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Edexcel GCE

Economics
Advanced Subsidiary
Unit 2: Managing the Economy

Monday 7 June 2010 – Afternoon Time: 1 hour 30 minutes	Paper Reference 6EC02/01
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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.

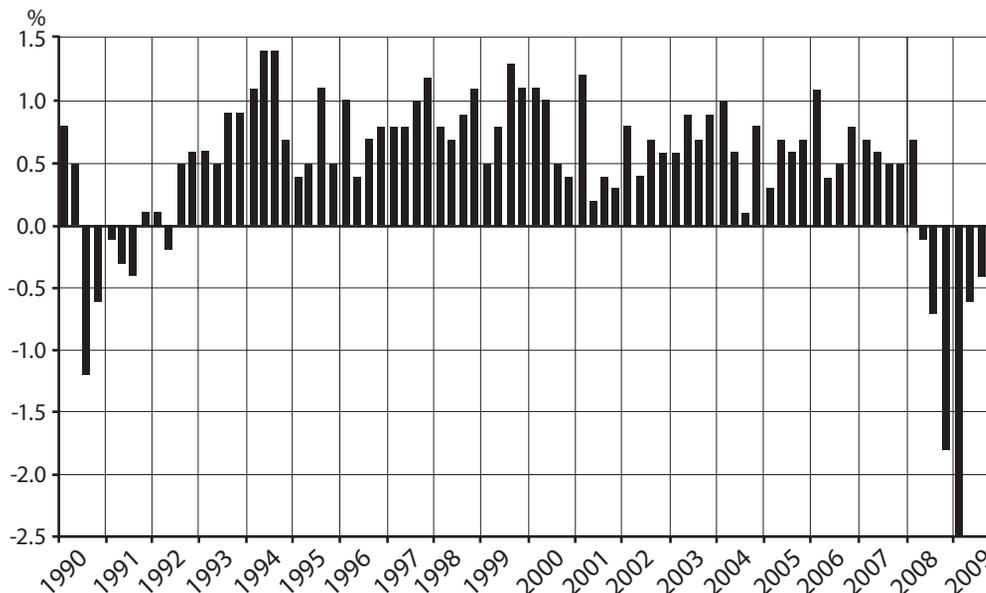
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Consider what that means. Much of the rich world will see unemployment rates that reach double figures, and then stay there. Inflation will become negative thanks to falling fuel costs and record economic spare capacity, pushing down prices and wages. 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.

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

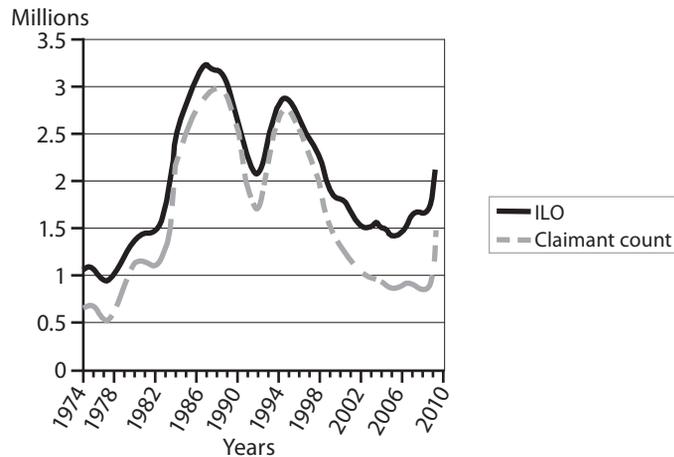
Figure 1 UK Growth rates at a 30-year low



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).

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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

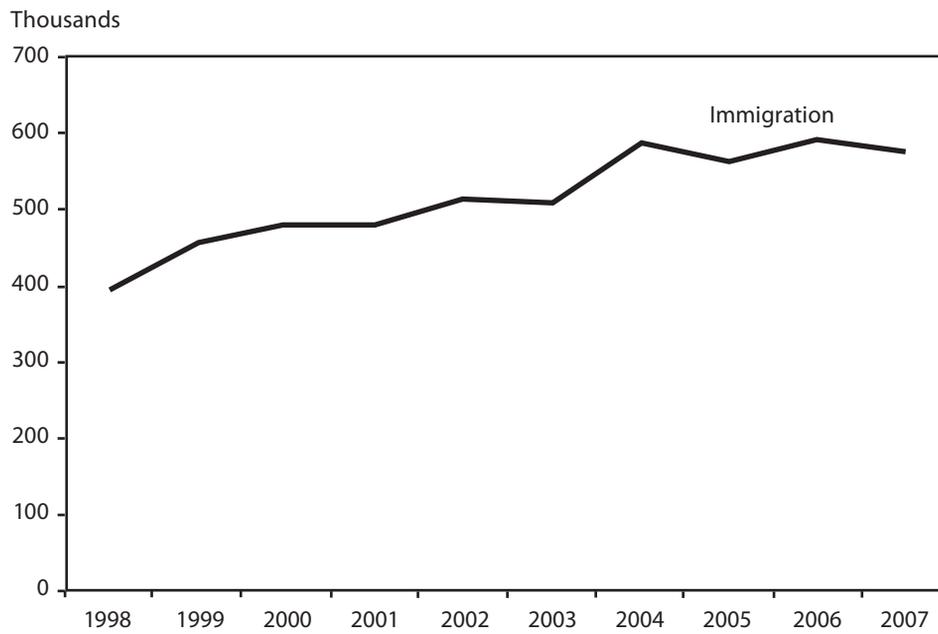
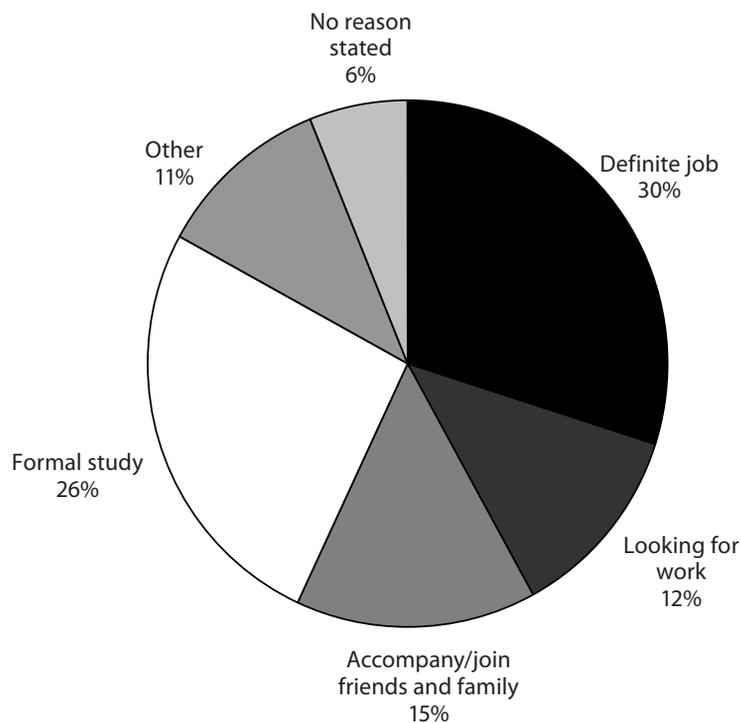


Figure 4 Estimates for the main reason for immigration to the UK, 2007



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



- (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)



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(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.

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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.

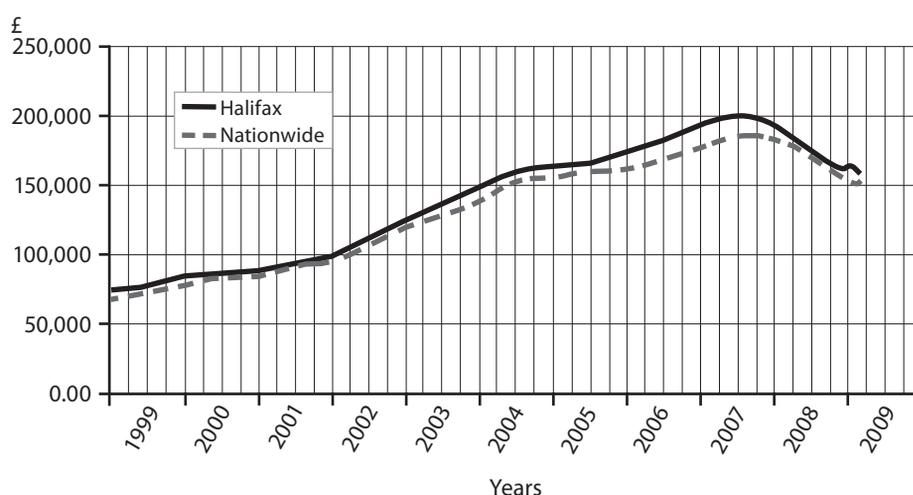
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The Committee noted that consumer price inflation had risen to 3.2 per cent in February, higher than expected and above the MPC’s own target. Despite this, the Committee continued to hold the view that inflation would fall back below its 2 per cent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

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

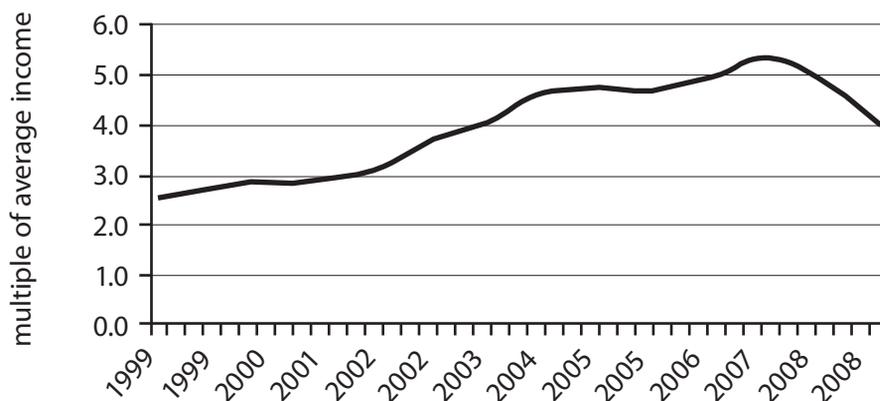
Figure 1: UK average house prices indicated by two large mortgage lenders, by quarter, 1999–2009



Source: Halifax/Nationwide



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)



With reference to Extract 1,

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

(4)

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

(8)

Reason one

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*(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)

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(Total for Question 2 = 80 marks)

TOTAL FOR PAPER: 80 MARKS

