



Rewarding Learning

ADVANCED SUBSIDIARY (AS)
General Certificate of Education
2017

Economics

Assessment Unit AS 2
assessing

Managing the National Economy

[SEC21]

MONDAY 22 MAY, MORNING



SEC21

TIME

1 hour 30 minutes.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **all** questions in section **A** and **B** and **one** question in section **C**.
You are permitted to use a calculator in this paper.

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.

- Section A: 25 Marks
- Section B: 35 Marks
- Section C: 20 Marks

Figures in brackets printed down the right-hand side of the pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time.

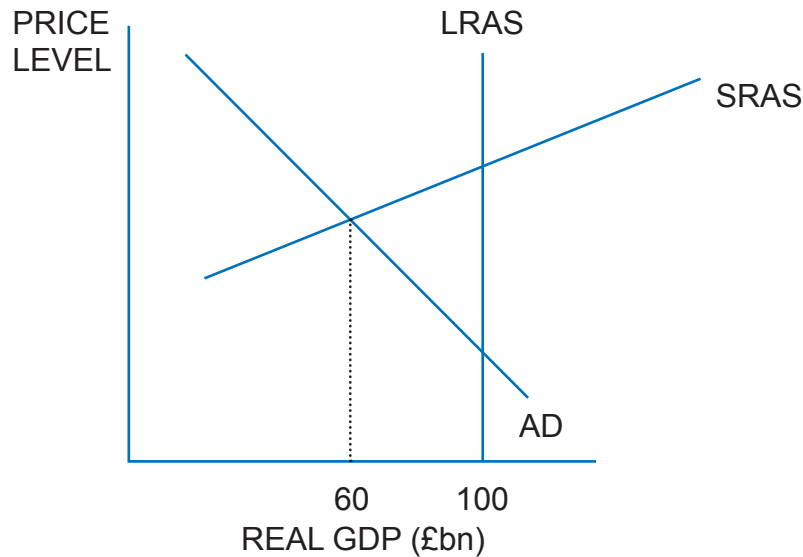
Quality of written communication will be assessed in Questions **6**, **7(b)**, **7(c)**, **7(d)**, **8** and **9**.
Quantitative skills will be assessed where appropriate.

Section A

Answer all questions (25 marks)

Show your workings

- 1 The diagram below shows the short and long run aggregate supply curves and the aggregate demand curve for an economy.



- (a) With reference to the above diagram explain the concept of an output gap. [3]
- (b) With the aid of an appropriate diagram explain the likely impact on this economy of the government adopting an expansionary fiscal policy. [3]
- 2 The following figures relate to the UK labour market in November 2014.

Category	Number of persons
In employment	30.8 million
Unemployed	2.0 million
Economically inactive	
Total working age (16/65) population	41.8 million

- (a) Using the above table calculate the number of persons who are economically inactive. [2]
- (b) Calculate the UK's rate of unemployment from the above table. [2]

3 With reference to the data below explain what is meant by the real rate of interest.

Average rate of return on bank deposits	1.5%
Consumer Price Index inflation	4%

[3]

4 In 2012 the Gini coefficient of income distribution for China was 0.47. For the USA in the same year the corresponding figure was 0.38.

Explain what is shown by the higher Gini coefficient in China.

[2]

5 Explain, with the aid of an appropriate diagram, the likely impact on the value of the pound against the euro of a rise in UK interest rates.

[4]

6 In November 2014 the price of oil fell to a 5 year low of \$60 per barrel. With the aid of an appropriate diagram explain the likely impact of low oil prices on an economy which is a major oil importer.

[6]

Section B: Data Response

Answer all questions (35 marks)

- 7 The following passage was written in January 2015. Read it carefully and answer the questions which follow.

Threat of deflation stalks UK economy

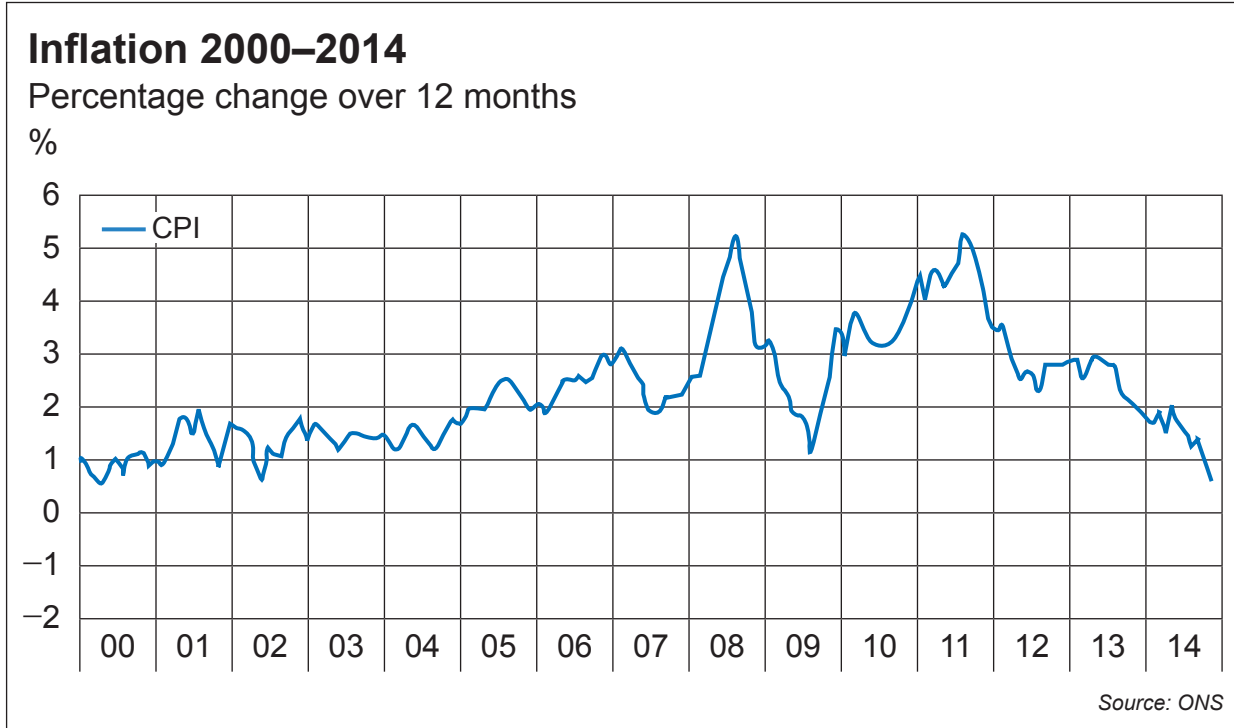


Fig. 1

Consumer Price Inflation time series dataset from The Office for National Statistics.
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In December 2014 consumer price inflation fell to its lowest level since May 2000. The annualised inflation rate was 0.5 per cent. This is 1.5 per cent below the Bank of England target rate of 2 per cent and will force the Bank's Governor to write a letter to the Chancellor explaining why inflation is more than 1 per cent below target. The previous Bank of England Governor, Mervyn King, had to write several similar letters, but explaining why inflation was significantly above target. 1

Some economists view these figures as evidence of a longer run trend toward lower inflation and perhaps even outright deflation. Paul Hollingsworth of Capital Economics said, "We doubt that inflation has reached its low point yet and a figure of 0.2 per cent in the coming months is highly likely. Indeed negative inflation cannot be ruled out." 2

A number of factors have contributed to the UK's low inflation rate. These include a high value of sterling against the euro, supermarket price wars and the slump in the oil price. Chancellor George Osborne tried to allay fears of deflation by pointing to the international origins of lower prices. He said, "The sharp drop in the Consumer Price Index is almost entirely driven by external factors, such as the oil price which has more than halved since June." He added that the UK could experience a few months of low or even negative inflation without any significant risk to the economy. 3

This rosy view was supported by Bank of England Governor Mark Carney who described falling oil prices as an “unambiguous net positive” for Britain’s economy and by Danny Alexander, the Treasury Chief Secretary, who said lower inflation was acting “like a giant tax cut for the economy”. A further benefit of lower inflation is the reduced probability of any rise in UK interest rates. Bank of England Chief Economist Andy Haldane confirmed that he expected interest rates to stay “lower for longer”.

4

However, not everyone shares this confidence. Many economists fear that the world is on the edge of a long term deflationary spiral with falling prices and little if any economic growth. Falling prices increase the real value of debt, and encourage consumers to delay purchases. Once this self-reinforcing spiral takes hold of an economy it becomes extremely difficult to break free from it. The World Bank has cut its forecasts for global growth in 2015 from 3.4 per cent to 3 per cent. For the Eurozone it predicted growth of 1.1 per cent and for Japan 1.2 per cent. Its chief economist, Kaushik Basu, added that the world was in “a critical situation”, meaning that it could easily slip into a long term recession.

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Independent economic analyst Gavin Armer argued that inflation and deflation were not equally undesirable. He said, “A low level of inflation imposes no significant costs on the real economy whereas deflation has a negative impact on economic growth, government finances and living standards.”

6

- (a) Describe the trend in CPI inflation from January 2000 till the end of 2014. (**Fig. 1**) [3]
- (b) Explain why UK interest rates were expected to stay “lower for longer”. (Para 4) [8]
- (c) Analyse the reasons for the fall in the UK rate of inflation. (Para 3) [9]
- (d) Evaluate the view that deflation is a much greater threat to the UK economy than inflation. [15]

Section C: Essays

Answer one question (20 marks)

- 8 UK output per hour is now (Spring 2015) 2.1 per cent below the peak it achieved in the first quarter of 2008. Low productivity means that GDP growth can only come from population growth and this is unlikely to increase living standards and GDP per capita.

Critically examine the view that addressing this “productivity gap” should be the government’s top economic priority.

[20]

- 9 In a one year period the value of the pound in euros has risen from 1.21 euros to 1.37 euros. Investment bank Goldman Sachs predict a continuation of this trend and anticipate the pound reaching 1.54 euros by 2017. While this would be good news for UK holiday makers it might make life extremely difficult for UK firms trying to export to the eurozone.

Critically examine the view that the Bank of England should take urgent steps to reduce the value of the pound against the euro.

[20]

THIS IS THE END OF THE QUESTION PAPER

Sources

- Q7. . .Source 1: Reference from: UK inflation rate falls to 0.5% in December. Published by BBC News, 13 January 2015.
<http://www.bbc.co.uk/news/business-30794673>
Source 2: Reference from: World Bank cuts global growth forecast. Published by BBC News, 13 January 2015
<http://www.bbc.co.uk/news/business-30802166>

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