Surname	StemUp Model Solution	Centre Number	Candidate Number
Other Names			2

GCE AS/A LEVEL

2520U10-1

S18-2520U10-1

ECONOMICS – AS unit 1
Introduction to Economic Principles

MONDAY, 14 MAY 2018 – MORNING

1 hour 15 minutes

For Examiner's use only		
Question	**Maximum Mark**	**Mark Awarded**
1-15	**15**	
16	**6**	
17	**16**	
18	**9**	
19	**9**	
Total	**55**	

2520U101
01

ADDITIONAL MATERIALS

A calculator.

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Write your name, centre number and candidate number in the spaces at the top of this page.

Answer **all** questions in the spaces provided in this booklet. You may use continuation paper on page 22 if necessary, taking care to number the continuation correctly.

INFORMATION FOR CANDIDATES

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

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SECTION A

For each question in Section A, write the letter (A, B, C, D or E) that corresponds to your answer in the box provided.

You are advised to spend approximately **30 minutes** *on this section.*

1. Identify the missing words from the following statement:

"According to the circular flow of income model, when an economy is in equilibrium we would expect withdrawals to ..... injections". [1]

A be greater than

B be less than

C be equal to

D be twice the size of

E be greater or less than

C

2. Which of the following is **least** likely to lead to a shift right of the long run aggregate supply curve? [1]

A Increase in efficiency of resources

B Increase in quantity of resources

C Increase in the cost of resources

D Increase in quality of resources

E Improvement in the state of technology

C

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3. Recent research into the banking system in Ghana found that many poor people, whose needs for basic survival are great and who are less able to make long-term plans, tend not to save any excess earnings and instead take out more loans that trap them into debt. [1]

This is an example of:

A High savings ratio

B The profit motive

C Government failure

D Irrationality

E Public sector debt

D

4. A government invests £240m into building a new hospital. That figure is matched by private sector investment in other infrastructure projects. Consumption, on the other hand, falls by £135m and the trade balance worsens by £60m. Assuming there is no multiplier process, what is the effect on aggregate demand? [1]

A Increases by £285m

B Increases by £555m

C Increases by £45m

D Increases by £675m

E Increases by £315m

A

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5. Which of the following indicates that two goods are complementary? [1]

A An inelastic cross-elasticity of demand

B A horizontal demand curve

C A positive income elasticity of demand

D A price elasticity of demand greater than –1

E A negative cross-elasticity of demand

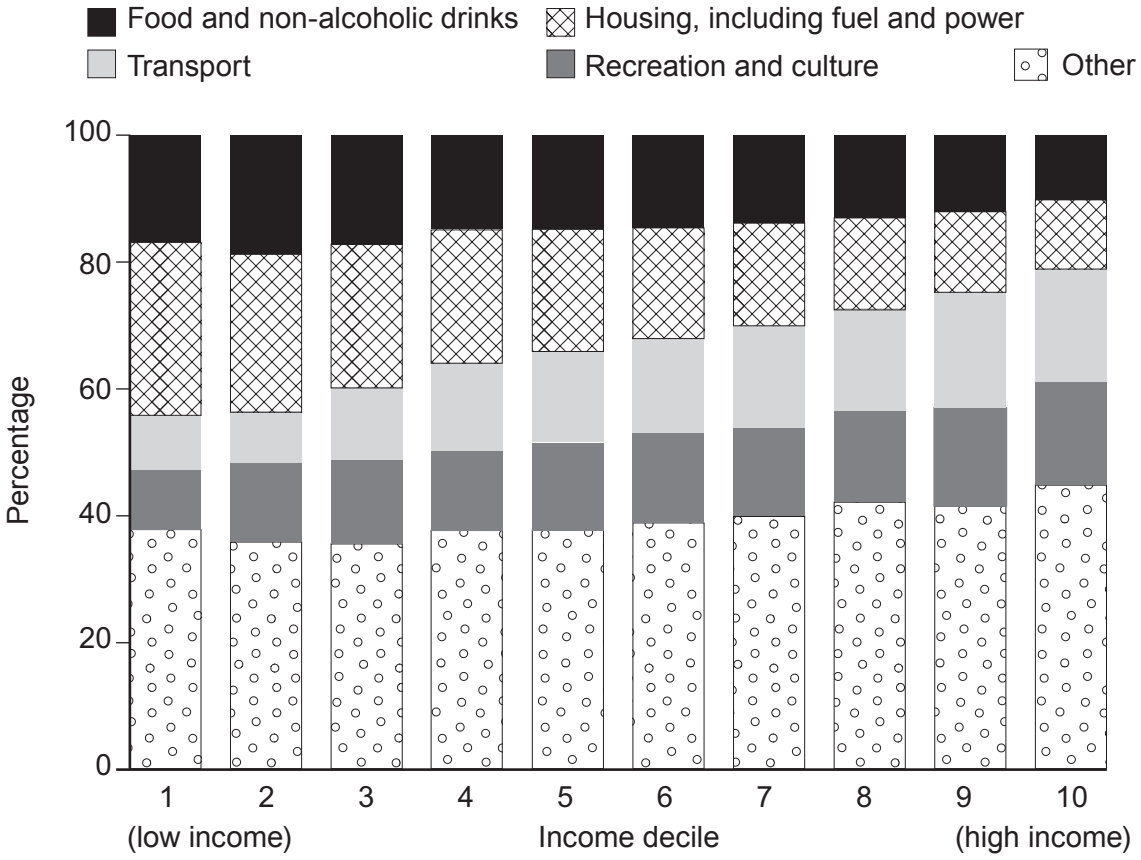
E

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6. The chart below shows household spending on different categories of goods and services by income decile.



It can be concluded that: [1]

A Low income groups spend more in total on food and non-alcoholic drinks than high income groups

B High income groups spend a higher proportion of their income on transport than low income groups

C The proportion of income spent on housing rises as income rises

D The proportion of income spent on other goods and services rises steadily as income rises

E The richest 10% of the population spend twice as much as the poorest 10% on recreation and culture

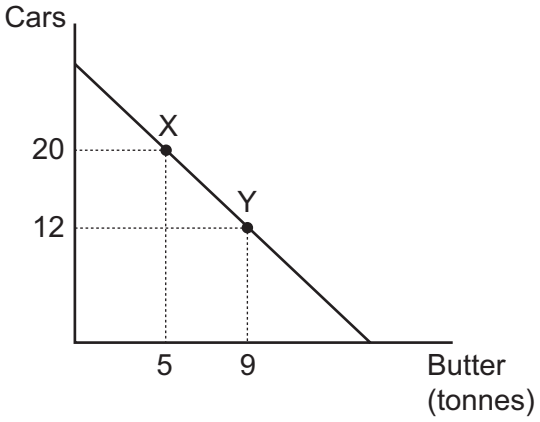
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7. Assume that resources are perfectly substitutable in an economy that makes cars and butter as shown in the production possibility frontier below. Between points X and Y, the opportunity cost of producing **one** more tonne of butter equals: [1]



A 2 cars

B 3 cars

C 4 cars

D 8 cars

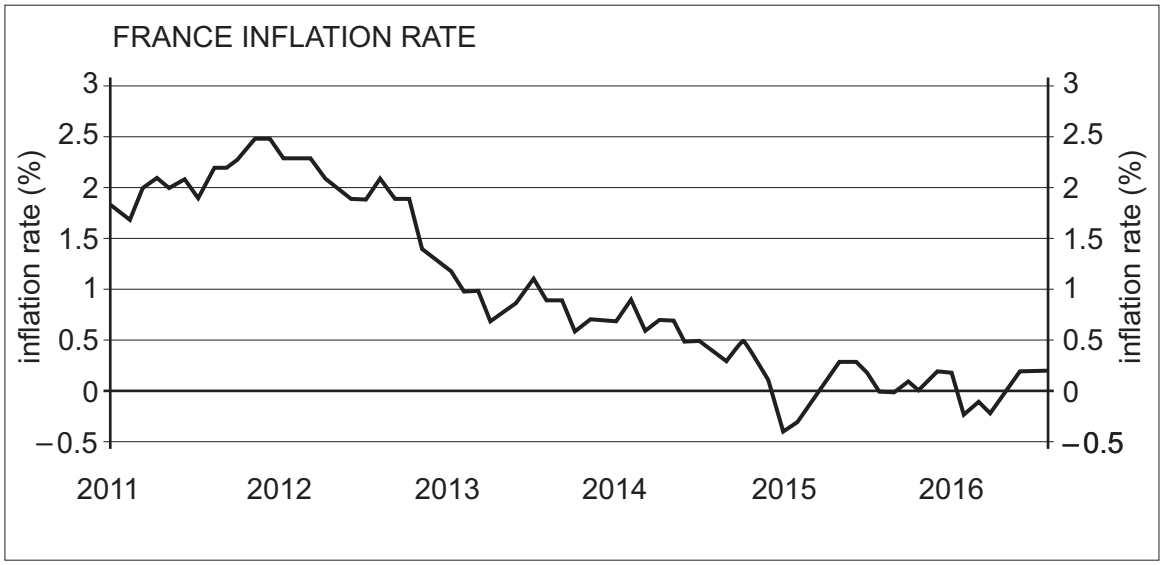
E 12 cars

A

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8. The graph below shows the inflation rate in France between 2011 and 2016.



Which of the following statements is **not** true? [1]

A The highest rate of inflation was 2.5%

B Prices fell between 2012 and 2013

C Inflation has not been above 1% since 2014

D Prices rose between 2011 and 2012

E France has experienced periods of deflation between 2011 and 2016

B

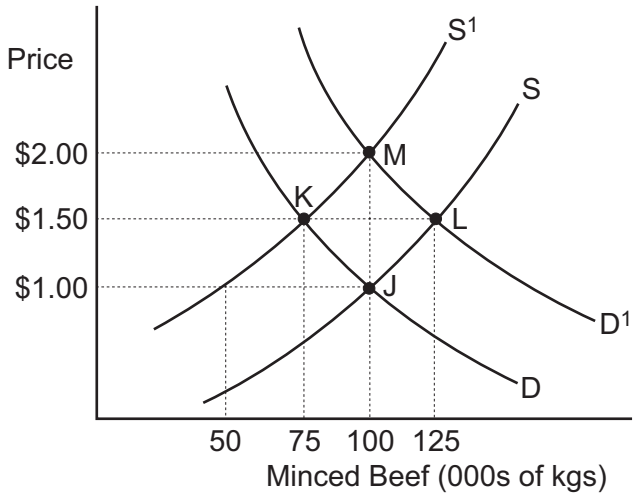
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Questions 9 and 10 refer to the diagram below.

The diagram shows the market for minced beef which is initially in equilibrium at point J. Minced beef is used to make hamburgers. You should assume that minced beef is an inferior good.



9. Which of the following could explain a movement to a new equilibrium at point M? [1]

A A change in tastes away from hamburgers combined with an increase in disease related cattle deaths

B An increase in buyers' income combined with a cost-saving technological advance in minced beef production

C An increase in the price of hamburgers combined with an increased cost of production of minced beef

D A fall in population combined with an increased price for an alternate form of packaged beef

E A decrease in buyers' income combined with an increase in price for cattle

E

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10. Which of the following is correct if equilibrium shifts from point J to point K? [1]

A Both the price and consumer surplus have increased

B The demand decreased due to a lower price substitute

C There is excess demand of 25 000 kg at the price of $1

D A shift in supply will cause a temporary shortage, which will disappear when the price rises to $1.50

E Both the demand curve and the quantity demanded have decreased

D

11. A positive consumption externality occurs when: [1]

A The social marginal benefit is greater than the private marginal benefit

B The social marginal cost is greater than the private marginal cost

C The social marginal cost is greater than the private marginal benefit

D The social marginal benefit is lower than the private marginal benefit

E The social marginal cost is lower than the private marginal cost

A

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12. Which of the following is **not** a function of the Bank of England? [1]

A Issuing bank notes in England and Wales

B Providing safe custody for the UK's gold reserve

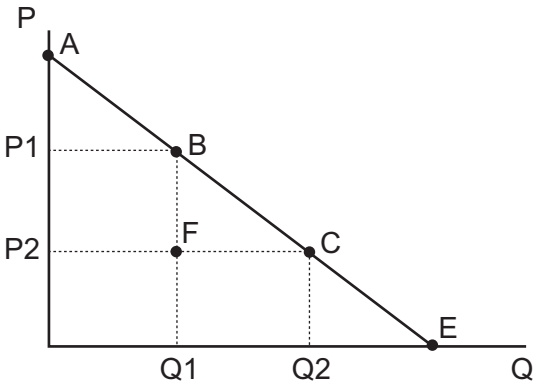
C Making sure the financial system is safe and sound

D Making sure that money is available to fund the UK's public services

E Operating monetary policy by moving the bank rate up and down

D

13. The diagram below represents the demand curve for a product.



The price falls from P1 to P2 and, as a result, the increase in consumer surplus is area: [1]

A P1BFP2

B P2AC

C P1BCP2

D FCQ2Q1

E BFC

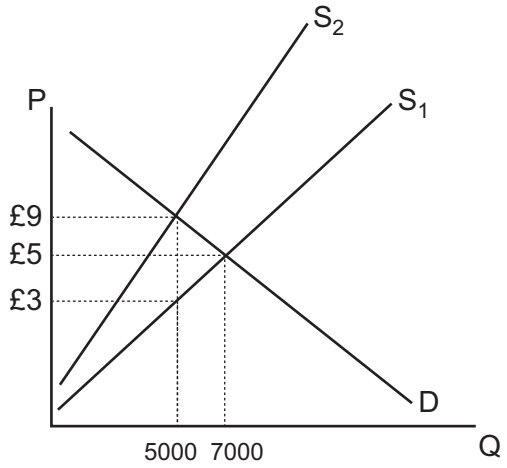
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14. The diagram below shows the market for a particular product. The Government has recently imposed an indirect ad valorem tax onto the product. How much tax revenue will the Government collect from this tax? [1]



A £25 000

B £30 000

C £35 000

D £15 000

E £45 000

B

15. A new report states that house prices in Swansea have increased by 2.1% between June 2015 and June 2016 to an average price of £134 822.

What was the average house price in Swansea in June 2015? [1]

A £2 831

B £137 653

C £131 991

D £111 423

E £132 049

E

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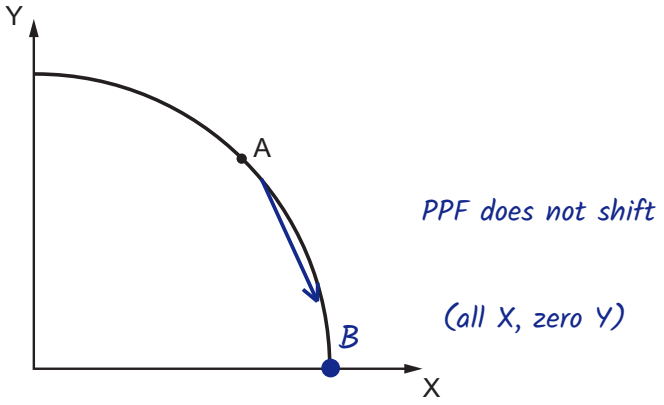
SECTION B

Answer **all** *the questions in the spaces provided.*

16. A country allocates its resources equally between the production of Goods X and Y.

(a) Adapt **Diagram 1** to illustrate the impact on resource allocation of total specialisation in product X. Explain your answer. [3]

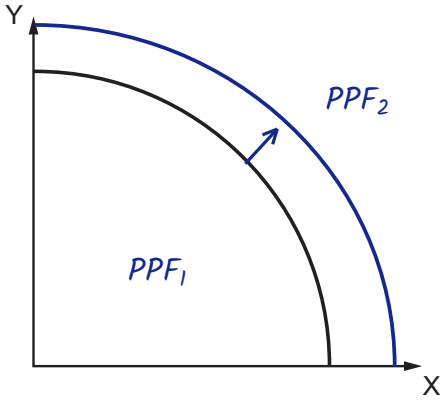
Diagram 1



Specialisation is when an economy concentrates its resources on producing one good. All resources move from Y into X, so the economy moves along the PPF from A to B: maximum X, zero Y. The PPF does not shift as total resources are unchanged, only their allocation.

(b) Adapt **Diagram 2** to illustrate the impact of division of labour on productivity within the economy. Explain your answer. [3]

Diagram 2



Division of labour is splitting production into separate tasks, each done by a different worker. Workers become more skilled and save time switching tasks, so productivity (output per worker) rises. Maximum output of X and Y increases, so the PPF shifts out from PPF_1 to PPF_2.

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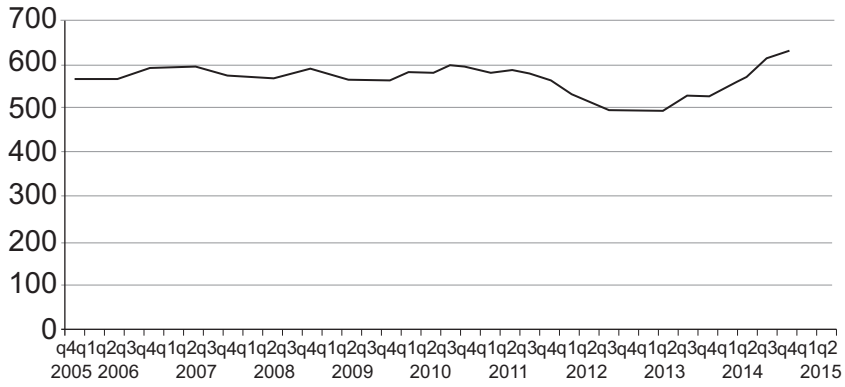
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17. During the debate over the UK's membership of the EU, the issue of immigration was a topical one. Clwyd West MP David Jones was quoted as saying immigration drives wages down in Wales and forces local people out of jobs. On the other hand, Swansea West MP Geraint Davies argued that immigration has had little effect on wages. "I don't think this is a major issue – the key issues are actually low economic growth and consumer spending", he said.

Source: BBC

Figure 1. Migration (thousands) into the UK – 2005-15.



Source: ONS

Figure 2. Average UK weekly earnings (at 2015 prices).



Source: IFS

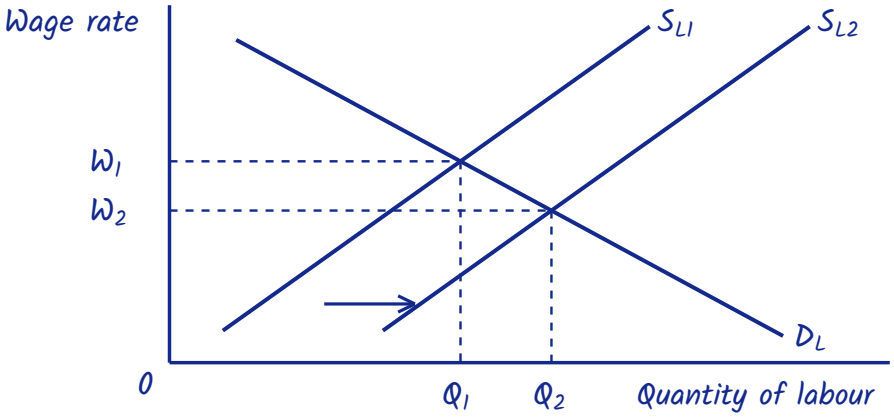
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(a) Using a diagram, outline why it might be argued that "immigration drives wages down in Wales". [4]

Draw diagram here



Immigration increases the number of workers willing and able to work in Wales, so the supply of labour shifts right from S_{L1} to S_{L2}. At the old wage W_1 there is now an excess supply of labour, which puts downward pressure on wages, so the wage falls from W_1 to W_2 (employment rises from Q_1 to Q_2).

(b) Describe the trends in immigration and average weekly earnings shown by the data in Figures 1 and 2. [4]

Figure 1: immigration was fairly constant at around 570,000 to 600,000 from 2005 to 2011. It then declined to about 500,000 in 2012 to 2013, before picking up rapidly from late 2013 to over 600,000 (about 630,000) by 2015, its highest level in the period.

Figure 2: real average weekly earnings rose steadily from about £403 in 2003-04 to a peak of about £423 in 2007-08, then fell rapidly to about £394 by 2011-12, and have since stagnated at around £393 to £398 (about £397 in 2014-15).

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(c) To what extent do you agree with the statement: low economic growth and consumer spending are the biggest factors affecting wages in the UK. [8]

Wages are the price of labour, and labour is a derived demand: firms want workers because of the demand for the goods they produce. Figure 2 shows real wages falling sharply from about £423 in 2007-08 to about £394 in 2011-12, exactly when the recession of 2008-09 caused a collapse in economic growth. Lower consumer spending (C is the largest part of AD) means less demand for products, so the demand for labour shifts left and wages fall. Rising unemployment also makes workers willing to accept lower pay, so the supply of labour rises and wages fall further, especially if welfare cuts increase the incentive to work. In a boom the reverse happens: higher consumption raises the derived demand for labour and wages rise. Wages therefore depend heavily on growth and spending.

However, other factors matter. Immigration increases labour supply, which can lower wages in low-skilled sectors, although Figure 1 shows immigration fell in 2012 to 2013 while wages stayed flat, suggesting its effect may be over-stated for political reasons. The National Minimum Wage sets a legal floor that raises wages at the bottom, and strong trade unions or high public sector employment can keep wages above the market level. Inflation also matters: Figure 2 is in real terms, so high inflation after 2008 with low pay rises cut real wages, and workers then demand rises above inflation, risking a wage-price spiral. Productivity, skills and globalisation

16

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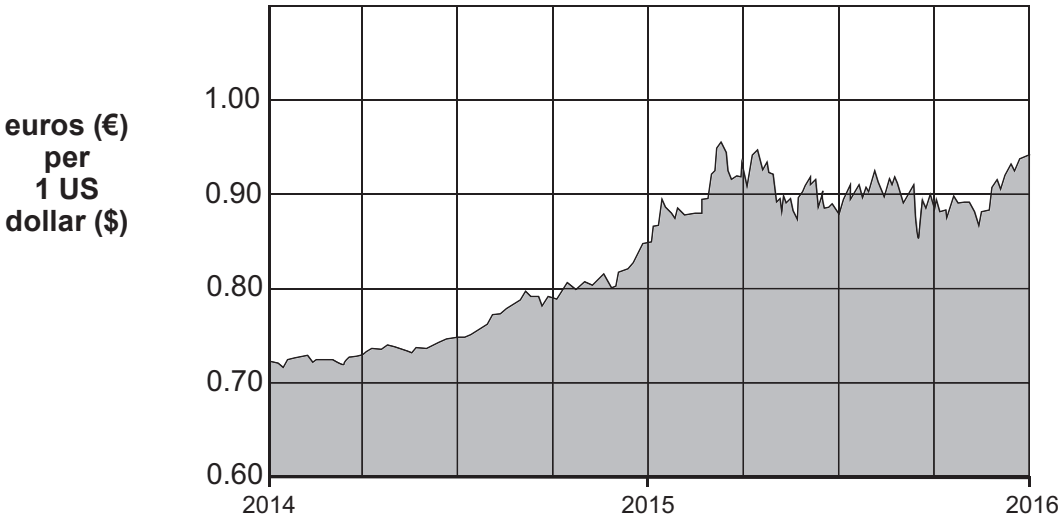
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18. The Eurozone is a collection of 19 European countries which have adopted the euro (€) as their common currency. The diagram below shows the exchange rate between the euro and the US dollar from 1 Jan 2014 to 1 Jan 2016. The European Central Bank operates much like the Bank of England in that it sets the base interest rate for the Eurozone members. The Eurozone imports nearly €450bn worth of goods and services from the US every year.

Figure 3. Exchange rate euros (€) per 1 US dollar ($).



(a) Calculate the % change in the value of the US dollar ($) over the two year period and state whether it has appreciated or depreciated against the euro (€). [3]

1 Jan 2014: €0.72 per $1 1 Jan 2016: €0.94 per $1

% change = (0.94 − 0.72) ÷ 0.72 × 100 = +30.56%

The US dollar has appreciated against the euro, by about 30.6%.

(b) Assume the price elasticity of demand (PED) of all Eurozone imports from the US is –0.8. Calculate the likely impact of this exchange rate change on the quantity demanded of Eurozone imports from the US. [2]

The price of US imports in euros rises by 30.56%.

$\%\Delta Qd = PED \times \%\Delta P = -0.8 \times 30.56\% = -24.44\%$

Quantity demanded of Eurozone imports from the US falls by about 24.4%.

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(c) If the European Central Bank increases the base interest rate, explain the likely consequences on the trade of goods and services between the US and the Eurozone. [4]

A higher ECB base rate raises the return on saving in Eurozone banks, so more American and other foreign savers move money into Eurozone banks. The demand for euros rises and the supply of euros falls, so the euro appreciates against the dollar. Eurozone exports become more expensive in dollars, so US consumers buy fewer Eurozone goods and services, while US goods become cheaper in euros. Also, higher interest rates raise borrowing costs and reward saving, so Eurozone consumption falls, including spending on imports. So Eurozone exports to the US fall, while imports from the US are cheaper but held back by lower spending.

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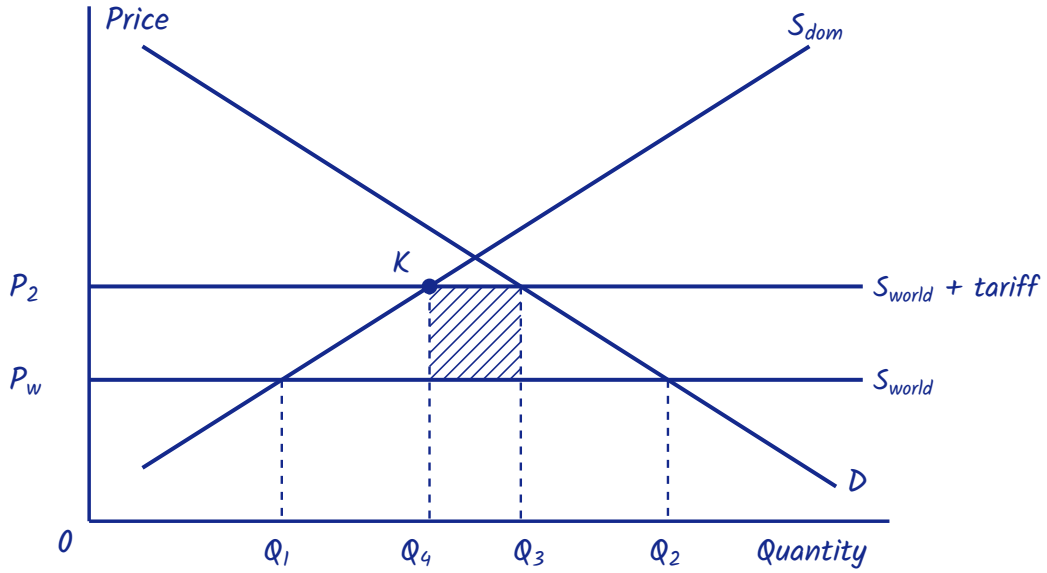
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19. During the 1970s, more than 200 000 people were employed in the UK steel sector but in 2016 the number stands at just over 30 000. Steel-making has been hit by a mixture of factors recently such as increasing energy costs, a strong pound, carbon taxes and competition from China.

China is the world's largest steel supplier; it supplies about half of the 1.6 billion tonnes of steel made worldwide per year. Chinese steel-making receives vast state subsidies which are reported to be worth around two-thirds of the cost of production. In July 2015, Chinese steel was cheaper per tonne than cabbage. The flood of excess cheap Chinese steel into the UK has had a devastating effect on UK steel manufacturers, who have condemned the British government for failing to introduce protectionist measures against the cheap Chinese imports.

With the aid of a tariff diagram, discuss whether the imposition of a tariff on Chinese steel could save UK-based jobs. [9]

Draw diagram here



A tariff is a tax on imports. Before the tariff, UK buyers pay the subsidised world price P_w; UK firms supply only $0Q_1$ and imports are Q_1Q_2. A tariff raises the price of Chinese steel to P_2, so demand contracts to Q_3 and UK firms, now more price competitive, expand output to $0Q_4$. Imports fall to Q_4Q_3. UK producers' revenue rises from $P_w \times 0Q_1$ to $0P_2KQ_4$. As labour is a derived demand, firms producing Q_1Q_4 more steel need more workers, so jobs in plants such as Port Talbot are saved or created, and the government gains the hatched tariff revenue.

However, the tariff may not save jobs. Other countries also subsidise steel, so UK buyers may simply switch to steel from other countries instead of China (trade diversion). The tariff may not be high enough: Chinese subsidies are worth around two-thirds of production costs, so even with a tariff Chinese steel may still be

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cheaper than UK steel, which faces high energy costs, carbon taxes and a strong pound. A further appreciation of the pound would cut import prices and cancel out the tariff. China may retaliate with tariffs on UK exports, starting a trade war that costs jobs in other export industries. Higher steel prices also raise costs for UK car and construction firms, so jobs may be lost there, and consumers lose surplus. Protection may also reduce the incentive for UK steel firms to become efficient. Overall, a tariff could save some UK steel jobs in the short run, but it depends on its size, the PED for steel and whether other countries retaliate or replace China; in the long run UK steel needs to become more competitive.

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END OF PAPER

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17 (c) also affect wages.

Overall, I largely agree: growth and consumer spending were the biggest factors behind the fall after 2008, but their importance depends on the time period, the sector and the skill level, and minimum wages and inflation also have a big effect.

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