Write your name here

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.

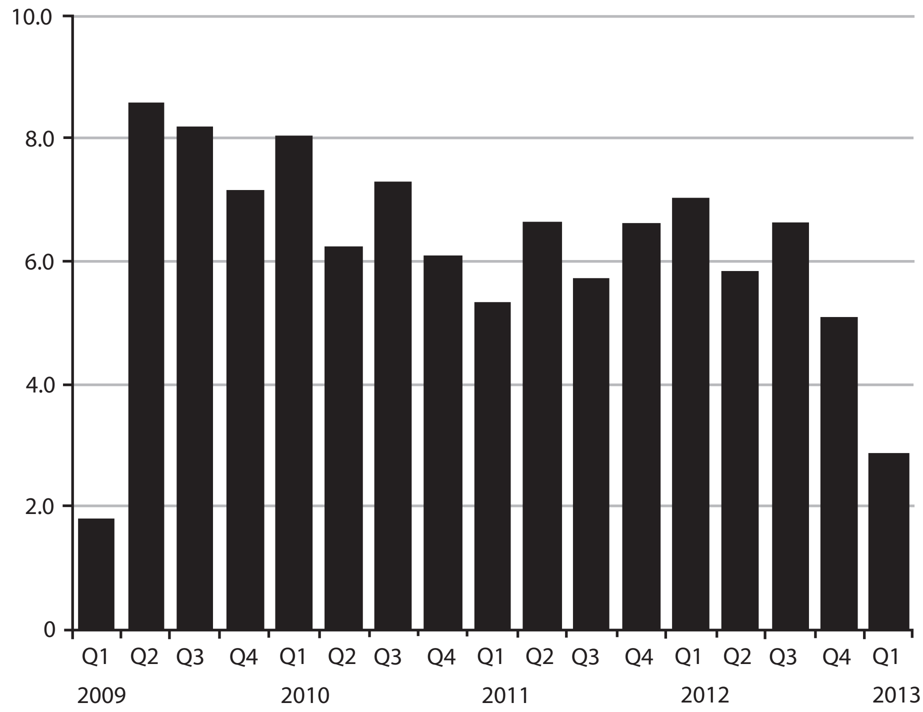
Turn over ▶

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

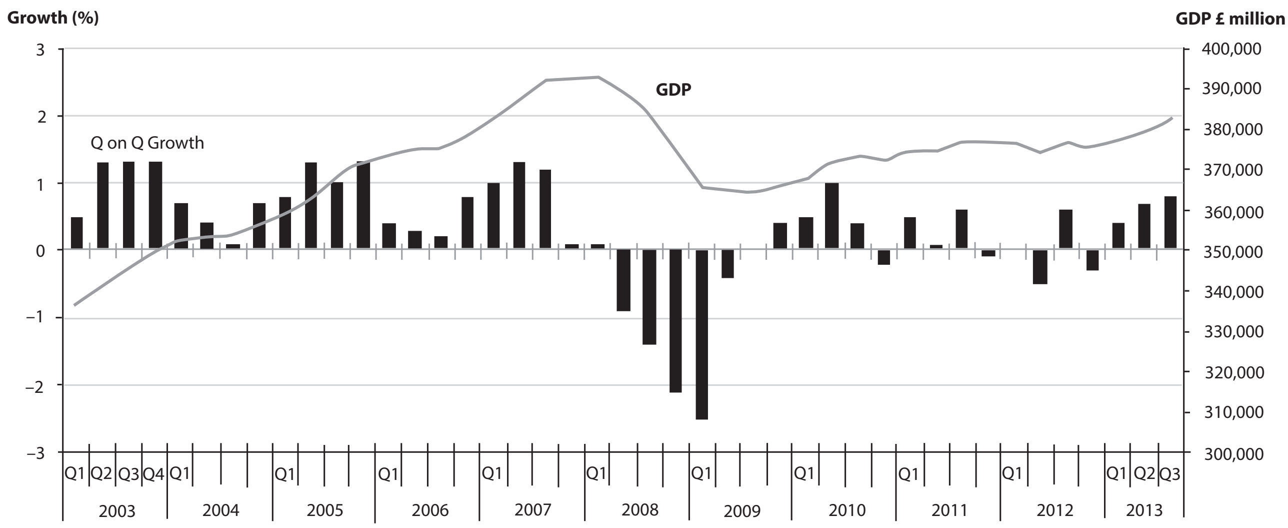
Figure 1 UK household savings ratio*



*Savings as a percentage of household disposable income

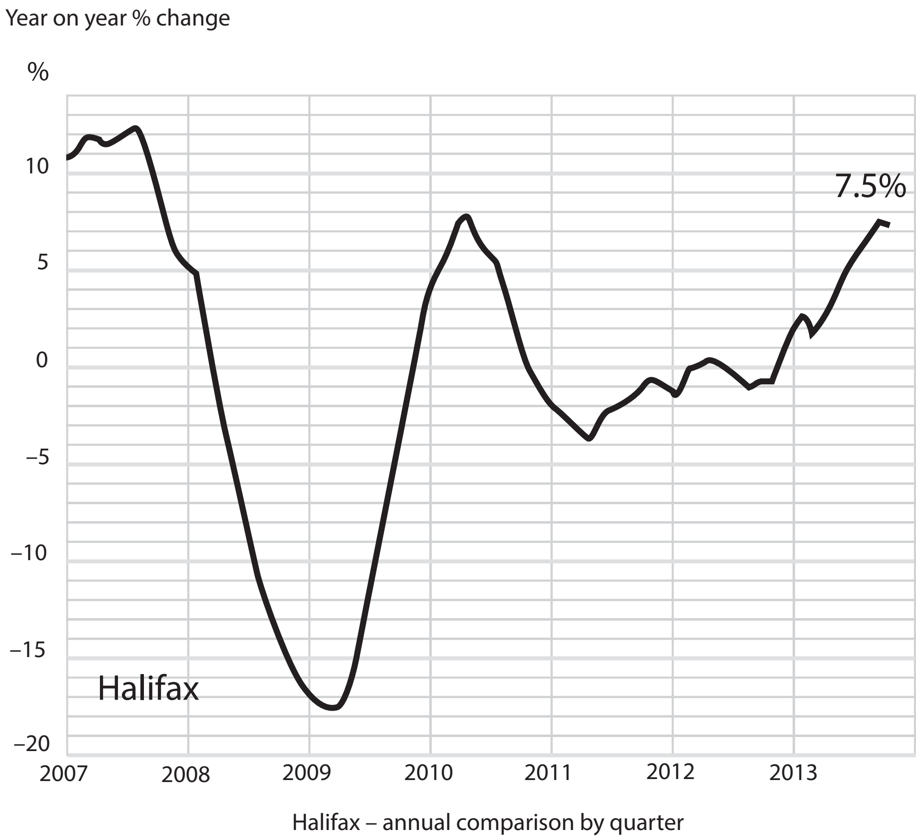
(Source: http://www.ons.gov.uk/ons/publications/re-referencetables.html?edition=tcm%3A77-324888)

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



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

Figure 3 Percentage annual change in UK house prices



(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.

(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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(Total for Question 1 = 80 marks)

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)

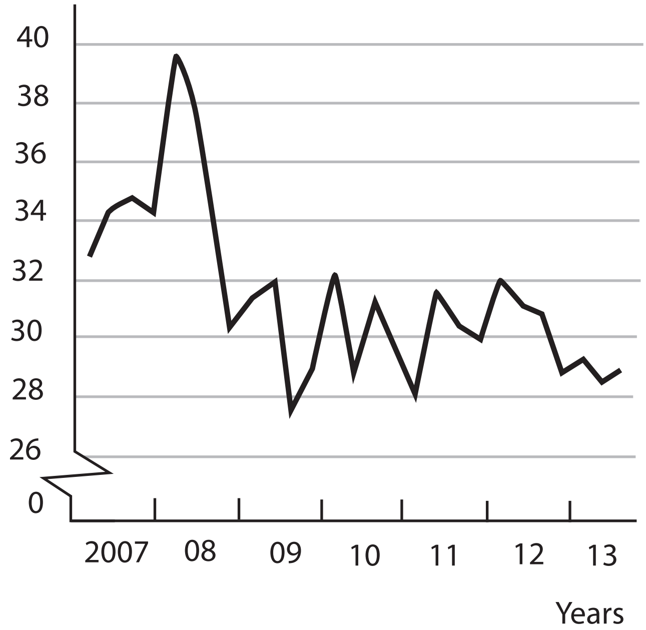
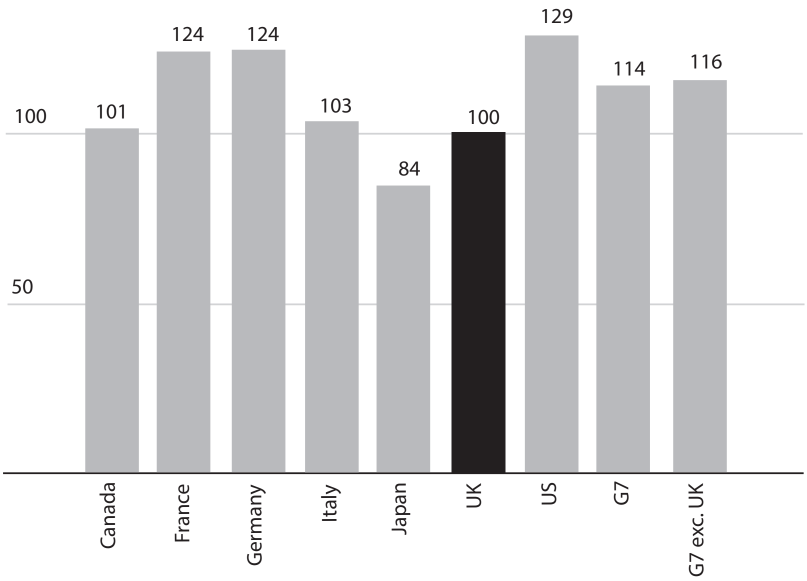
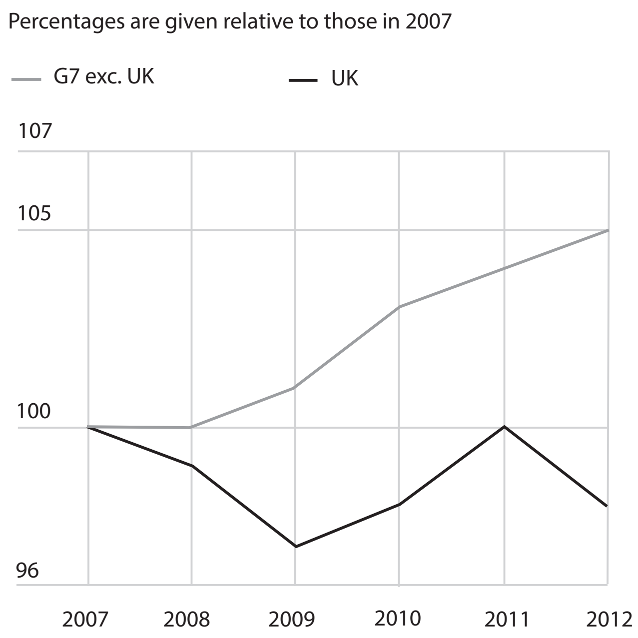


Figure 2 GDP per hour worked relative to the UK in 2012



(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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(30)

(Total for Question 2 = 80 marks)

TOTAL FOR PAPER = 80 MARKS

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