



GCE AS

B520U20-1



ECONOMICS – AS component 2
Exploring Economic Issues

THURSDAY, 17 MAY 2018 – MORNING

2 hours

B520U201
01

ADDITIONAL MATERIALS

In addition to this examination paper, you will need a calculator and a WJEC pink 16-page answer booklet.

INSTRUCTIONS TO CANDIDATES

Answer **all** questions.

Use black ink or black ball-point pen.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question.

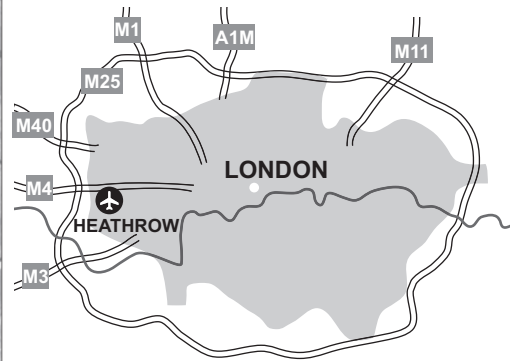
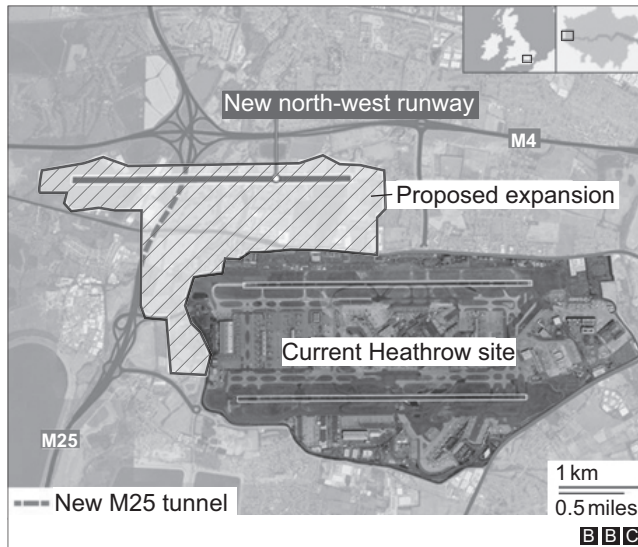
Answer all questions.

1.

EXTRACT 1: THIRD RUNWAY AT HEATHROW CLEARED FOR TAKEOFF

The government has approved a third runway at Heathrow to expand UK airport capacity.

Proposed new runway at Heathrow



Source: Airport Commission

Transport Secretary, Chris Grayling, said the “truly momentous” decision would support trade and create jobs. The Department for Transport said a new runway at Heathrow would bring economic benefits to passengers and the wider economy worth up to £61bn and create as many as 77 000 additional local jobs over the next 14 years.

Heathrow Airport said the expansion would allow it to offer more direct flights to UK destinations as well as up to 40 new cities abroad such as Wuhan in China, Osaka in Japan and Quito in Ecuador. Air industry analysts also said that unless the third runway goes ahead, the fact that Heathrow is already at full capacity would lead to an average £200 increase in the price of a return flight in today’s prices within a decade.

Sadiq Khan, the Mayor of London, however, said that expanding Heathrow was the wrong decision for both London and the UK.

“There are more people affected by noise because of Heathrow than people affected by the airports in Paris, Amsterdam, Frankfurt, Munich and Madrid combined,” he said. “The air in London is a killer. It makes you sick and it’s unlawful.”

Greenpeace UK chief, John Sauven, also said a third runway at Heathrow would increase air pollution and “be a waste of time, money and lives”.

The issue has split the government, with Foreign Secretary Boris Johnson saying a third runway was “undeliverable”; the implication being that the decision would be resisted by local councils and residents meaning millions of pounds being spent on legal fees. Industry analysts also suggest that the project will require at least £11bn of government money if it is to become a reality, although the government claims that the cost will be closer to £5bn.

Other analysts have pointed out that with unemployment in and around London at a historic low, finding the workforce to complete these projects could well be a challenge, requiring an influx of overseas workers and running the risk of creating significant inflationary pressures in the South East, reducing the forecasted benefits. Likewise, the risk to London’s economy as a result of the UK’s decision to leave the EU makes the benefits of the expansion harder to quantify.

EXTRACT 2: THE LONDON HOUSING MARKET

The Government has given the go-ahead for the third runway, and if there's one group of people who won't be happy about it, it's the people living nearby.

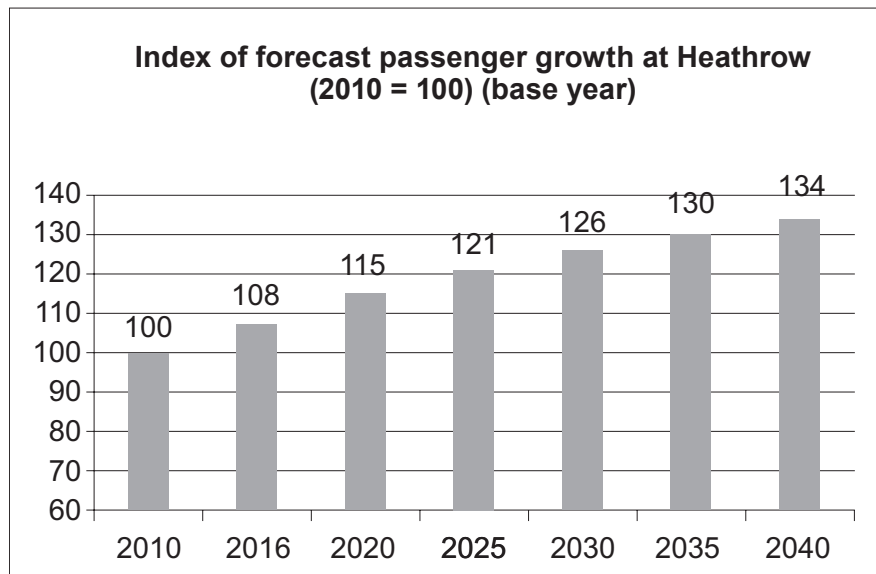
Estate agents eMoov think the decision could lead to a 20% drop in house prices in the area due to the noise and air pollution that the project will bring.

Others argue that any effect will be temporary at most. The possibility of Heathrow expansion has been known about for over 40 years and house prices already reflect this. In any case, the London housing market has been extremely strong as a result of good economic performance – London is forecast to grow more than twice as fast as the rest of the UK over the next 5 years – and that's before the effects of Heathrow are taken into account.

With the average house price in affected areas at £410 000, there is some hope that the decision might result in more affordable housing in London, something that has been a long time coming.

EXTRACT 3: FORECAST PASSENGER GROWTH AT HEATHROW

(Assuming no supply constraints): 2016 numbers = 70 million passengers per year



- (a) (i) Assuming that the eMoov forecast in **Extract 2** is correct, calculate the predicted average price of a house in areas affected by the third runway, following the Government's announcement. [2]
- (ii) Using a supply and demand diagram, discuss how likely it is that house prices will fall by 20% in affected areas over the next few years. [8]
- (b) To what extent might the decision to build a third runway at Heathrow be considered to be an example of government failure? [10]
- (c) (i) Using the data in **Extract 3**, calculate the forecast number of passengers for Heathrow in 2040 assuming that there are no supply constraints. [2]
- (ii) Using a supply and demand diagram, explain how the construction of a third runway at Heathrow is expected to prevent a £200 increase in the price of a return flight. [6]
- (d) Using AD/AS diagrams, evaluate the claims made by the Department of Transport in the first paragraph of **Extract 1**. [12]

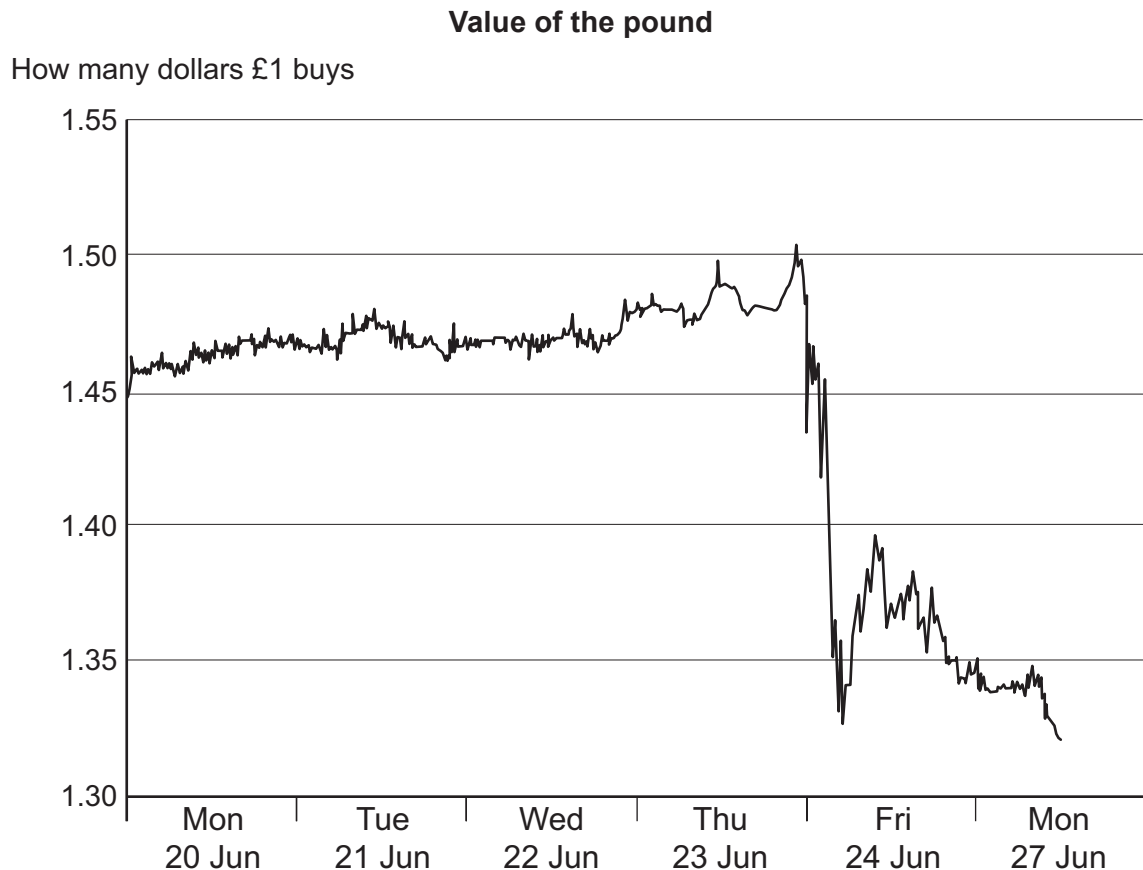
2. HIGHER OIL PRICE AND WEAKER POUND START TO PUSH UP INFLATION

13th September 2016

Official figures today will show inflation rising for a third consecutive month as higher oil prices and the weaker pound (Figure 1) start to push up prices. Consumer price inflation hit 0.8% in August 2016, the highest since November 2014. The Bank of England expects prices to be growing at almost 2% and climbing by the middle of 2017 increasing pressure for an interest rate rise.

Evidence of growing inflation has also been seen in Office for National Statistics (ONS) data. The ONS believes that production costs will rise by 8.1% on an annual basis, the highest since December 2011. These are seen as an early indicator for inflation, as businesses have to absorb rising costs or pass them on to consumers. Production costs are soaring because of the fall in the value of the pound, down by 10% since the Brexit vote on the UK's membership of the EU on the 23rd June.

Figure 1



BBC

Source: Bloomberg-data as of 11.27 BST. MON 27 June

The Bank of England's Monetary Policy Committee cut interest rates to 0.25% from 0.5% in August 2016 as well as providing the commercial banks with £100bn of cheap funding. Business confidence is at a four-year low following the Brexit vote, with the outlook for demand, employment and investment weakening across all sectors of the economy. However, this relaxed monetary policy may have to be reversed if inflation takes hold and rises above its target of 2%; then interest rates would be likely to rise.

20 The UK's vote to leave the EU means that goods coming into this country from EU member
 states could be subject to tariffs which could also push up prices. However, supporters of
 Brexit think that the EU will be keen to sign a free trade deal with the UK as some EU member
 states, especially Germany, have a trade surplus with the UK. Theresa May, the British Prime
 Minister, says she wants to turn post-Brexit Britain into a "global leader in free trade". Indeed
 25 many supporters of Brexit want to see the UK copy the so called "Singapore model" including
 Patrick Minford the economic advisor to former Prime Minister, Margaret Thatcher. Minford,
 who is a leading supporter of Singapore's tariff-free trade said "They got rid of protectionism
 and have flourished as one of the world's most free market economies."

30 However, the global trading system has never looked under greater strain and protectionist
 forces are on the rise everywhere. In the past year global public opinion has swung against
 free trade putting pressure on governments to stop further moves towards freer trade.

Source: The Times 13th September 2016 (adapted)

- (a) Using a supply and demand diagram, explain why a higher oil price and a weaker pound could cause the price of a product to rise. [4]
- (b) Why might a business's ability to "absorb rising costs or pass them on to consumers" (line 9) depend upon the price elasticity of demand for its product? [4]
- (c) Using an appropriate diagram, outline possible causes of the change in the value of the pound at the start of Friday the 24th June (Figure 1). [4]
- (d) To what extent will "a fall in the value of the pound" (line 10) benefit UK firms? [8]
- (e) Using AD/AS diagrams and with reference to the data, discuss whether the Bank of England will need to increase interest rates to prevent inflation from rising above its target level. [10]
- (f) Using an appropriate diagram and with reference to the data, evaluate the economic effects of UK tariffs being imposed on products imported from the rest of the EU. [10]

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