(c) Evaluate three ways in which economic policy can be used to 'stimulate UK economic growth' (*Extract 1, lines 4 to 5*).

(30)

(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

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GCE

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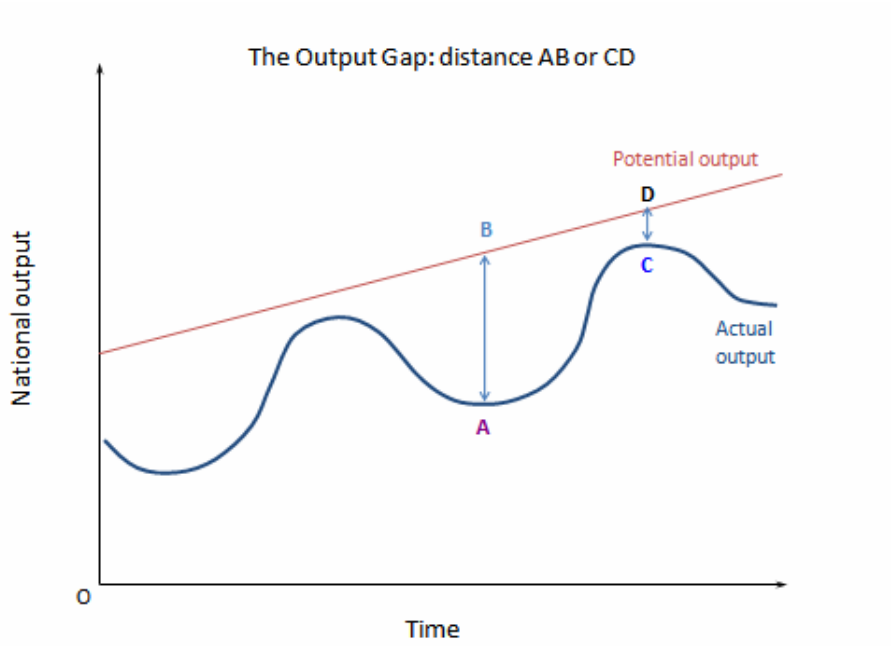
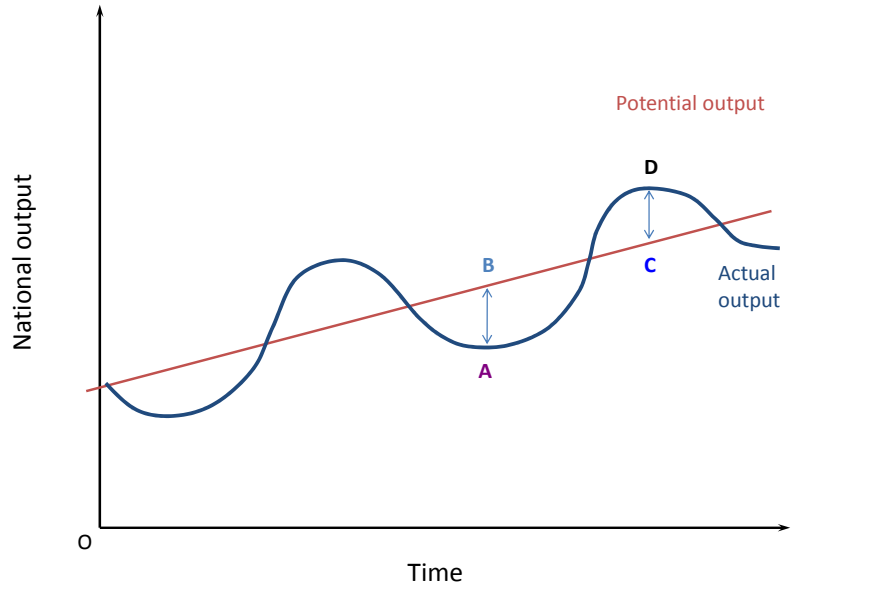
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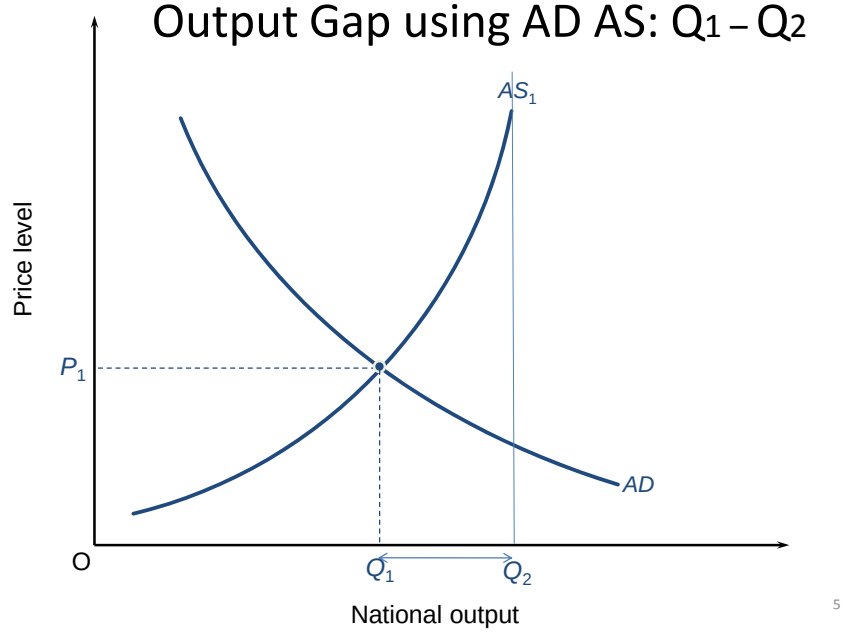
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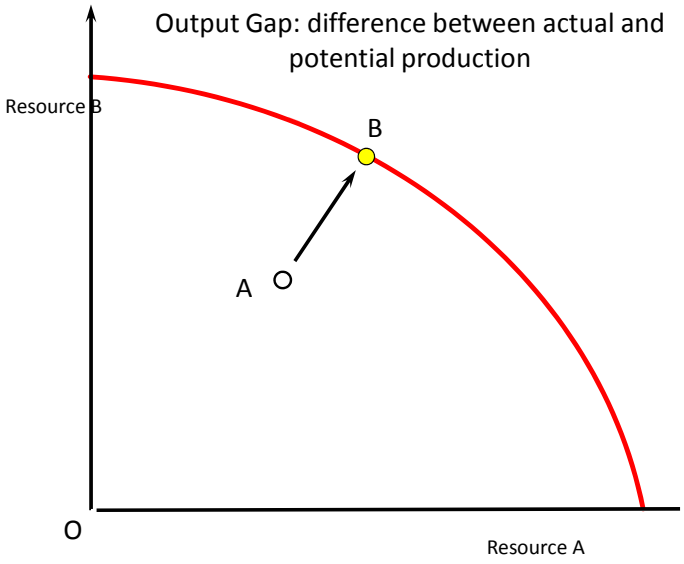
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Question Number	Answer	Mark
1(a)(i)	**A measure of the difference between actual and potential (or trend) growth/output/GDP. Reward explanations of both positive and negative output gaps. (2 marks).** **Allow up to 2 marks for written explanation OR an appropriate diagram (AS/AD, PPF, Business Cycle showing trend or potential and actual) showing actual and potential growth/output/GDP.**  The Output Gap  **continued on next page**	**(4)**





Reference: data or extract (2 marks)

Question Number	Answer	Mark
1(a)(ii)	**Definition of fiscal (2 marks: G 1 and T 1) and monetary policies – interest rates are sufficient (2 marks)** **Use of extract 2 marks** **Identification of certain differences (up to 4 marks), e.g.** • **body in charge, government vs MPC;** • **frequency of adjustment, typically annual vs monthly.**	**(6)**

Question Number	Answer	Mark
1(a)(iii)	**KAA 12 marks** **Expansionary: (4 marks) G rises or T falls (2 marks); interest rate falls (2 marks)** **How the policy shifts AD (right/up) either:** • **Written explanation (2x4 marks); or** • **Up to 8 marks can be awarded for a written explanation and diagram; Axes labelled (1), Lines labelled (1), correct movement (1), Equilibrium labelled (1)** **Evaluation (4 marks) factors might include (1x4 marks or 2x2 marks)** • **that demand management might not work if AS vertical** • **the policies work in tandem** • **the policies cancel each other out** • **inaccurate or missing information** • **time lag or other short run/long run distinction** • **taxes may have to rise, or government spending fall in the future** • **size of multiplier, e.g. high savings ratio means the policy is not very effective** • **other things not equal, e.g. low confidence, credit crisis**	**(16)**

Question Number	Answer	Mark
1(b)(i)	**Unemployment (ILO) up to 2 marks:** • **out of work in last four weeks (1)** • **ready to work in two (1)** • **Questionnaire/interview (1)** • **Survey by phone call/paper (1)** • **Internationally recognised (1)** • **age 16-65 (1)** • **Sample, and related problems (1)** **Claimant count up to 2 marks:** • **the number of people claiming/receiving (1)** • **JSA/dole/or unemployment related benefit (1)** • **Age range – 18-60/65 (1)** • **savings cap (1)** • **must be able to prove they are looking for work (1).** • **Register at unemployment offices (1)**	**(4)**

Question Number	Answer	Mark
1(b)(ii)	**Unemployment is a lagging indicator or similar indication that there is a time delay (2 marks).** **Allow one reason up to 4 marks, or two reasons 3+3 marks or 4+2 marks.** • **Workers are not laid off immediately when sales fall because contracts are in place or for compassionate reasons (this may be two points).** • **Cost of redundancy and recruitment** • **Fear that recovery will not be sustained, therefore lack of investment in recruitment and training** • **As recession hits workforce, incomes fall, so spending falls, so unemployment increases further. A vicious circle.** • **Workers are only laid off as a last resort because they represent investment in human capital** • **Unreliable ILO data**	**(6)**

Question Number	Answer	Mark
1(c)	**KAA 10 marks** **Use of data (2 marks)** **Significance of immigration for employment:** • **30% of immigrants have definite job – the immigrants may fill vacancies that cannot be filled by indigenous workers** • **Increased supply of labour might push down wages and average wage levels will fall. The demand for workers increases and employment increases** • **Increased consumer spending from increased population means more jobs are created** **(4 marks for one point or 2+2 marks or 3+1 mark)** **Significance of immigration for unemployment:** • **12% of immigrants are looking for work or the 30% with jobs – these might displace current employees** • **Surplus labour in the market, e.g. friends and family, might attempt to join labour market but with inappropriate skills** **(4 marks for one point or 2+2 marks or 3+1 mark)** **The arguments in reverse are allowable in the context of falling immigration rates (shown in fig. 3)** **Evaluation 4 marks (2+2 marks or 3+1 mark):** • **Evidence might not be reliable – e.g. reason for immigration is a loaded question** • **It is not known whether those coming for 'formal study' are going to remain in the UK** • **The friends and family may or may not wish to join the labour market; they cannot be counted as unemployed unless they are willing and able to work in the next two weeks. Might have dependents.** • **Dependents may or may not have an effect** • **Net migration is a more significant figure**	**(14)**

Question Number	Answer	Mark
1(d)	**KAA 18 marks** **Identification of falling GDP (might be implicit) (2 marks)** **Diagram or equivalent verbal analysis showing AD and/or AS shift to left/down. Axes labelled (1), Lines labelled (1), correct movement (1), Equilibrium labelled (1)** **(4 marks)** **Effects. Award three effects 3 x 4 marks, or two well-argued, 2 x 6 marks. Include positive and negative effects but allow negative/positive effects as evaluation. Factors might include:** • **Unemployment** • **Lower incomes** • **Less government revenue, so there may be lower government spending in future on health, education** • **Fall in investment so innovation suffers and R&D** • **Less investment by domestic and foreign firms in UK so job security is lost** • **Lower external costs of growth** • **Less inflationary pressure** • **Trade deficit narrows** • **Exchange rate changes** • **Regional effects** • **Inequality** • **Social factors, e.g. crime rate, poor health** • **House prices depressed** • **Labour market impacts** **Evaluation 12 marks as 4 x 3 marks or 2 x 6 marks** **Accept benefits if costs given above or vice versa** **Factors might include:** • **Counter-arguments – there are benefits despite costs or vice versa** • **Changes over time – or other short run/long run issues** • **Other things are not equal, e.g. depends on government policy or redistribution of income** • **Falling inflation** • **environmental damage lessens although jobs fall, as fewer people travel by air** • **Falling house prices make houses affordable to non-homeowners**	**(30)**

Question Number	Answer	Mark
2(a)(i)	1 marks for explaining weights: weights are attached to reflect relative importance (1 mark) Other elements, up to 3 marks Exclusion of housing costs (1 mark) Price survey (1 mark) Index use (1 mark) Base year (1 mark) Reference to data 3.2% (1 mark) From the expenditure and food survey (1 mark) Basket of goods (1 mark).	(4)

Question Number	Answer	Mark
2(a)(ii)	Award two reasons (2 x 4 marks) • Inflation damages those on fixed incomes • Other widening of income gaps • Maintain international competitiveness • Helps price signalling • Increased confidence in government control of economy • Avoids the dangers of hyperinflation • Avoiding deflation • To maintain value of savings • To encourage investment • Avoid wage/price spiral • Avoid shoe leather costs and/or menu costs 1 mark identifying each reason, 1 mark defining each reason, up to 2 marks explaining each reason.	(8)

Question Number	Answer	Mark
2(a)(iii)	KAA 10 marks Interest rates must be raised to reduce inflation or vice versa (2 marks) Description of transmission mechanisms as follows or costs of borrowing increases(2 x 4 marks): C falls as: • mortgage interest repayments increases • the return to savings increases • hire purchase costs increase I falls as the opportunity cost or cost of credit rises; expectation of future income might fall Pound sterling rises in value. • Imports cheap exports dear, so AD falls The transmission mechanism could be explained using a diagram. Axes labelled (1), Lines labelled (1), correct movement (1), Equilibrium labelled (1) 2 marks can be awarded for use of data Evaluation (4 marks). Factors might include (1x4 marks or 2x2 marks): • Time lag of 18-24 months before the full effects is felt • Fixed rate mortgages held by half the 9.5 million mortgage holders in the UK • Investment depends on many things besides interest rates, e.g. confidence, availability of credit • Commercial banks might not pass rate changes on • Magnitude or timing of changes (one big change or a prolonged series of change). • Possible impact on AS	(14)

Question Number	Answer	Mark
2(b)(i)	Up to 2 marks for each figure Trend (1 mark) correct use of numerical data (1 mark) e.g. fig. 1 House prices peaked (1) in 2007 (1) or at £200 000 (1) e.g. fig. 2 Affordability similar path (1) – reached over 5 times earnings of first time buyers (1), but houses are now more affordable (1), at 4 times earnings (1) Affordability peak in 2007, but give credit for 2008. (1)	(4)

Question Number	Answer	Mark
2(b)(ii)	When asset (accept house prices or shares etc.) values change (accept data) (2 marks) This affects changes in spending (or similar, e.g. confidence) (2 marks).	(4)

Question Number	Answer	Mark
2(b)(iii)	KAA 12 Diagram AD shifts to left. Axes labelled (1), Lines labelled (1), correct movement (1), Equilibrium labelled (1) (4 marks) State output falls (2 marks) and price level falls (2 marks) Transmission mechanisms (1x4 or 2x2 marks) showing: • house price effect on consumption and/or other elements of AD • AD falls with multiplier effects, as C falls. Refer to mortgage equity withdrawal, credit problems or confidence issues. Evaluation (1 x 4 marks or 2 x 2 marks) might include: • This appears to be a return to trend of affordability. • Housing is a very significant proportion of UK assets • Confidence is likely to improve, but it depends on other factors too. • Other things may not be equal, e.g. global recession effects on confidence • First time buyers can now enter the market. • Time factors might delay impact • There is only limited and possibly inaccurate information. • Depends on elasticity of AS • Magnitude of the multiplier effect	(16)

Question Number	Answer	Mark
2(c)	KAA 18 marks of which Identification of concept of stimulating growth, that is, raising real or potential GDP (might be implicit) (2 marks) Diagram, or equivalent written analysis (4 marks). AD/AS or shift to the right. Axes labelled (1), Lines labelled (1), correct movement (1), Equilibrium labelled (1) Policies that might stimulate growth (12 marks) 3 x 4 marks might include: • Increased government spending • Cutting tax • Monetary policy (e.g. cutting interest rates) • Improved trade, e.g. export led growth • Supply side policies (may count as up to three separate policies) Evaluation (12 marks) 3 x 4 marks or 2 x 6 marks might include: • Depends on elasticity of AS when AD shifts • Conflict between policies • Depends on credit availability. Credit problems might prevent growth policy from working, e.g. Greece 2010 or other countries with problems of increased fiscal deficit • Time lag and implementation lags • Other things are not equal – e.g. depends on global economic changes • Proximity to full capacity if AD led growth • Magnitude of multiplier effect Other side effects of policies, e.g. higher growth rates tend to widen income inequality.	(30)

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Write your name here

Surname	Other names

Edexcel GCE

Centre Number	Candidate Number

Economics

Advanced Subsidiary
Unit 2: Managing the Economy

Wednesday 3 June 2009 – 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. Write your answers in the spaces provided in this question paper.
- 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

- 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.*
- There are 28 pages in this question paper. Any blank pages are indicated.

Advice

- Quality of written communication will be taken into account in the marking of your answers in Question 1(c)(ii) and 1(d) and in Question 2(b)(ii) and 2(d). These questions are indicated with an asterisk. Quality of written communication includes clarity of expression, the structure and presentation of ideas and grammar, punctuation and spelling.

Turn over ▶

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Answer EITHER Question 1 OR Question 2

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

Question 1 Measures of economic performance

Figure 1 Measures of economic performance, selected developed countries

	Economic growth % (2006)	Inflation (% increase in CPI) (2006)	Current account of the Balance of Payments (% of GDP) (2006)	Human Development Index (HDI) value (2005)
France	2.0	1.8	-1.8	0.952
Germany	2.0	1.8	5.1	0.935
Spain	2.7	2.8	-10.2	0.949
United Kingdom	2.3	2.0	-3.6	0.946

Source: www.imf.org (2007 report) and www.undp.org (2007 report of HDI based on 2005 values)

Figure 2 School enrolment figures and HDI ranks, selected developed and developing economies (2005)

Economy	Combined enrolment ratio for primary and secondary education (%)	HDI Rank
France	99	10
Spain	98.5	13
United Kingdom	97	16
Pakistan	44.5	136
Kenya	60.5	148
Ethiopia	44.5	169
Niger	24	174

Source: http://hdr.undp.org/en/statistics (2007 report based on 2005 figures)

S.T.E.M.U.B. C.O. U.K.

(a) With reference to Figure 1,

(i) explain what is meant by the term *economic growth*.

(4)

(ii) outline how the Consumer Price Index is calculated.

(4)

(iii) discuss **two** reasons why economic growth is inadequate as a measure of changes in living standards over time.

(12)

(b) (i) Does Spain's current account balance as shown in Figure 1 represent a net *injection* or *withdrawal*? Explain your answer.

(4)

(ii) Outline **two** possible reasons for Spain's current account balance, with reference to the data in Figure 1.

(6)

(c) With reference to Figures 1 and 2,

(i) explain what is meant by the term *Human Development Index*.

(4)

*(ii) evaluate the advantages of the HDI in making comparisons between countries.

(16)

*(d) Evaluate the use of supply side policies to achieve economic growth.

(30)

S T E M U P . C O . U K

(a) With reference to Figure 1,

(i) explain what is meant by the term *economic growth*.

(4)

(ii) outline how the Consumer Price Index is calculated.

(4)

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(iii) discuss **two** reasons why economic growth is inadequate as a measure of changes in living standards over time.

(12)

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(b) (i) Does Spain's current account balance as shown in Figure 1 represent a net *injection* or *withdrawal*? Explain your answer.

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S T E M U P . C O . U K

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(4)

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(16)

S T E M U P . C O . U K

*(d) Evaluate the use of supply side policies to achieve economic growth.

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(30)

(Total for Question 1 = 80 marks)

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

Question 2 Demand management

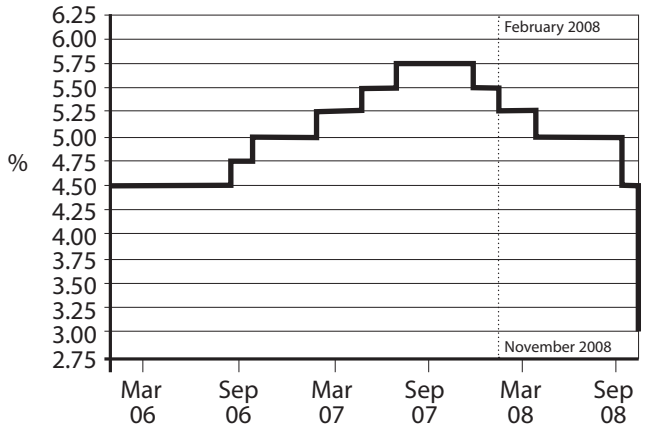
Extract 1 Bank of England cuts interest rates again

The Bank of England's Monetary Policy Committee today voted to reduce the official interest rate. The prospects for global output growth abroad have worsened and the disruption to world financial markets has continued. In the UK, credit conditions for households and businesses are tightening. Consumer spending growth appears to have eased. Although the substantial fall in the sterling exchange rate is likely to lessen the effects of the fall in aggregate demand, output growth has moderated to around its historical average rate and business surveys suggest that further slowing is in prospect. These developments might lead to CPI inflation falling below target in the long run.

CPI inflation, at 2.1% in December 2007, was close to the inflation target, but higher energy and food prices are expected to raise the rate of inflation, possibly quite sharply, in the short run. The lower level of sterling will significantly increase import costs.

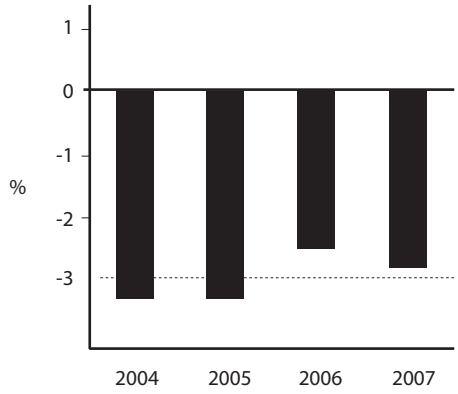
Source: Adapted from press release February 2008 www.bankofengland.co.uk

Figure 1 The Bank of England's official interest rate



Source: www.bankofengland.co.uk November 2008

Figure 2 Government fiscal position as a percentage of GDP



Source: www.statistics.gov.uk 7 April 2008

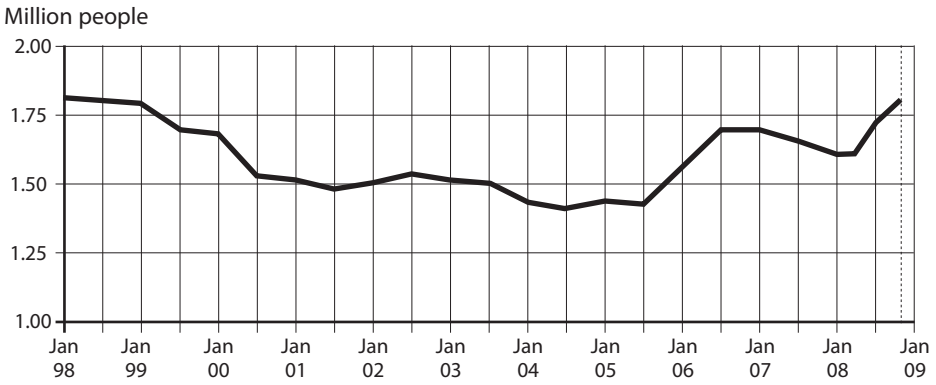
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Extract 2 Government budget deficit

Provisional estimates show that for the calendar year 2007 the UK recorded a government budget deficit of £39.4 billion, which was equivalent to 2.8 per cent of gross domestic product (GDP).

Source: www.statistics.gov.uk 7 April 2008

Figure 3 Unemployment in the UK



Source: ONS

(a) (i) What is meant by an *inflation target* (Extract 1, line 9)?

(4)

(ii) Using the evidence from Extract 1 and Figure 1, analyse **two** possible reasons why the MPC took the decision to cut the official interest rate in February 2008.

(10)

(iii) Assess the likely impact of a cut in interest rates on the distribution of income.

(8)

With reference to Extract 2 and Figure 2,

(b) (i) Explain the phrase *government budget deficit*.

(4)

*(ii) Evaluate why a change in the government budget deficit may lead to a more than proportional change in aggregate demand. Use an aggregate demand and supply diagram to illustrate your answer.

(14)

(c) With reference to Figure 3, explain **two** costs of unemployment.

(10)

*(d) To what extent do demand-side policies lead to conflicts between macroeconomic objectives?

(30)

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(a) (i) What is meant by an *inflation target* (Extract 1, line 9)?

(4)

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(10)

S T E M U P . C O . U K

(iii) Assess the likely impact of a cut in interest rates on the distribution of income.

(8)

S T E M U P . C O . U K

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(14)

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(c) With reference to Figure 3, explain **two** costs of unemployment.

(10)

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*(d)To what extent do demand-side policies lead to conflicts between macroeconomic objectives?

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(30)

(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

END

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GCE

GCE Economics (8EC01)

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Summer 2009

Publications Code US021258

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

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6EC02 Mark Scheme

Question Number	Answer	Mark
1(a)(i)	Increase **(1 mark)** in actual or real **(1 mark)** GDP or income or output **(1 mark)**. Allow potential **(1 mark)** output. Further valid explanation. **(1 mark)** Use of data for example France 2.0%, Germany 2%, Spain 2.7%, or UK 2.3%. **(1 mark)**	**(4)**

Question Number	Answer	Mark
1(a)(ii)	Up to four marks available. Award reference to: Basket of goods **(1 mark)** price survey **(1 mark)** food and expenditure survey (or equivalent) **(1 mark)** index (process of how an index is complied) **(1 mark)** base year. **(1 mark)** 650 items (allow in range 600 to 700). **(1 mark)** Further development. **(1 mark)**	**(4)**

Question Number	Answer	Mark
1(a)(iii)	**Award two factors only, up to 4 marks each:** For identification of each factor **(1 mark) each** and development of the factor **(3 marks each).** Factors might include: • ignores distribution of income • population changes (per capita discussion) • real versus nominal • quality versus quantity • factors that GDP ignores such as self produced goods. Evaluation **(4 marks)**. Award **(2 x 2 marks or 1 x 4)**: • GDP is very useful in the wider context of a composite indicator • living standards are not quantifiable • prioritisation of measures of living standards, with justification • best method we have?	**(12)**

Question Number	Answer	Mark
1(b)(i)	Withdrawal – explanation, for example money is flowing out. **(2 marks)** Use of data -10.2% of GDP to support this. (**2 marks)**	**(4)**

Question Number	Answer	Mark
1(b)(ii)	Accept two plausible reasons. **(2 x 3 marks)** Identification **(1 mark)** and explanation. **(2 marks)** Factors might include: • high level of growth, sucking in imports **(3 marks)** • high level of inflation, reducing competitiveness **(3 marks)** • high level of exports from Germany, which has higher relative competitiveness. **(3 marks)** Accept answers **not** related to data, for example level of confidence, low level of unemployment.	**(6)**

Question Number	Answer	Mark
1(c)(i)	*Accept a reasonable definition such as:* A composite measure of economic development **(1 mark)** which includes longevity, years of school enrolment, literacy and GDP at PPPs **(1 mark for each element given)** presented as an index or rank which gives an indication of health and education rather than just incomes. **(1 mark)**	**(4)**

Question Number	Answer	Mark
1(c)(ii)	QWC marks to be awarded as implicit. KAA 12 marks. Identification of three advantages and explanation **(4 marks each) or (3 marks) for four less well developed factors (3 marks each)**. Factors might include: • measures chosen are easy and cheap to collect • measures chosen are fairly reliable • indicates GDP has been used to increase social welfare • GDP rank minus HDI rank as a useful measure or health and education • use of education and health is a sign of successful government policies • shift of PPF or AS curve outwards as a sign of increased potential without increases in costs, so HDI rank is a sign of welfare in the future. Evaluation **(2 x 2 marks or 1 x 4 marks) (4 marks).** Factors might include: • an indication of deprivation or poverty would increase the usefulness of HDI • PPP values change very quickly and are likely to be inaccurate or misleading • still very little sense of income distribution in this measure • still very little sense of quality of life in this measure, for example wars, political oppression • very difficult to measure human development – sense of prioritisation of options • other measures, such as access to the internet, might be more useful • better to use a combination of measures • changes over time or 'other things are not equal' make the measures less useful.	**(16)**

Question Number	Answer	Mark
1(d)	Knowledge, application and analysis **(18 marks**), of which: Definition of supply side policies. **(2 marks)** Diagram showing the effects of relevant government policies on the price level and output, showing an increase to the right of AS. **(4 marks)** Analysis **(12 marks)** of the effect of chosen policies – award three factors **(4 marks each)** or two factors **(6 marks each)**. Factors might include: supply side policies: • privatisation • education and training • deregulation • cutting bureaucracy • promotion of competition • control of power of monopolies • reduction in planning restrictions • improvement in human capital increases the value of workers' output, meaning that firms can produce more for the same price • improved education increases opportunities which means that incentives can work more effectively. Evaluation **(12 marks)** – award three points up to **4 marks each** or two well-developed points up to **6 marks each**. Points might include the following: • time lag for the education to have a result on workforce • education might not be effective, for example Madonna studies, Surf Science • expansionary fiscal implications of supply side policies • other policies might be more effective, such as cutting interest rates • scope for further supply side policies is limited • time lags, for example supply side policies can lag for decades • supply side policy conflicts - Increased government spending and tax can cause disincentives - Supply side policy might have positive impact on the fiscal side in the long run.	**(30)**

Question Number	Answer	Mark
2(a)(i)	A permitted range for the increase in the price levels, measured by changes in the CPI **(2 marks)**; of 2% **(1 mark)**(+ or – 1%) **(1 mark)** OR as a government-determined goal set for the MPC. **(2 marks)** Reference to data (2.1%) (**1 mark)**	**(4)**

Question Number	Answer	Mark
2(a)(ii)	For each point (allow **two** points only for up to 5 marks each): Identification of evidence **(1 mark)**; with explanation of point **(2 marks)**; **and link to price level. (2 marks)** Evidence might include: • prospects for output growth have worsened • disruption to global financial markets • tight credit • consumer spending growth has eased • output growth has moderated.	**(10)**

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Question Number	Answer	Mark
2(a)(iii)	Distribution of income improves (if justified): identification of groups (ie winners and losers) affected by cut in interest rates, for example savers, borrowers, mortgage holders, pensioners, hire-purchasers. **(2 marks)** Award up to **(4 marks)** for further analysis, for example savers are likely to be the higher-income groups and their returns will fall, monthly mortgage interest payments will reduce affecting lower-income groups more as a proportion of their income, link between interest rates and house prices. Evaluation **(4 marks)**. Award **(2 x 2 marks or 1 x 4)**. Points might include: • higher-income groups are not necessarily higher savers • higher-income groups might have larger mortgage interest payments as a proportion of their income • time implications for impact of interest rate changes • effects on income might take longer than wealth effects or other wealth issues • or other time issues.	**(8)**

Question Number	Answer	Mark
2(b)(i)	This is where the government spends more that it receives in taxation revenue. **(2 marks)** Reference to data either £39.4 billion or 2.8% GDP. **(2 marks)** Credit sense of negative figure or deficit. **(1 mark)**	**(4)**

Question Number	Answer	Mark
2(b)(ii)	Identification of multiplier. **(2 marks)** Diagram showing rightward shift in AD, and/or rightward shift in AS or equivalent verbal description. **(4 marks)** Analysis of multiplier. **(4 x 1 marks)** Points might include: • spending becomes other peoples' incomes • explanation of reasons for size of leakages • process continues until all extra income is leaked away • relevance to government spending, for example on hospitals • knock-on effects can be shown with the multiplier formula, although this is not required. Evaluation **(4 marks)** Allow 2 x 2 marks or 1 x 4 marks. Factors might include: • discussion of the size of the multiplier • time lag effects • depends on the shape or the AS curve • other things might not be equal, for example the pound might change in value.	**(14)**

Question Number	Answer	Mark
2(c)	Award two costs. Identification of costs **(2 marks for each cost clearly identified)**. For development/application of costs **2 marks each**. Costs might include: • loss of income, credit problems such as house repossession, welfare problems for dependants, poverty issues • loss of skills and other human capital: hard to get back into labour market • government revenue falls so spending likely to fall, other fiscal issues • social costs: large numbers of idle workers can have negative effect on society, for example crime, morale, social disintegration • opportunity costs: resources could be used elsewhere.	**(10)**

Question Number	Answer	Mark
2(d)	Knowledge, application and analysis **(18 marks), of which:** • definition **(2 marks)**: demand side policies refer to monetary and fiscal policy • diagram (or equivalent) **(4 marks)** showing an increase to the right of AD • identification and link to two macroeconomic objectives **(4 marks)** • analysis **(12 marks)** of the effect of **conflicts** in macroeconomic objectives – award three factors **(3 marks each)**; or two factors **(6 marks each)**. Factors might include: • Phillips curve short run trade off • expansionary policy causes growth **but** inflationary pressures occur • expansionary policies might increase employment **but** worsen the impact on the environment • rises in interest rates can control inflation **but** worsen the distribution of income • cuts in interest rates can encourage growth **but** there is likely to be a worsening of the current account • tight monetary policy can cause the value of the currency to rise increasing living standards **but** there is a worsening effect on the current account of the balance of payments. Conflicts might include: • inflation and growth • inflation and employment • inflation and balance of payments issues • growth and environment • growth and income redistribution • growth and balance of payments issues - or any other combination. Evaluation **(12 marks)** – award three points up to **4 marks each** or two well-developed points up to **6 marks each**. Points might include: • depends on elasticities, for example LRAS when AD shifts • short run versus long run arguments, for example unemployment is a lagging indication • prioritisation of objectives with justification	

	• other things are not equal – confidence, availability of credit or inter-bank lending rates might be a more important influence on consumer spending than the repo rate • policies themselves might conflict • unreliable or missing information.	**(30)**

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