



GCE AS/A level

1132/01 – **LEGACY**



S16-1132-01

ECONOMICS – EC2

A.M. MONDAY, 23 May 2016

2 hours

ADDITIONAL MATERIALS

In addition to this examination paper, you will need a 12 page answer booklet.

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Answer **all** the questions in Section A.

Answer **one** question from Section B.

Answer **one** question from Section C.

You are advised to spend no more than 55 minutes on Section A.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question. Section A has 40 marks, Section B has 20 marks and Section C has 20 marks.

You are reminded that assessment will take into account the quality of written communication used in answers that involve extended writing in the second part of the questions in Sections B and C.

SECTION A

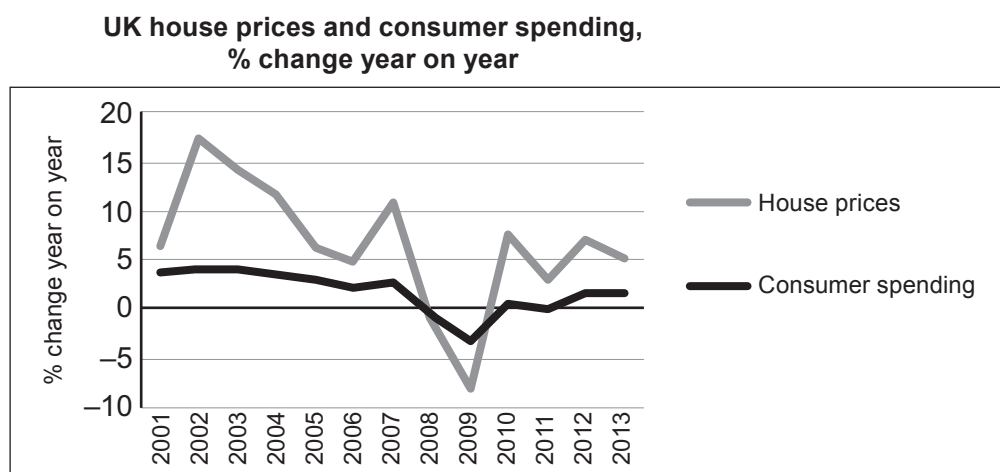
Answer all the questions in this section.

1. Study the information and then answer the questions that follow.

UK housing market continues to be problematic in 2014

- Soaring house prices are helping the UK economy to grow by increasing consumer spending (see Figure 1), but there are concerns that house prices are now too high for many people. Some economists argue that the Bank of England may need to increase interest rates to bring house prices under control.

Figure 1



Politicians, architects and planners all say that the housing crisis is only going to get worse without drastic action; population trends suggest that 6 million new homes are required over the next 30 years.

- That means 200,000 new homes are needed each year, but only 112,000 new homes were built in 2014. With house prices rising in 2013 (and especially quickly in London) the price of renting a property has also increased, pushing many into a rental trap where rents are so high, they cannot afford to save for a house.

- A variety of solutions have been proposed. In the 2014 Budget, George Osborne, the Chancellor of the Exchequer, announced plans for a new 'garden city' to be built at Ebbsfleet in Kent. Some critics of this proposal have pointed out that Ebbsfleet is on a flood plain and that without significant government spending on flood defences (such as flood barriers), the new city could face flooding. Instead, some argue that the government should intervene more directly in the market with maximum price controls on rents or a programme of government-built affordable housing to be rented to low-income households.

- What everyone agrees is that something needs to be done. Although in 2014 unemployment in the UK has dropped below 2 million and economic growth is rising at last, the Bank of England is reluctant to increase interest rates from their current all-time low; inflation is down to 0.5%, wage growth is still low and parts of the eurozone are at risk of another recession making the interest rate decision difficult.

December 2014

- (a) With reference to Figure 1, analyse the links between house prices and consumer spending in the UK. [6]
- (b) Using a supply and demand diagram explain why, if existing trends continue, house prices are likely to continue to rise. [6]
- (c) Explain why flood defences are generally considered to be public goods. [4]
- (d) Explain why public goods are generally supplied by the government rather than by private sector firms. [4]
- (e) Discuss, with the aid of a diagram, whether imposing a maximum rent below the free market equilibrium would be a good solution to the housing market problems identified in the data. [10]
- (f) Using the data, discuss whether an increase in interest rates would have been advisable given the economic situation at the end of 2014. [10]

SECTION B

Answer one question from this section.

2. HOUSEHOLD INCOMES REACH RECORD LEVELS. MORE FAMILIES INCREASE SPENDING ON LUXURY ITEMS

- (a) Explain why the supply of manufactured goods tends to be more price elastic than the supply of agricultural goods. [8]
- (b) Discuss, using diagrams, whether rising incomes in the UK will be likely to have more impact on the prices of agricultural goods or on the prices of manufactured goods. [12]

3. 40% OF GRADUATES STILL UNEMPLOYED 6 MONTHS AFTER LEAVING UNIVERSITY

- (a) Explain why the presence of external costs might lead to 'market failure'. [8]
- (b) Discuss whether the UK government should subsidise university education. [12]

4. INTERNATIONAL RESEARCH SUGGESTS THAT INCREASES IN THE MINIMUM WAGE MIGHT NOT CAUSE JOB LOSSES

- (a) Using examples, explain why an increase in the minimum wage might **not** cause unemployment to rise. [8]
- (b) Discuss, using diagrams, whether an increase in the supply of labour in the UK caused by immigration will be likely to reduce wage rates. [12]

SECTION C

Answer one question from this section.

5.

UK NEEDS SUPPLY SIDE REFORMS TO RAISE GROWTH

- (a) Using examples, explain how supply side policies in the markets for land, labour and capital can boost the potential of the UK economy. [8]
- (b) Discuss whether supply side policies can, by themselves, achieve the government's macroeconomic policy objectives. [12]

6.

HIGHER GOVERNMENT CAPITAL SPENDING MAY NEED TO BE FINANCED BY INCREASED VAT RATES

- (a) Using an aggregate demand and aggregate supply diagram, explain how an increase in VAT rates might be expected to affect the equilibrium level of output, employment and price level in an economy. [8]
- (b) Discuss whether significant increases in capital spending by the government are likely to be beneficial for the UK economy. [12]

7.

CALLS FOR MORE FREE TRADE AS SLOWING GLOBAL GROWTH LEADS TO RISING PROTECTIONISM

- (a) Explain what is meant by free trade and explain how it provides benefits to an economy. [8]
- (b) Discuss whether a sharp appreciation in the pound will benefit the UK economy. [12]

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