



GCE AS

B520U20-1



S25-B520U20-1 R1



MONDAY, 19 MAY 2025 – MORNING

ECONOMICS – AS component 2
Exploring Economic Issues

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

Use black ink or black ball-point pen.

You may use a pencil for graphs and diagrams only.

Answer **all** questions.

Write your answers in the separate answer booklet provided.

INFORMATION FOR CANDIDATES

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

You are reminded of the necessity for good English and orderly presentation in your answers.

Answer **all** questions.

1. Housing problems?

Extract A: Rents forecast to rise four times faster than house purchase prices between 2023 and 2026

Rents are set to rise by four times more than house prices between 2023 and 2026, according to leading estate agent group, Hamptons. It is forecasting that rents will rise 25% between 2023 and 2026, exceeding the 5.5% average growth in house prices during that same period.

A typical monthly rent of a newly rented property was £1304 in October 2023. Owners of properties to be rented face increased costs due to increased regulation and higher mortgage rates. At the same time, demand from renters is ever growing as young people struggle to buy their own homes.

Extract B: Government considering extending mortgage scheme for 5% deposits in the UK

Many UK house buyers purchase a house with a mortgage, a special loan from banks for house purchases. Mortgages require borrowers to pay a cash deposit equal to a specified percentage of the value of the home, between 5% and 40%.

A government guarantee scheme to help current renters to become first time buyers was launched in March 2021. Under the scheme high street lenders can offer mortgages to borrowers with a deposit of just 5% of the house value. The UK Government offers a guarantee to compensate lenders if the borrower defaults on repayments. Lenders will still carry out affordability checks as required by Bank of England regulations. The UK Government has also considered a tax cut on buying a house (stamp duty).

Extract C: Mortgage borrowing rates

A series of interest rate rises since 2022 has pushed up mortgage rates for both homeowners and landlords.

% of house value paid as a cash deposit	5%	10%	25%	40%
Typical interest rate on mortgage per year in 2023*	5.65%	5.15%	4.75%	4.5%

*Exact interest rate depends on lender and product chosen

Extract D: New-build housing market

25 More than three million new homes have been built in the UK since 2001 and the UK
 Government target is 300 000 new homes each year by the mid-2020s. The new-build
 business is now a £60 billion industry that leads to further private sector investment. Yet,
 while housing developers have made record profits, owners have been left to deal with many
 30 problems. Home buyers expect a high-quality new home, but 94% of new-build homeowners
 report at least one fault once their property is complete. The average property is now
 completed with as many as 157 defects. Currently, house builders opt into the New Homes
 Quality Code and the New Homes Ombudsman Scheme (NHOS) voluntarily. The NHOS is a
 service that impartially investigates and resolves complaints about new homes. However, the
 35 Government could make it compulsory. The Home Builders Federation says new builds are
 boosting local economies and that customer satisfaction is 'extremely high'.

- (a) Using **Extract A** and a demand and supply diagram(s), outline why rents were forecasted to rise so greatly between 2023 and 2026. [6]
- (b) (i) Using **Extract C**, calculate the difference between the annual interest payments on a house priced at £300 000 for a buyer with a 5% deposit and a buyer with a 40% deposit. Assume that the total sum borrowed remains the same over the year. [5]
- (ii) Evaluate whether interest rates are the most significant factor that determines the purchase price of houses. [8]
- (c) (i) Explain **two** factors that could increase private sector investment in the UK. [4]
- (ii) Using **Extract D**, discuss whether the new-build house market suffers from market failure. [7]
- (d) Using the data, discuss whether making homes easier to buy is beneficial to the UK economy. [10]

2. History to be repeated?

Extract A: The Great Depression

The Great Depression from late 1929 until about 1939 caused large declines in industrial production leading to mass unemployment.

It involved:

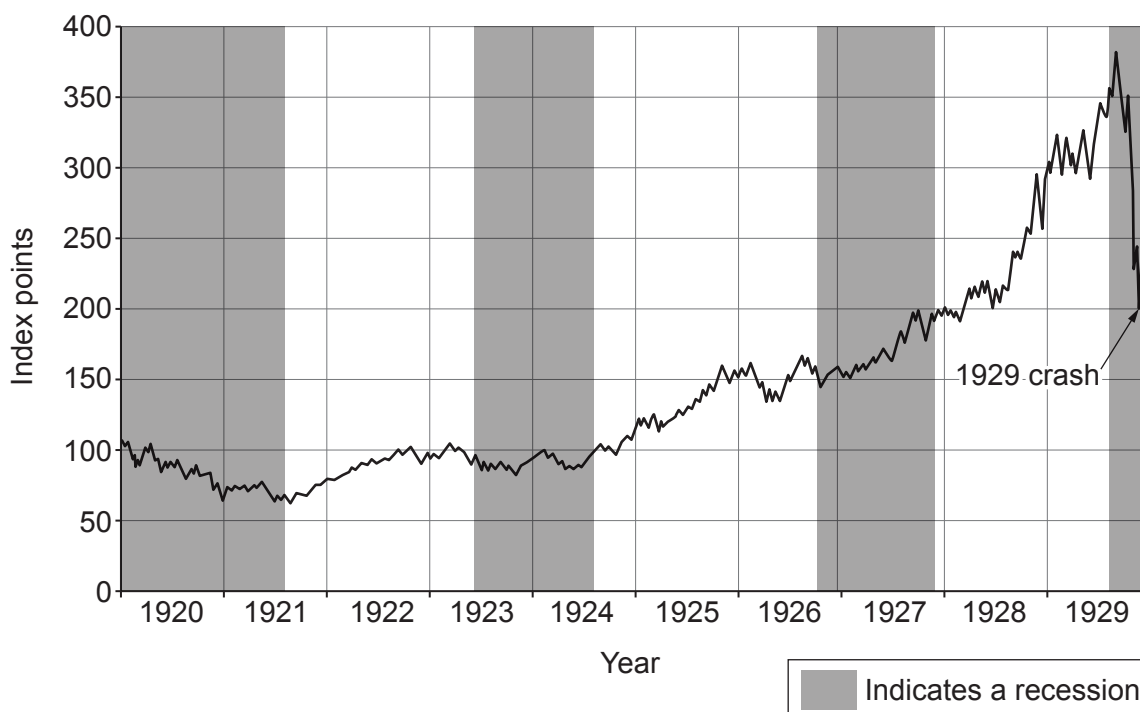
5 **Asset price bubble bursting with the stock market crash of 1929:** During the 1920s, the United States (US) stock market underwent a historic expansion and investing in the stock market came to be seen as an easy way to increase personal wealth. Even people of average income used much of their disposable income or took out loans to buy shares.

10 **Banking panics:** Between 1930 and 1932, the US experienced four banking panics where large numbers of bank customers simultaneously attempted to withdraw their savings in cash. By 1933, one fifth of the banks in existence in 1930 had failed.

Trade surplus: Declining consumption and deflation (falling domestic prices) in the US caused a trade surplus. This threatened to depreciate other currencies.

15 Due to share prices rising to very high levels in 1928 and 1929, the Federal Reserve (US central bank) decided to increase interest rates. As shown in **Figure 1**, this led to a sharp decrease in share prices in 1929 – the stock market crash.

Figure 1: Dow Jones Industrial Index 1920s*



*The Dow Jones Industrial Average is an index that measures the daily share price movements of 30 large American companies.

Extract B: US Government response to the 1929 Great Depression

20 The US Government response included a mix of protectionist policies and expansionary fiscal policy.

The US Government passed the Smoot-Hawley Tariff Act (1930), imposing tariffs averaging 20% on a wide range of agricultural and industrial imports.

25 In 1932, President Roosevelt implemented the “New Deal”, increasing government spending from 3.2% to 9.3% of real GDP by 1936. New Deal initiatives provided work to the unemployed from unskilled labourers through the construction of roads, buildings, parks, tunnels and bridges, to directly employing highly skilled artists in cultural projects.

Extract C: The Great Recession of 2007–2009

Almost 80 years later, another asset bubble burst, causing the Great Recession of 2007–2009.

30 From 2001 to 2004, the Federal Reserve had decreased interest rates to low levels. Simultaneously, due to deregulation in the financial markets, house loans were made available to “sub-prime” borrowers (borrowers who previously would not qualify for a house loan). Thus, house prices increased.

35 However, in 2005 the Federal Reserve started to increase interest rates, causing the US housing market bubble to burst. The banks and financial institutions that had lent large amounts to sub-prime borrowers could not recover the funds they had lent. Some of these banks and financial institutions failed. The Federal Reserve had to react to ensure monetary and financial stability through lower interest rates and increased money supply.

40 Fast forward to 2023, and US interest rates increased from 0.25% to 5.5% between March 2022 and July 2023 as the Federal Reserve attempted to fight high inflationary pressure. Could history be repeated?

- (a) (i) Using a PPF diagram, outline how large declines in industrial production led to mass unemployment during the Great Depression (line 2). [4]
- (ii) Assess the possible impact of mass unemployment on the demand for goods with an income elasticity of demand of +2. [6]
- (b) Explain how an increase in the US trade surplus could depreciate the currencies of other countries. [5]
- (c) Using a diagram or diagrams, explain how a tariff on agricultural goods could affect consumer and producer surplus within the US agriculture market. [6]
- (d) Evaluate whether expansionary fiscal policy is an effective method to achieve all government macro-economic policy objectives. [9]
- (e) Using the data, assess the importance of the central bank’s role in creating monetary and financial stability within an economy. [10]

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Answer booklet

Write the question number in the left-hand margin at the start of each answer.

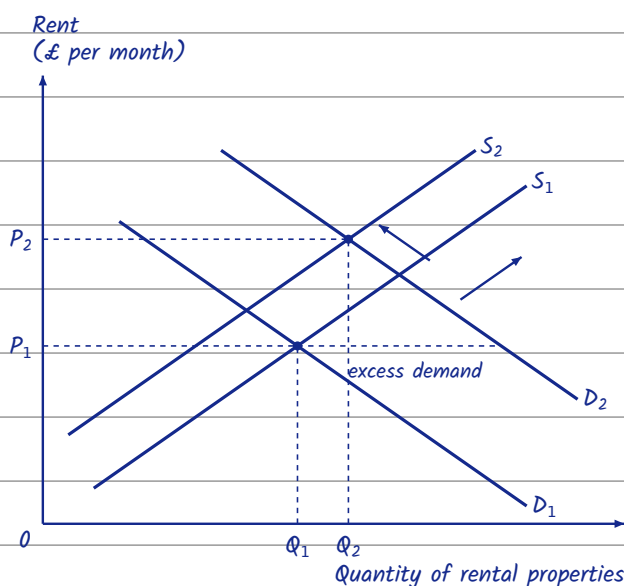
Question
number

1 (a)

Extract A forecasts that rents will rise by 25% between 2023 and 2026 (line 4), over four times the 5.5% rise in house prices. This is because the rental market is experiencing a decrease in supply and an increase in demand at the same time.

Supply: owners of rented property face increased costs because of increased regulation and higher mortgage rates (lines 7 to 8). Mortgage interest and the cost of meeting regulations are costs of supplying a rental property, so at each rent fewer properties are profitable to let and some landlords sell up. Supply shifts to the left from S_1 to S_2 .

Demand: demand from renters is 'ever growing' as young people struggle to buy their own homes (lines 8 to 9). Higher mortgage rates make buying less affordable, so would-be buyers remain in the rental market. Demand shifts to the right from D_1 to D_2 .



As the diagram shows, at the original rent P_1 there is now excess demand.

Renters compete for the scarce properties and bid up rents until a new

equilibrium is reached at P_2 . Because both shifts push rents upwards, the rise from P_1 to P_2 is very large, while the change in quantity (Q_1 to Q_2) is small. This explains why the typical monthly rent of £1304 in October 2023 is forecast to rise so greatly, much faster than house prices.

- 1 (b)(i) Amount borrowed with a 5% deposit = $95\% \times £300\ 000 = £285\ 000$
 Amount borrowed with a 40% deposit = $60\% \times £300\ 000 = £180\ 000$
 Annual interest with a 5% deposit = $5.65/100 \times £285\ 000 = £16\ 102.50$
 Annual interest with a 40% deposit = $4.5/100 \times £180\ 000 = £8\ 100$
 Difference = $£16\ 102.50 - £8\ 100 = £8\ 002.50$ per year

- 1 (b)(ii) An interest rate is the cost of borrowing and the reward for saving. For house buyers it is the percentage charged by the bank on top of the mortgage loan each year, so it determines the cost of the monthly mortgage repayments. When interest rates rise, as they have since 2022 (Extract C), mortgage repayments take a larger share of buyers' incomes and the total cost of buying a house rises. Some buyers can no longer afford to borrow and others decide to rent instead, so the demand for houses falls (shifts left). With supply of houses fixed in the short run, there is excess supply at the old price and sellers must lower prices, so purchase prices fall. Lower interest rates have the opposite effect. Interest rates also affect consumer confidence: if people expect rates to rise further, they delay buying, reducing demand further. However, other factors also determine house prices. Rising incomes increase affordability, and housing demand tends to be income elastic, so economic growth can push prices up even when interest rates are high, while rising unemployment reduces demand. The availability of mortgages matters: the 5% deposit guarantee scheme (Extract B) increases the number of people able to borrow, raising demand. On the supply side, a shortage of new homes (below the 300 000 target in Extract D) pushes prices up. Taxes such as stamp duty add to the cost of buying, and location matters, as desirable areas with limited

supply have much higher prices.

Overall, interest rates are a very significant factor in the short run because most buyers depend on mortgages, so a change in rates quickly changes affordability and demand. However, house prices are still forecast to rise by an average of 5.5% despite the rate rises (Extract A), which suggests that in the long run the shortage of supply relative to demand and rising incomes are more significant in determining the price of houses.

1 (c)(i) Private sector investment is spending by firms (not the government) on capital goods such as machinery and buildings to increase productive capacity.

1. A fall in interest rates: borrowing to fund investment becomes cheaper, so more projects have an expected rate of return above the cost of borrowing. Firms therefore borrow and invest more.

2. An increase in expected future demand and business confidence: if firms expect sales and profits to rise, they need more capacity to meet the higher demand, and confident firms are willing to take the risk, so they invest in new capital goods. Higher current profits also provide retained funds to invest.

1 (c)(ii) Market failure occurs when the free market leads to a misallocation of resources (over or under allocation) and a loss of welfare. One cause is asymmetric information, where one party in a transaction has more information than the other.

The new-build market appears to suffer from asymmetric information. Builders know the quality of their work but buyers cannot easily check it before purchase. Buyers 'expect a high-quality new home', yet 94% of new-build homeowners report at least one fault and the average property is completed with as many as 157 defects (lines 29 to 31). If buyers had full information they would value these homes less and pay lower prices, so too many resources are allocated to low-quality building. Developers have made record profits (line 28) while owners deal with the problems, which suggests weak consumer sovereignty.

There may also be under provision: more than three million homes have been built since 2001 (line 25), an average of only about 130 000 a year, well below the 300 000 target, so the external benefits of housing, such as a mobile and healthy workforce, are not fully gained.

On the other hand, the Home Builders Federation says customer satisfaction is 'extremely high' (line 35), and the New Homes Quality Code and Ombudsman Scheme already exist to investigate complaints, which reduces the information gap. Reviews and media coverage also make buyers more aware. However, both schemes are voluntary (line 32), so builders who opt out face little pressure to improve.

On balance, the new-build market does suffer from market failure through asymmetric information, as the scale of defects shows. The extent depends on how serious the defects are, and making the Ombudsman scheme compulsory could correct much of the failure.

1 (d)

Making homes easier to buy, through the 5% deposit mortgage guarantee scheme (Extract B), a possible stamp duty cut (line 20) and building 300 000 new homes a year (line 26), could bring several benefits to the UK economy. First, it would help renters escape rents that are forecast to rise by 25% by 2026 (Extract A). A buyer with a 5% deposit pays 5.65% interest (Extract C), so the guarantee makes ownership possible for those without large savings. A lower stamp duty reduces the cost of moving, so more houses are bought and sold. This increases the geographical mobility of labour: workers can move to where firms need them, reducing geographical unemployment, raising productivity and increasing potential output.

Second, greater demand for homes would encourage house building. The new-build industry is worth £60 billion and leads to further private sector investment (lines 26 to 27). More construction directly increases output and creates jobs on site and in the supply chain. Through the multiplier effect, the extra incomes are spent in local economies, raising AD and real GDP further,

and higher profits fund investment that increases long run economic growth.

Third, rising house prices (5.5% average growth forecast) create a positive wealth effect: owners feel wealthier and more confident, so consumption and AD rise. Owners can also withdraw equity to finance spending. Ownership of an appreciating asset by lower income households could also reduce wealth inequality.

However, the benefit depends on whether supply keeps up with demand. If building stays below the 300 000 target, making buying easier simply increases demand and pushes prices even higher, so the scheme benefits existing owners and makes homes less affordable for others, increasing wealth inequality. Higher house prices may also lead workers to demand higher wages, adding to inflation. It also depends on interest rates. If rates rise further, buyers with only 5% deposits and the highest rates may be unable to afford repayments and default. As the government guarantees these loans, its spending and the budget deficit would rise, although Bank of England affordability checks (line 19) reduce this risk. In addition, if building materials and furniture are imported, net exports fall, reducing the boost to AD.

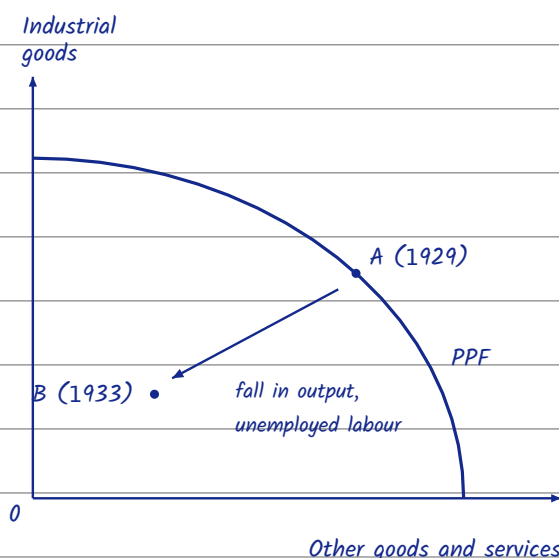
Overall, making homes easier to buy is beneficial to the UK economy, mainly through greater labour mobility and higher output and jobs in construction.

However, it is only beneficial in the long run if it is combined with increased supply of good-quality homes; otherwise, schemes that boost demand alone mainly raise prices and the risk of default.

2 (a)(i)

A large decline in industrial production means firms produce much less output.

Labour is a derived demand, so firms need fewer workers and lay them off to cut costs and avoid losses. A large percentage of those willing and able to work are left without jobs, so there is mass unemployment.



As the PPF diagram shows, before the Depression the US was producing at point A, close to the PPF boundary. The fall in output moves the economy to point B, far inside the PPF. The economy's productive potential has not changed, but actual output is far below maximum potential output because resources, especially labour, are unemployed.

2 (a)(ii) Income elasticity of demand (YED) measures the responsiveness of demand to a change in income. A YED of +2 means the good is a normal, luxury good with income elastic demand; a 1% change in income causes a 2% change in demand in the same direction.

Mass unemployment greatly reduces household incomes, as the unemployed lose their wages. With less disposable income, households cut spending on expensive luxury goods first. As YED is +2, a 10% fall in incomes would reduce demand by 20%, a more than proportional fall. Unemployment also reduces confidence: even those still in work fear losing their jobs, so they save more and delay buying luxuries, so demand falls further.

However, the impact depends on who buys the good. If its customers are high-income, highly skilled workers who kept their jobs, their incomes may not fall, so demand may fall by much less. It also depends on interest rates: the Federal Reserve raised rates (line 15), increasing the cost of borrowing to buy luxuries and making the fall worse, but if rates are cut, those still in work could

borrow and keep buying. Overall, demand for a good with YED of +2 is likely to fall significantly, by double the fall in income, but by less if its buyers are not affected by unemployment.

2 (b)

An exchange rate is the price of one currency in terms of another, determined by the demand for and supply of currencies on the foreign exchange market. A US trade surplus means the value of US exports is greater than the value of US imports.

When other countries buy US exports, their importers must sell their own currency to buy US dollars. A larger US surplus therefore increases the supply of other countries' currencies on the foreign exchange market and increases the demand for dollars. At the same time, Extract A says the surplus was caused by declining US consumption, so the US imports less. US importers need less foreign currency, so they sell fewer dollars and the demand for other currencies falls.

With supply of their currencies rising and demand for them falling, there is excess supply of those currencies at the old exchange rate, so their value falls: other countries' currencies depreciate against the dollar, while the dollar appreciates. The other countries now have trade deficits with the US, meaning more of their currency flows out than in.

2 (c)

A tariff is a tax on imports. The Smoot-Hawley Act imposed tariffs averaging 20% on agricultural imports (line 21), raising the price of imports from the world price P_w to $P_w + T$.

of real GDP by 1936 (line 24) through capital spending on roads, bridges and tunnels. Government spending is a component of AD, so AD shifts right and real GDP rises. Firms need more workers to produce the extra output, so unemployment falls, and the newly employed spend their incomes, creating a multiplier effect that raises GDP further. Cutting income tax, especially for low earners with a high marginal propensity to consume, raises disposable income and consumption, with the same effect.

However, it is unlikely to achieve all objectives at once. If the economy is near full capacity, rising AD causes demand-pull inflation, and as unemployment falls, labour becomes scarce and workers bargain for higher wages, so price stability is threatened. Higher inflation makes exports less competitive and higher incomes increase imports, worsening the balance of payments. Higher spending and lower taxes also increase the budget deficit and national debt, although growth widens the tax base in the long run.

The outcome depends on the type of policy. Spending on infrastructure, education and training, or cuts in corporation tax that encourage investment, also shift LRAS to the right, increasing productive potential, so growth can occur without inflation. Even then it depends on whether spending is well allocated and whether firms invest rather than paying higher dividends, and supply side effects take time.

Overall, expansionary fiscal policy is effective for growth and unemployment, especially in a deep recession with spare capacity such as the Great Depression, when inflation is not a risk. However, because of conflicts with price stability, the balance of payments and the budget, it cannot achieve all macroeconomic objectives at the same time on its own.

2 (e)

A central bank, such as the Federal Reserve in the US, manages a country's monetary policy and money supply. Its roles include issuing currency, setting interest rates (and quantitative easing) to meet an inflation target such as 2%, acting as lender of last resort to commercial banks, and regulating and

monitoring banks to keep the financial system safe.

Monetary stability means stable, low inflation. By setting interest rates according to its inflation forecast, the central bank keeps prices stable, so households are confident to spend now and firms are confident to invest and produce. In 2022 to 2023 the Federal Reserve raised rates from 0.25% to 5.5% (lines 38 to 39) to fight high inflation: higher rates increase the cost of borrowing and reward saving, so consumption, investment and AD fall, reducing demand-pull inflation.

Financial stability means a banking system that can keep lending. As lender of last resort, the central bank provides liquidity to banks short of cash, maintaining confidence and preventing bank runs. Its importance is shown by the Great Depression: between 1930 and 1932 there were four banking panics and by 1933 one fifth of US banks had failed (lines 9 to 11), so households and firms could not borrow, and spending and output collapsed. In the Great Recession the Federal Reserve reacted with lower interest rates and increased money supply (lines 36 to 37), helping banks continue lending so consumption and investment continued.

However, the central bank can also create instability. The Federal Reserve's rate rise in 1928 to 1929 contributed to the crash, with the Dow Jones falling from about 380 to around 200 points (Figure 1). Its low rates from 2001 to 2004 (line 29) helped cause the housing bubble, and raising rates from 2005 burst it (line 33). In addition, the bubble was partly caused by financial deregulation (line 30), the responsibility of the government, and fiscal policy such as the New Deal was needed to restore growth. Rescuing failing banks may also create moral hazard, encouraging risky lending.

Overall, the central bank's role is very important, because it is the only institution that can act as lender of last resort and control interest rates and money supply. However, it does not create stability alone: its policies must be well timed, and it depends on strong government regulation and fiscal policy working alongside it.