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Pearson	Centre Number	Candidate Number									
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Economics A

Advanced Subsidiary

Paper 2: The UK economy – performance and policies

Sample assessment material for first teaching September 2015 Time: 1 hour 30 minutes	Paper Reference 8EC0/02
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You do not need any other materials.	Total Marks
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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.
- There are two sections in this question paper.
- Answer **all** questions in Section A.
- In Section B, answer **all** of questions 6(a) to 6(e) and one question from 6(f) or 6(g).
- 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.*

Advice

- Read each question carefully before you start to answer it.
- Try to answer every question.
- Check your answers if you have time at the end.

Turn over ►

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SECTION A

Answer ALL questions. Write your answers in the spaces provided.

Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

- 1 The table below shows UK annual real GDP values for 2011–2013.

	Annual real GDP (£ billion)
2011	1 502
2012	1 506
2013	1 534

(Source: ONS)

- (a) Define the term 'economic growth'.

(1)

- (b) Calculate the annual UK economic growth rate for 2013. You are advised to show your working.

(2)

- (c) Which **one** of the following can be inferred from the table?

(1)

- A Real GDP was falling between 2012 and 2013
- B The annual UK economic growth rate for 2012 was negative
- C Nominal GDP was falling between 2012 and 2013
- D The annual UK economic growth rate for 2012 was positive

Answer

(Total for Question 1 = 4 marks)

2 In 2011, the Bank of England estimated that the marginal propensity to consume for UK households was on average 0.4.

(Source: <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/qb110402.pdf>)

(a) Define the term 'marginal propensity to consume'. (1)

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(b) Calculate the value of the multiplier for the UK in 2011. You are advised to show your working. (2)

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(c) Which **one** of the following is a likely cause of an increase in the value of an economy's multiplier? (1)

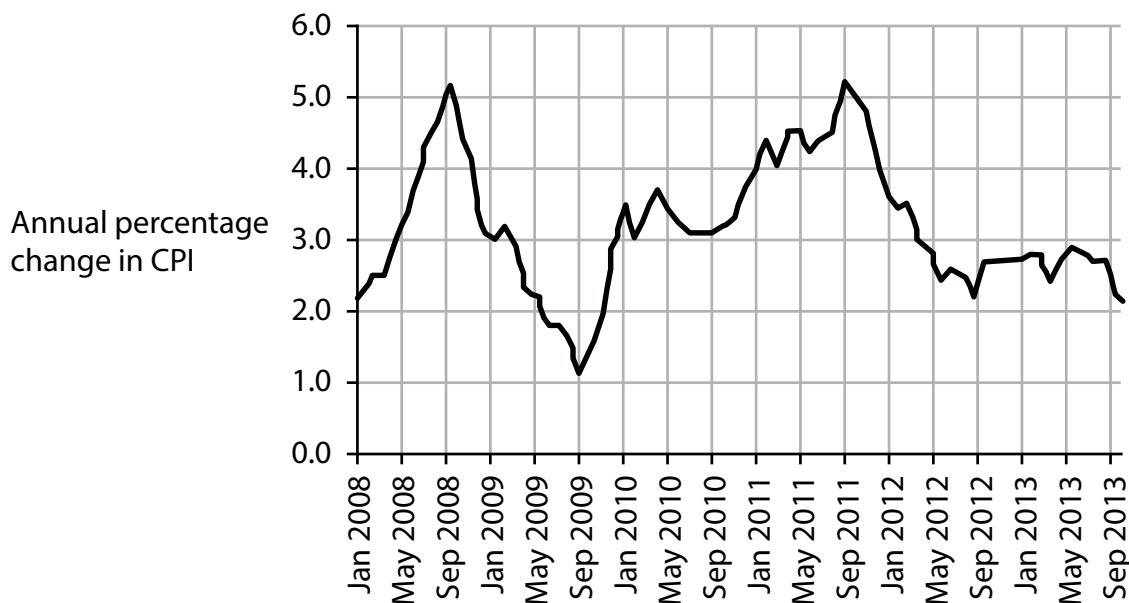
- A An increase in the marginal propensity to save
- B An increase in the basic rate of income tax in the economy
- C A decrease in the marginal propensity to import
- D A decrease in investment in the economy

Answer

(Total for Question 2 = 4 marks)

- 3 The chart below shows the annual percentage change in the UK Consumer Prices Index (CPI).

Annual percentage change in UK CPI, January 2008 – October 2013



(Source: <http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/november-2013/consumer-price-inflation-summary--november-2013.html>)

- (a) Define the term 'inflation'.

(1)

- (b) Which **one** of the following can be inferred from the chart?

(1)

- A There was deflation in the UK economy between September 2008 and September 2009
- B The CPI inflation rate was higher in September 2012 than in September 2009
- C From January 2011 to January 2012, the average price level in the UK fell
- D From May 2010 to September 2010, the cost of living in the UK fell

Answer

(c) Explain **one** limitation of using the CPI to measure the rate of inflation.

(2)

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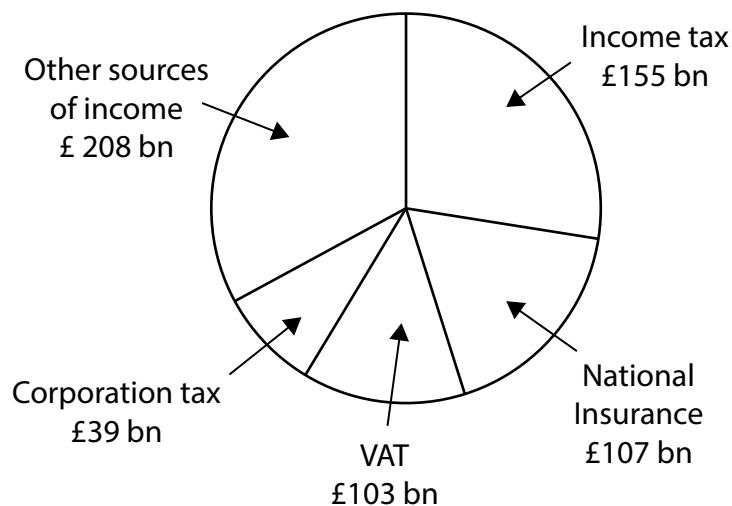
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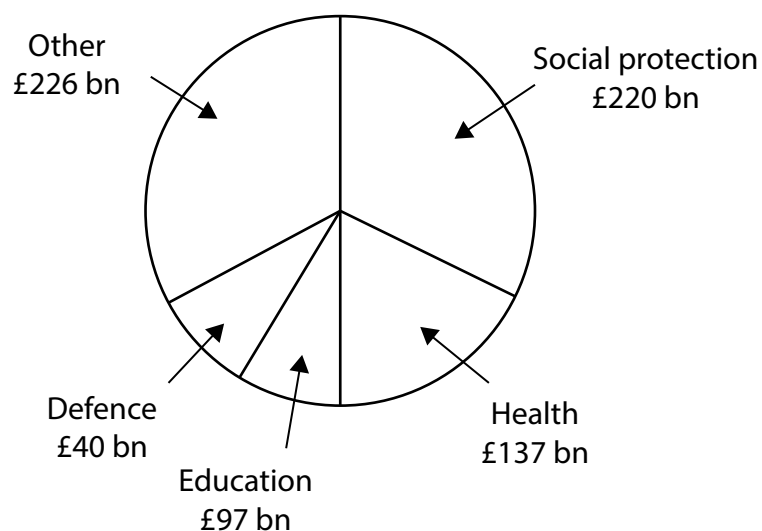
(Total for Question 3 = 4 marks)

- 4 The charts below show forecast UK government revenue and government spending for the financial year 2013/2014.

**Source of government revenue = £612 bn
(forecast 2013/2014)**



**Areas of government spending
(forecast 2013/2014)**



(Source: Budget 2013, HM Treasury, <https://www.gov.uk/government/publications/budget-2013-documents>)

(a) Which **one** of the following can be inferred from the charts above?

The UK government forecast that for the financial year 2013/2014:

(1)

- A** it would earn five times as much revenue from income tax as from corporation tax
- B** it would spend more on health, than on education and defence added together
- C** more than one quarter of its revenue would come from VAT
- D** spending on social protection would comprise more than 30% of its total spending

Answer

(b) Using the data in the two charts, calculate the size of the UK government's forecast budget deficit for the financial year 2013/2014.

(3)

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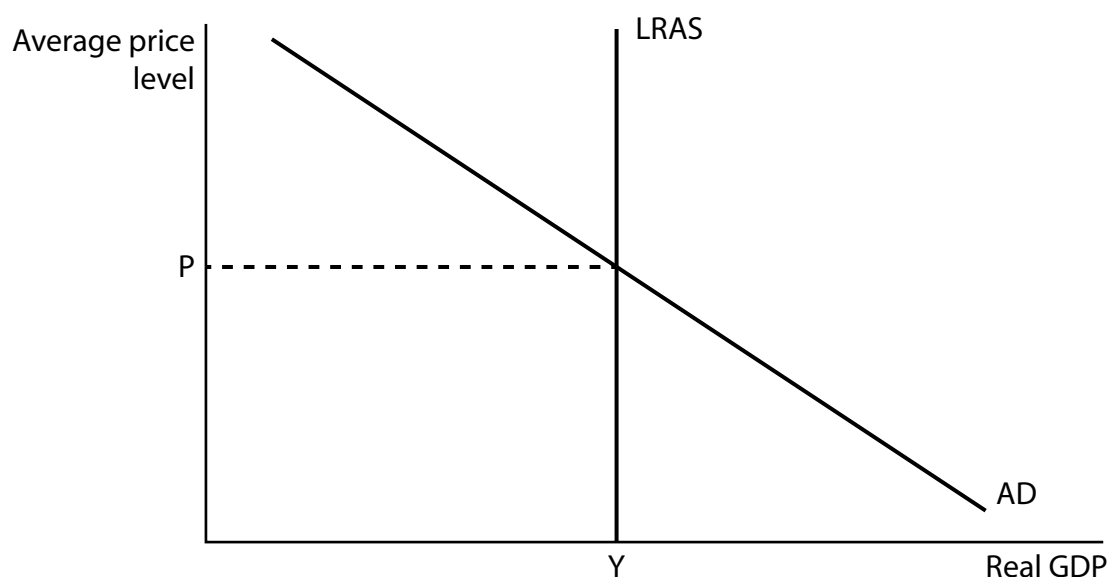
(Total for Question 4 = 4 marks)

5 (a) Define the term 'productivity'.

(1)

(b) Using a classic long-run AS curve, annotate the diagram below to show the effect of an increase in productivity on the equilibrium level of real national output and the average price level of the economy.

(2)



(c) Which **one** of the following statements is correct?

(1)

- A** The Keynesian long-run AS curve implies that an economy may have a negative output gap in the long run
- B** The Keynesian long-run AS curve is perfectly inelastic at all levels of real national output
- C** The classic long-run AS curve implies that an economy may have spare capacity in the long run
- D** The classical long-run AS curve is perfectly elastic at all levels of real national output

Answer

(Total for Question 5 = 4 marks)

TOTAL FOR SECTION A = 20 MARKS

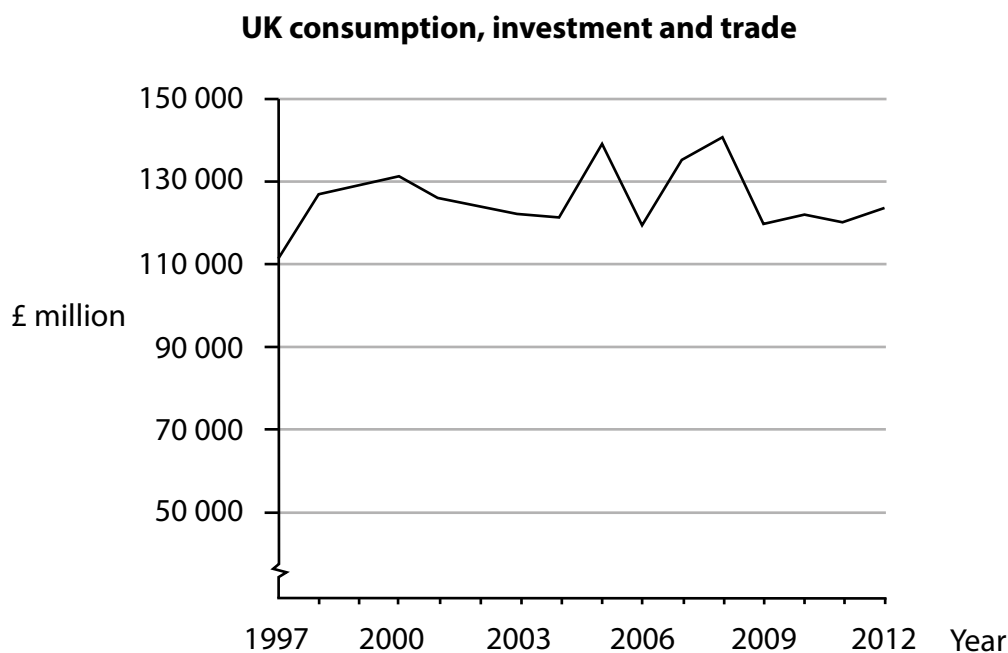
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QUESTION 6 BEGINS ON THE NEXT PAGE.

SECTION B

Read Figures 1 and 2 and extract (A) before answering Question 6.

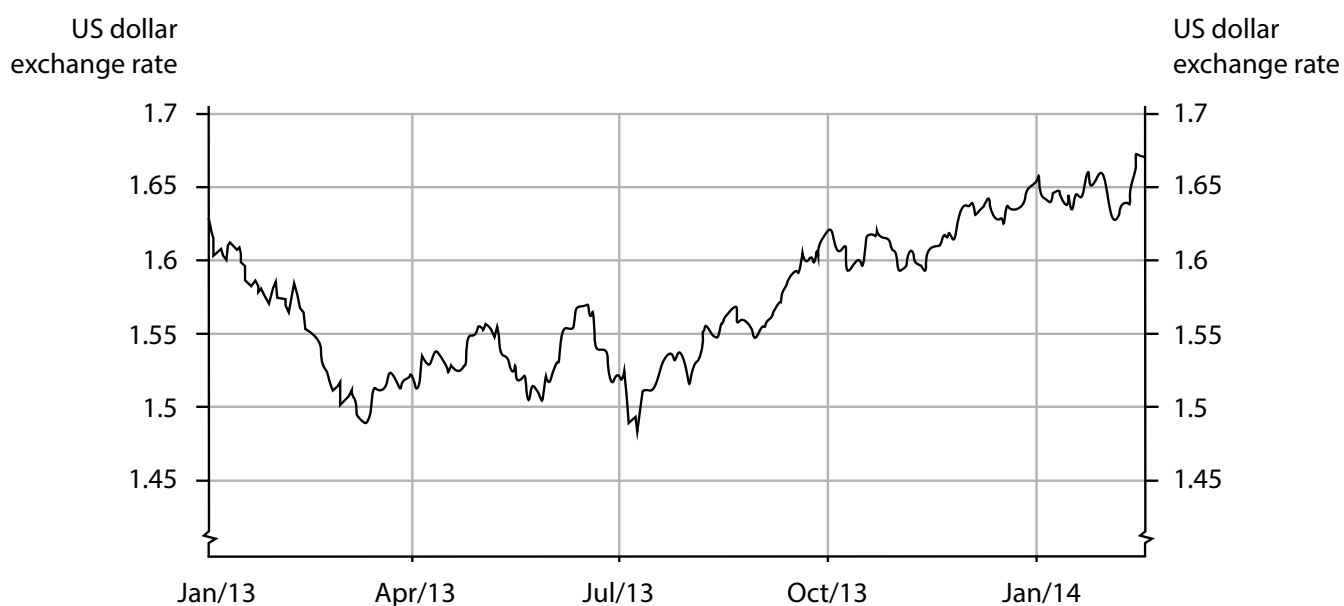
Answer ALL Questions 6(a) to (e), and EITHER Question 6(f) OR Question 6(g).

Question 6



(Source: <http://www.ons.gov.uk/ons/rel/bus-invest/business-investment/q3-2013-provisional-results/stb-business-investment-q3-2013-provisional.html#tab-Business-Investment-and-other-components-of-GFCF>)

Figure 1: UK real annual business investment, 1997–2012 (seasonally adjusted)



(Source: <http://www.tradingeconomics.com/united-kingdom/currency>)

Figure 2: British pound (£) to US dollar (\$) exchange rate, 1 January 2013 to mid-February 2014

Extract A

Why Britain needs a pay rise

UK growth in 2013 has been caused mainly by increases in consumption. Rising consumption tends to encourage companies to invest. The increase in demand for goods and services means firms need more productive capacity, often moving to bigger premises and buying capital equipment. Crucially, though, they only do so if they think the increase in consumption is likely to be permanent. 5

At the start of 2013, it was hard to see why consumer spending would rise. The economy had recorded little growth for two years and confidence was low. Inflation had been higher than earnings growth during 2012, making it hard for families to manage.

Three factors combined to change the picture: cheap credit, the Bank of England’s funding for lending scheme (FLS), and rising consumer confidence. The Bank of England cut its official interest rate to 0.5% in early 2009, but it took a long time for the monetary stimulus to have an impact. 10

It only really did so when FLS was announced in the summer of 2012. This was a deal under which the commercial (high street) banks could borrow more cheaply from the Bank of England provided they passed on the benefits to their customers. 15

The idea was that household and business borrowers would benefit: loans would become more readily available and the interest rates charged on them would be lower. Lending to businesses was disappointing, but the impact on the mortgage market was rapid and significant: more mortgages were approved, and at lower rates of interest. This contributed to the improvement in the housing market, which in turn boosted confidence, leading to higher spending, and this led to higher growth. 20

Consumers ran down their savings to fund this higher spending. Again, this is not unusual. Households become more cautious in troubled times and they save more just to be on the safe side.

However, unless consumers are willing to save less and less and borrow more and more, there is only so long this process can continue. Eventually, consumer spending growth has to be the result of rising real incomes rather than falling savings. 25

After a year in which the consumer has been the driving force behind the expansion of the economy, 2014 should be the year when investment contributes to growth. Many of the conditions for an increase in business spending are in place: companies are cash rich, profitability is good, interest rates are set to stay low, and ageing capital stock needs replacing. 30

The one factor not in place is the most important one of all: an increase in real wages. If companies believe that consumers will carry on spending, they are much more likely to go ahead with new investment projects. If they think consumer spending will not increase, then they will be unwilling to invest. This will mean that inflationary pressures build up and the trade deficit will continue to widen. 35

(Source: adapted from ‘Why Britain needs a pay rise’, Larry Elliott, *The Guardian*, 29 December 2013 <http://www.theguardian.com/money/2013/dec/29/why-britain-needs-pay-rise>)

(a) With reference to Figure 1, explain what has happened to real annual business investment since 2008.

(4)

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(b) With reference to Figure 2, explain the likely effect of an appreciation of the British pound (£) against the US dollar (\$) on the volume of UK imports from, and UK exports to, the USA.

(5)

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