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Candidate signature

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# A-level ECONOMICS

Paper 3 Economic principles and issues

Tuesday 4 June 2019

Morning

Time allowed: 2 hours

## Materials

For this paper you must have:

- the insert
- a calculator.

## Instructions

- Answer **all** questions.
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Fill in the boxes at the top of this page.
- You will need to refer to the insert provided to answer **Section B**.
- You must answer the questions in the spaces provided. Do not write outside the box around each page or on blank pages.
- Do all rough work in this answer book. Cross through any work that you do not want to be marked.

## Information

- The maximum mark for this paper is 80.
- The marks for questions are shown in brackets.
- No deductions will be made for wrong answers.

For Examiner's Use	
Section	Mark
A	
B	
<b>TOTAL</b>	



J U N 1 9 7 1 3 6 3 0 1

IB/M/Jun19/E14

**7136/3**

**Section A**Answer **all** questions in this section.Only **one** answer per question is allowed.

For each answer completely fill in the circle alongside the appropriate answer.

CORRECT METHOD



WRONG METHODS

If you want to change your answer you must cross out your original answer as shown. If you wish to return to an answer previously crossed out, ring the answer you now wish to select as shown. **0 1**

A monopolistically competitive firm's demand curve is

**A** also the market demand curve.**B** inelastic throughout its length.**C** the firm's average revenue curve.**D** the same as its marginal revenue curve.**[1 mark]**

**0 2**

The table below contains selected data on a country's macroeconomic performance over a 20 year period.

Year	Unemployment (%)	Rate of inflation (%)	Balance of trade on current account (\$ bn)
1998	6.0	3.5	-20
2003	5.8	3.0	-19
2008	5.5	2.5	-12
2013	5.2	2.0	-2
2018	5.0	1.5	+3

All other things being equal, which one of the following, **A**, **B**, **C** or **D**, can be inferred from the above data?

- A** The natural rate of unemployment is falling
- B** The price level is increasing more slowly
- C** The volume of exports is increasing
- D** There is an inverse relationship between unemployment and inflation

**[1 mark]****0 3**

Which one of the following is most likely to result in complete market failure?

- A** Negative externalities in production and consumption
- B** Non-excludability and no enforceable property rights
- C** The existence of demerit goods in some markets
- D** The government setting maximum prices for excludable and rival goods

**[1 mark]**

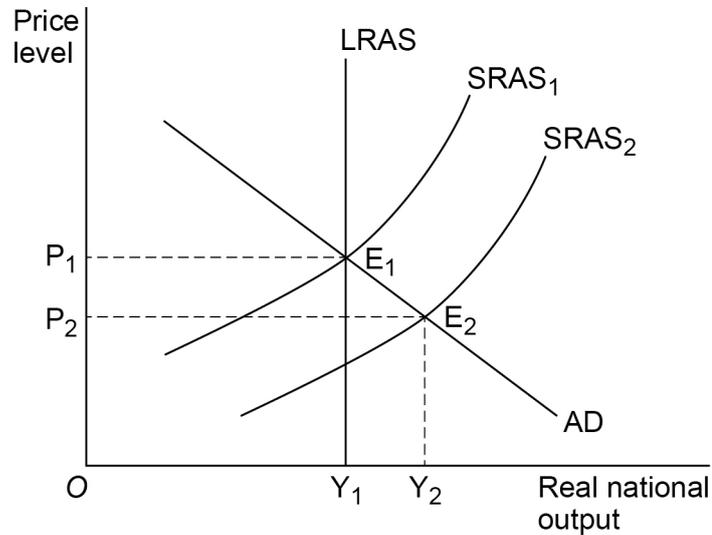
**Turn over for the next question**

**Turn over ►**



0 4

The diagram below shows the aggregate demand (AD) curve, the long-run aggregate supply (LRAS) curve, and two short-run aggregate supply (SRAS<sub>1</sub> and SRAS<sub>2</sub>) curves for an economy. The economy's initial equilibrium is at E<sub>1</sub>.



The most likely explanation for the move of the economy from its initial equilibrium at E<sub>1</sub> to a new short-run equilibrium at E<sub>2</sub> is a decrease in the

- A** level of tariffs on imports.
- B** productivity of capital.
- C** rate of wage inflation.
- D** value of government subsidies to farmers.

[1 mark]

0 5

Which one of the following policies is most likely to improve the supply side of the economy? A policy which

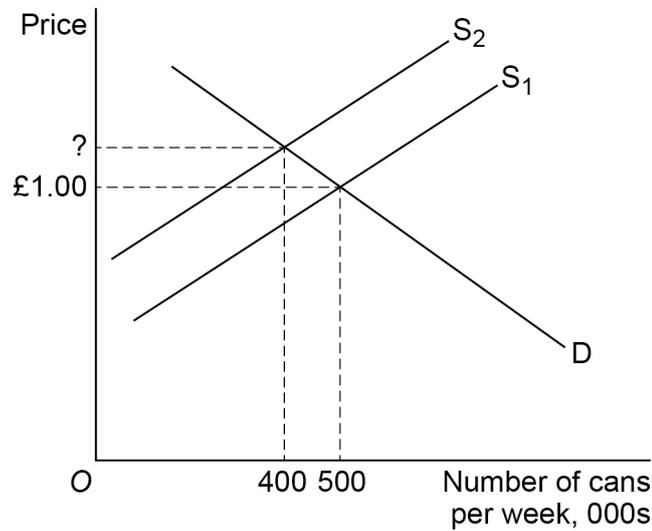
- A** increases the budget surplus.
- B** reduces the natural rate of unemployment.
- C** shifts resources from capital to labour intensive industries.
- D** shifts the burden of tax from indirect to direct taxation.

[1 mark]



0 6

The diagram below shows the market demand (D) curve and two supply ( $S_1$  and  $S_2$ ) curves for a brand of soft drink. The drink is a demerit good because of its high sugar content. The government imposes an indirect tax on each can sold that cuts consumption by 100 000 cans per week.



If the price elasticity of demand for the drink is  $-2.0$ , the price must have increased by

A 5p

B 10p

C 15p

D 20p

[1 mark]

0 7

The hypothesis of diminishing marginal utility

A assumes that at least one factor of production is fixed in the short run.

B can be used to help explain why a demand curve is downward sloping.

C explains why firms try to maximise profit.

D states that total utility must fall as consumption increases.

[1 mark]

Turn over for the next question

Turn over ►



0 8

A rational, utility maximising consumer is considering the purchase of a used car. Her final choice is between two cars which are identical in **all** respects except for the differences shown below.

	Price	Period of guarantee against faults
Car 1	£8 000	3 months
Car 2	£10 000	12 months

Based on the above information, which one of the following is the most likely explanation for the customer's purchase of Car 2? She

- A** has £10 000 of savings available to buy herself a used car.
- B** has a positive income elasticity of demand for used cars.
- C** has a price inelastic demand curve for used cars.
- D** wants to reduce the risks from asymmetric information.

[1 mark]

0 9

All other things being equal, if the velocity of circulation is constant, the quantity theory of money based on Fisher's equation of exchange,  $MV=PQ$ , predicts that an x% increase in the money supply will always cause an x%

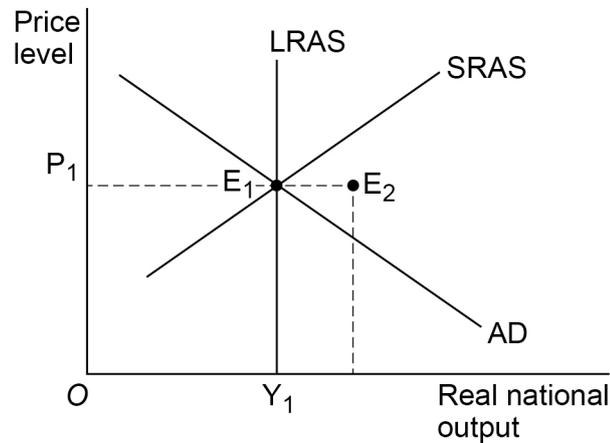
- A** decrease in the rate of interest.
- B** increase in nominal national income.
- C** increase in real national income.
- D** increase in the rate of economic growth.

[1 mark]



1 0

The diagram below shows the aggregate demand (AD) curve, the short-run aggregate supply (SRAS) curve and the long-run aggregate supply (LRAS) curve for an economy. The economy's initial equilibrium is at  $E_1$ .



The government wants to achieve economic growth without conflicting with its long-run objective of price stability. All other things being equal, which one of the following policy combinations is most likely to enable the economy to achieve a new long-run equilibrium at  $E_2$ ?

- A** A reduction in interest rates and increased government borrowing.
- B** A reduction in the budget deficit and the rate of growth of the money supply.
- C** Increased government expenditure on apprenticeships and transport infrastructure funded through borrowing.
- D** Increased government expenditure on welfare funded through higher indirect taxes.

[1 mark]

**Turn over for the next question**

**Turn over ►**



1 1

The table below shows how a firm's total cost of producing handbags changes as output increases.

Output (handbags per month)	Total cost per month (£)
0	45 000
1 000	165 000
2 000	250 000
3 000	360 000

What is the average fixed cost of producing 3 000 handbags per month?

A £15

B £105

C £110

D £120

[1 mark]

1 2

The existence of negative externalities in consumption results in a misallocation of resources. This is because at the free market level of output the

A marginal private benefit is greater than the marginal private cost.

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

C marginal social benefit is less than the marginal social cost.

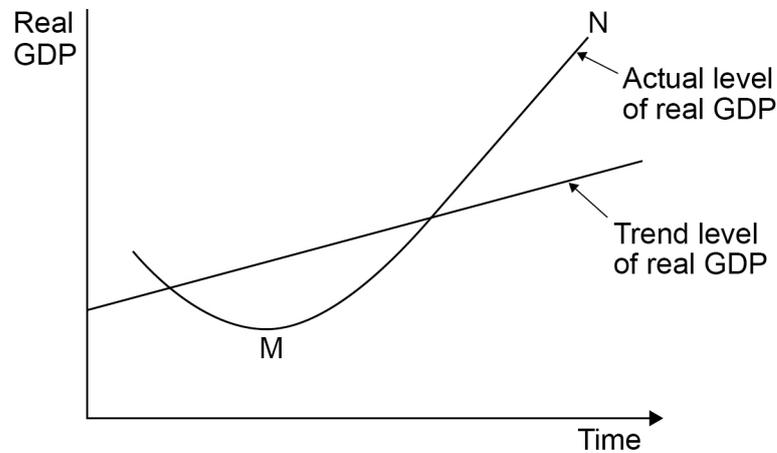
D marginal social cost is less than the marginal private benefit.

[1 mark]



1 3

The diagram below shows the actual level of real GDP and the trend level of real GDP over time for an economy. The economy starts its recovery from recession at point M. After several years of growth the economy reaches point N.



All other things being equal, which one of the following is the most likely consequence of the economy's growth path between points M and N?

- A** A decrease in the level of interest rates due to deflation.
- B** A decrease in the rate of inflation due to increased output.
- C** An increase in investment due to the accelerator process.
- D** An increase in the value of the multiplier due to a rise in the savings ratio.

[1 mark]

1 4

All other things being equal, which one of the following would be most likely to result in a reduction in inequality in the distribution of income in the UK? An increase in the

- A** amount of government tax revenue.
- B** average standard of living.
- C** level of median income.
- D** share of income of the lowest quintile.

[1 mark]

**Turn over for the next question**

**Turn over ►**



**1 5**

The table below shows different combinations of changes in the rate of interest and the government's budget position. The economy has a negative output gap. All other things being equal, which one of the combinations of policies, **A**, **B**, **C** or **D**, is most likely to reduce the economy's negative output gap?

	Rate of interest	Government's budget position	
<b>A</b>	Increase	Decrease in surplus	<input type="radio"/>
<b>B</b>	Decrease	Increase in surplus	<input type="radio"/>
<b>C</b>	Increase	Decrease in deficit	<input type="radio"/>
<b>D</b>	Decrease	Increase in deficit	<input type="radio"/>

**[1 mark]****1 6**

The table below shows the value of the Gini coefficient for a country between 2012 and 2016. Over the five year period, the government has used progressive taxation to change the distribution of income.

Year	Gini coefficient
2012	0.60
2013	0.55
2014	0.50
2015	0.45
2016	0.40

Based on the above data, which one of the following is a positive statement?

- A** A progressive tax system is the fairest way of correcting income inequality.
- B** Between 2012 and 2016 the distribution of income in the country became more equal.
- C** The Gini coefficient is the best way of measuring changes in the distribution of income.
- D** The government should continue to tax the rich to improve the distribution of income.

**[1 mark]**

1 7

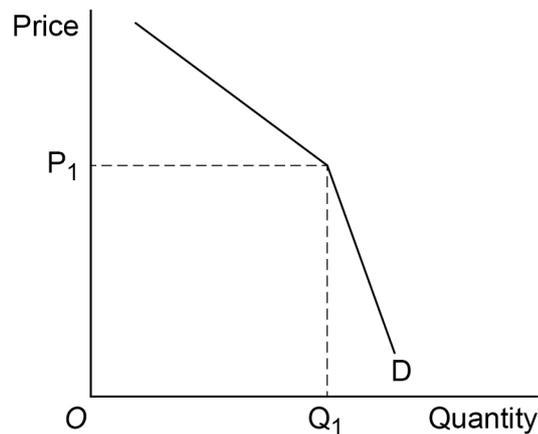
The UK's labour productivity increases by only 10% over a five year period. Over the same period its main trading partners increase their productivity by 25%. All other things being equal, the most likely consequence for the UK is

- A** a decline in UK imports from its main trading partners.
- B** a 15% deterioration in its balance of trade on the current account.
- C** a loss of competitiveness against its main trading partners.
- D** the imposition of a 15% tariff on imports to maintain international competitiveness.

[1 mark]

1 8

The diagram below shows the kinked demand curve (D) for a firm operating in a competitive oligopolistic market.



The kinked demand curve model provides an explanation of why the

- A** firm colludes with competitors to set the price of  $OP_1$ .
- B** firm's demand curve becomes more elastic as it lowers its price.
- C** firm's price changes depend on competitors' pricing behaviour.
- D** firm won't change its price from  $OP_1$  even if competitors change their prices.

[1 mark]

**Turn over for the next question**

**Turn over ►**



**1 9**

A large Asian steel-producing country dumps its surplus steel on the world market. All other things being equal, if the demand for steel is price elastic, the most likely consequence for the EU market for steel will be to

**A** reduce excess capacity in the EU steel-making industry.

**B** reduce the value of steel imports into the EU.

**C** shift the demand curve for EU steel workers to the left.

**D** shift the supply curve of EU steel workers to the left.

**[1 mark]****2 0**

A company has an issued share capital of £1 million and an outstanding corporate bond issue of £200 000. To fund its expansion, the company issues additional corporate bonds for £300 000. All other things being equal, after the issue of the additional corporate bonds the ratio of the company's total debt to its equity will be

**A** 0.2:1

**B** 0.3:1

**C** 0.5:1

**D** 2.0:1

**[1 mark]****2 1**

Despite its central bank operating a policy of quantitative easing for several years, an economy has rising unemployment and a rate of inflation significantly below the target rate set by the government. All other things being equal, which one of the following actions is the central bank most likely to take in order to meet the target for inflation?

**A** A policy leading to an appreciation of the exchange rate.

**B** An increase in its base rate of interest and the reversal of its quantitative easing policy.

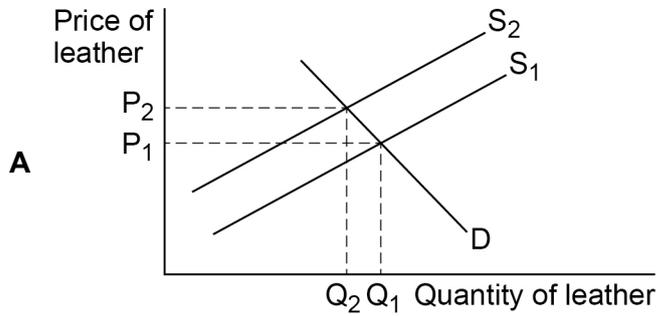
**C** Providing forward guidance indicating that the bank will continue with its programme of quantitative easing.

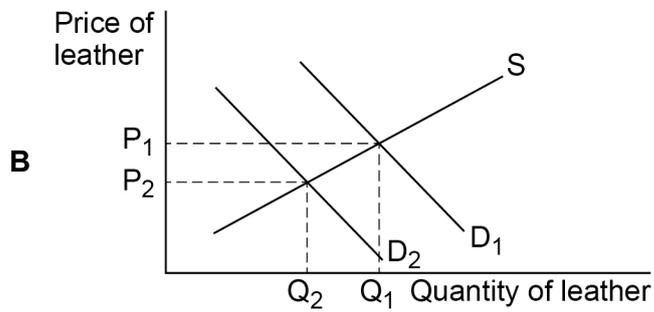
**D** Selling some of its stock of government bonds to other financial institutions.

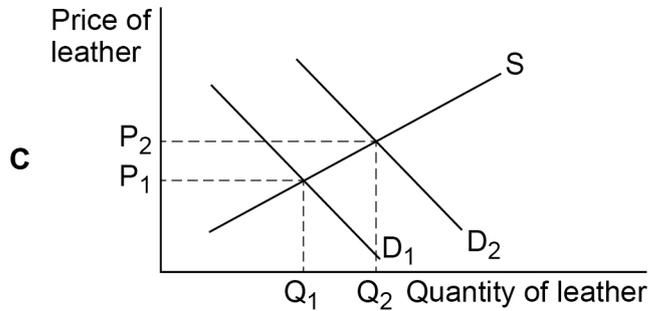
**[1 mark]**

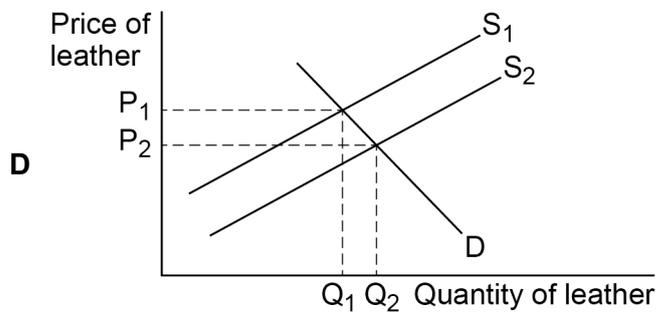
2 2

Beef and leather are in joint supply. Changes in farming methods have resulted in a significant fall in the price of chicken, a substitute for beef. All other things being equal, which one of the following diagrams, **A**, **B**, **C**, or **D**, best illustrates the effects of the fall in the price of chicken on the market for leather?










[1 mark]

Turn over ►



**2 3**

The table below shows different combinations of changes in a commercial bank's liquidity and capital ratios. All other things being equal, which one of the following combinations, **A**, **B**, **C** or **D**, is most likely to improve the bank's financial stability?

	Liquidity ratio	Capital ratio	
<b>A</b>	Increase	Decrease	<input type="radio"/>
<b>B</b>	Increase	Increase	<input type="radio"/>
<b>C</b>	Decrease	Increase	<input type="radio"/>
<b>D</b>	Decrease	Decrease	<input type="radio"/>

**[1 mark]****2 4**

An economy had a 3% increase in its real GDP over a one year period. In the same period its population grew by 5% and its rate of inflation was 2.5%. From these data it can be inferred that

- A** its Human Development Index decreased by 2%.
- B** nominal GDP per capita increased.
- C** real wages fell due to inflation.
- D** the number of unemployed people increased.

**[1 mark]****2 5**

The marginal propensity to consume (MPC) in an economy is 0.5. If the MPC increases by 20% the new value of its multiplier will be

- A** 2.0
- B** 2.5
- C** 5.0
- D** 10.0

**[1 mark]**

2 6

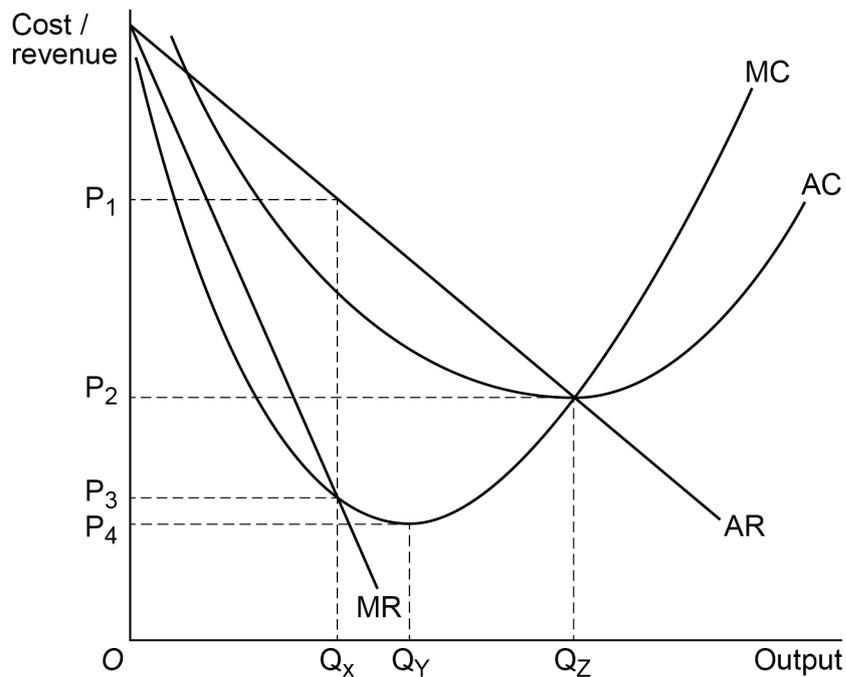
All other things being equal, which one of the following is most likely to cause the marginal revenue product of labour curve in the shoe manufacturing industry to shift to the right?

- A** A decrease in money wage rates in the shoe industry.
- B** A decrease in the number of workers employed in the shoe industry.
- C** An increase in the market demand for shoes.
- D** An increase in the number of firms competing in the shoe industry.

[1 mark]

2 7

The diagram below shows the average revenue and marginal revenue (AR and MR) curves, and the average cost and marginal cost (AC and MC) curves, for the only firm in an industry.



If the market is highly contestable, in the long run, the firm is most likely to set its price at

- A**  $OP_1$
- B**  $OP_2$
- C**  $OP_3$
- D**  $OP_4$

[1 mark]

Turn over ►



**2 8**

A country experiences a large net capital outflow. All other things being equal, the most likely consequence of this in the short run will be a decrease in

**A** its exchange rate.

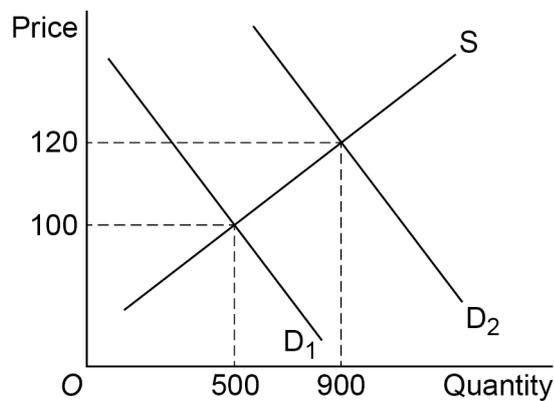
**B** its net income from overseas investments.

**C** its rate of interest.

**D** the value of exports and imports.

**[1 mark]****2 9**

The diagram below shows two market demand curves ( $D_1$  and  $D_2$ ) and the market supply curve ( $S$ ), for Good X.



The price elasticity of supply of Good X when the demand curve shifts from  $D_1$  to  $D_2$  is

**A** +0.25

**B** +2.0

**C** +4.0

**D** +7.5

**[1 mark]**

**3 0**

An economy's GDP increased from £400 billion in 2016 to £428 billion in 2018. Using 2016 as the base year, what is the value of the index for GDP in 2018?

**A** 103.5**B** 106.5**C** 107.0**D** 128.0**[1 mark]****Turn over for Section B****30****Turn over ►**

**Section B**

Answer **all** questions in this section.

**Refer to the insert for Extracts A, B, C, D and E.**

**Total for this investigation: 50 marks**

**The UK's broken housing market**

**INVESTIGATION**

**Scenario**

You are an economist working for the Ministry of Housing, Communities and Local Government (MHCLG).

You have been asked to investigate the state of the UK housing market.

As part of this investigation, you are to provide answers to three questions.

**Referring to the insert**, study **Extracts A, B, C and D**, then use these extracts and your knowledge of economics to help you answer Questions 31 and 32. There is also a news report, **Extract E**, which is to be used with the other extracts to help you answer Question 33.

**3 1**

To what extent, if at all, do the data suggest that houses in the UK were more affordable in 2017 than they were in 2007? You must use the data in **Extract C** to support your assessment.

**[10 marks]**

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ANSWER IN THE SPACES PROVIDED**

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## A-level ECONOMICS

Paper 3 Economic principles and issues

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Insert

**DO NOT WRITE ANY ANSWERS IN THIS INSERT. YOU MUST ANSWER THE QUESTIONS IN THE ANSWER BOOKLET PROVIDED.**

**The UK's broken housing market**

**Questions 31 to 33**

- **Extract A:** The UK housing market
- **Extract B:** Putting a roof over our heads
- **Extract C:** Selected indicators of the affordability of buying a house
- **Extract D:** Changing UK house prices
- **Extract E:** Mending the UK's broken housing market

---

### Extract A: The UK housing market

The housing market is a large part of the UK economy, comprising over 28 million residential dwellings. Buying a house is the largest investment that many people will make in their lifetime. Most owner occupiers finance the purchase of their house by borrowing, using a mortgage provided by a bank or building society. However, the UK housing market is changing, with fewer people owning their own homes and more people renting from private landlords or housing associations, but the number of dwellings rented from local authorities has fallen. Housing associations and local authorities provide social housing at rents that are generally below the free market level.

Source: News reports, February 2018

### Extract B: Putting a roof over our heads

In 1997, the median price of a house was less than four times median earnings. Today the median price of a house is almost eight times median earnings, an all-time record. As a result, it is difficult to get onto the housing ladder, and the proportion of people living in the private rented sector has doubled since 2000.

More than 2.2 million households with below-average incomes spend a third or more of their disposable income on housing. This means they have less money to spend on other things and struggle to save the money needed for the deposit to buy a house.

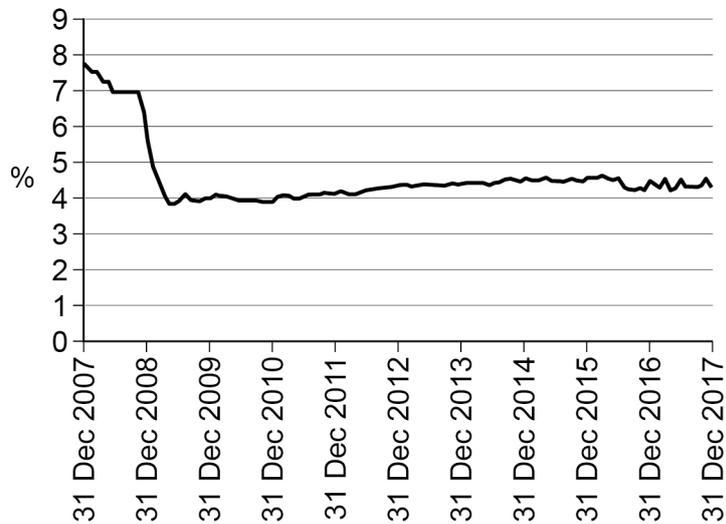
Building more homes will slow the rise in house prices and should also bring the cost of renting down. For decades, the pace of house building has been too slow. Since the 1970s, there have been on average 160 000 more new homes each year in England. The consensus is that we need more than 225 000 new homes each year to keep up with population growth and to tackle years of under-supply.

The most basic of human needs – a safe, secure home to call your own – isn't just a distant dream for millions of people, it's a dream that's moving further and further away.

Source: Government report, February 2017, Cm 9352

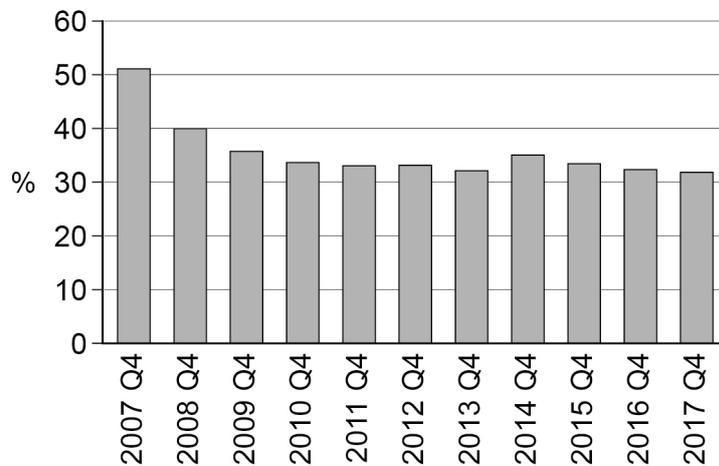
### Extract C: Selected indicators of the affordability of buying a house

**Figure 1** Standard variable mortgage interest rate charged to UK households, December 2007 to December 2017



Source: Bank of England, February 2018

**Figure 2** Mortgage payments for first-time buyers in the UK as a percentage of mean take home pay, 2007 Quarter 4 to 2017 Quarter 4



Source: Nationwide Building Society, February 2018

**Extract C continues on the next page**

**Turn over ►**

**Figure 3** House price to earnings ratio for first-time buyers in the UK, 2007 Quarter 4 to 2017 Quarter 4

Date	Ratio
2007 Q4	5.4:1
2012 Q4	4.3:1
2017 Q4	5.2:1

Source: Nationwide Building Society, February 2018

**Figure 4** Average UK house price, average weekly earnings in nominal terms and their annual percentage changes, December 2007 to December 2017

Date	House price	House price, annual percentage change	Weekly earnings	Weekly earnings, annual percentage change
December 2007	£189 193	7.0	£425	2.9
December 2008	£160 954	-14.9	£435	2.4
December 2009	£168 082	4.4	£439	0.9
December 2010	£168 703	0.4	£449	2.2
December 2011	£167 048	-1.0	£457	1.8
December 2012	£168 843	7.7	£462	1.0
December 2013	£177 971	5.4	£468	1.4
December 2014	£191 669	7.7	£480	2.5
December 2015	£204 919	6.9	£489	1.9
December 2016	£215 500	5.2	£498	1.9
December 2017	£226 756	5.2	£512	2.8

Source: ONS, February 2018

### Extract D: Changing UK house prices

The housing market is very sensitive to the economic climate and shocks to the macroeconomy. 1  
 The demand for housing is affected by income, wealth, the availability and cost of credit, as well  
 as households' expectations and confidence in their future economic prospects. The financial  
 crisis of 2007–08 had a significant effect on the housing market. House prices fell by around  
 15% between January 2008 and March 2009. Since then the UK economy has recovered, and 5  
 house prices have risen. Also, planning rules restricting the supply of land for building and the  
 failure to adopt innovations that reduce the cost of constructing houses have influenced the  
 underlying rate of growth of house prices in the UK.

Source: News reports, February 2018

### Extract E: Mending the UK's broken housing market

Problems in the housing market affect the rented sector as well as people who want to buy a home of their own. House prices and rents are higher in the UK than in many other countries. Average rents in the UK are between 40% to 50% higher than in the Netherlands, Belgium, Germany and France. This has led some to argue that rent controls should be imposed to prevent private landlords exploiting their tenants. Others have responded by stating that high rents are the market signalling that there is a shortage of supply and that rent controls will reduce the supply of properties to rent, making the problem worse.

Decent quality housing is often regarded as a merit good. A range of government policies exist to help people afford a reasonable place to live. These include the payment of Housing Benefit, or Universal Credit, to help people on low incomes pay their rent, and the Help to Buy Scheme. Such measures increase the demand for houses, but do they increase supply or just increase the cost of housing?

It is widely accepted that more houses should be built, and the Government has an ambitious target to increase housing supply by 300 000 each year by the mid-2020s. The November 2017 budget included total support for housing of £44 billion over a five-year period. Some believe that this is insufficient to support the private sector, housing associations and local authorities in ensuring that the supply of houses increases sufficiently to provide people with a suitable place to live. In 2016–17, total public-sector expenditure on services amounted to £711.5 billion, of which £10.4 billion was spent on 'Housing and community affairs' compared to £144.3 billion on 'Health' and £37.1 billion on 'Defence'. The budget deficit was £46 billion. If the Government spends more on housing, how will that affect the macroeconomy?

It is not all about governments spending more money; planning laws affect the amount of land available for development. Such restrictions raise the price of land for building, which increases property prices, allowing developers and landlords to make speculative gains. If local authorities released more land for housing and eased restrictions on where houses can be built, some believe that the housing shortage could be eliminated without an increase in government spending, but at what cost to the environment?

Source: News reports, February 2018

**END OF EXTRACTS**

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