

Name: _____

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A-Level Economics — Practice Exam

Instructions: Answer all questions in the spaces provided. Show your working — method marks are awarded even when the final answer is wrong. The answer key with worked solutions is available at examtex.com/free-exams.

Time Limit: 60 minutes

Multiple Choice (6 questions)

- [1 point] 1. A bus company raises its single fare from 2.00 pounds to 2.50 pounds. Weekly passenger journeys fall from 40,000 to 34,000. Over this range, the price elasticity of demand for bus journeys is:
- A. -0.6 , so demand is price inelastic
 - B. -1.67 , so demand is price elastic
 - C. $-12,000$, so demand is price elastic
 - D. -0.6 , so demand is price elastic
- [1 point] 2. An economy producing only capital goods and consumer goods is operating on its production possibility frontier. It moves along the frontier to a point with more capital goods and fewer consumer goods. This movement illustrates:
- A. economic growth, because more capital goods are produced
 - B. unemployment of some factors of production
 - C. the opportunity cost of capital goods in terms of consumer goods forgone
 - D. productive inefficiency, because consumer good output has fallen
- [1 point] 3. Consumers systematically underestimate the long-term health damage caused by regularly consuming energy drinks. In a free market, this information gap means energy drinks are most likely to be:
- A. under-consumed, because they are a merit good
 - B. under-provided, because non-payers cannot be excluded from consuming them
 - C. consumed at the socially optimal level, provided no third parties are affected
 - D. over-consumed, because perceived marginal private benefit exceeds the true marginal private benefit

- [1 point]** 4. In the aggregate demand identity $AD = C + I + G + (X - M)$, which of the following is recorded as investment (I)?
- A. a household buying newly issued shares in a housebuilding company
 - B. a supermarket chain building a new distribution warehouse
 - C. a household buying a new car for private use
 - D. the government building a new hospital
- [1 point]** 5. In an economy, the marginal propensity to consume out of additional income is 0.75. The government increases its spending by 2 billion pounds, with no change in taxation. Using the multiplier, the eventual total increase in national income is:
- A. 1.5 billion pounds
 - B. 2.67 billion pounds
 - C. 6 billion pounds
 - D. 8 billion pounds
- [1 point]** 6. The pound sterling depreciates significantly against the currencies of the UK's main trading partners. Assuming the Marshall–Lerner condition holds, the most likely effect is that:
- A. export volumes rise and import volumes fall, improving the current account position
 - B. cost-push inflation falls because imported raw materials become cheaper
 - C. export revenue falls because UK goods now sell at lower foreign-currency prices
 - D. aggregate demand contracts because net exports decrease

Short Answer (1 question)

- [20 points]** 7. The UK housing market. Read Extract A and answer all parts of the question. Extract A: The average price of a UK home rose from 240,000 pounds in 2020 to 288,000 pounds in 2024, taking the ratio of average house prices to average annual earnings from 7.2 to 8.6 over the same period. Housebuilders completed only 220,000 new homes in 2024, well short of the government's target of 300,000 per year, and blame a restrictive planning system in which fewer than half of large applications are approved within the statutory time limit. Successive governments have instead intervened on the demand side: the Help to Buy scheme offered first-time buyers an equity loan of up to 20 per cent of the price of a new-build home (40 per cent in London). Critics argue that subsidising the buyers of a good in inelastic supply chiefly bids up its price.

[2 points] (a) Define the term "subsidy" (Extract A).

[2 points] (b) Using the data in Extract A, calculate the percentage change in the average UK house price between 2020 and 2024.

- [6 points]** (c) With the aid of a supply and demand diagram, explain how a restrictive planning system affects the equilibrium price of housing.

- [10 points]** (d) Using Extract A and your own knowledge, assess whether demand-side subsidies such as Help to Buy are an effective way of making housing more affordable.

Essay Questions (1 question)

- [25 points]** 8. Evaluate the view that an increase in the national minimum wage will reduce employment.

Answer Key

1. A
2. C
3. D
4. B
5. D
6. A
7.

(a) A subsidy is a grant or payment made by the government to producers or consumers (1 mark), with the aim of lowering the cost of production or the price paid and so encouraging output or consumption of the good (1 mark). Application such as recognising Help to Buy's equity loan as a payment that lowers the effective price faced by first-time buyers may earn the second mark.

(b) $\frac{288,000 - 240,000}{240,000} \times 100 = \frac{48,000}{240,000} \times 100 = 20\%$. Award 1 mark for a correct method (the change divided by the original 2020 value, multiplied by 100) and 1 mark for the answer: a rise of 20 per cent.

(c) Diagram (up to 3 marks): axes labelled price of housing (vertical) and quantity of housing (horizontal); an initial equilibrium at P_1 , Q_1 ; planning restrictions shown either as a leftward shift of the supply curve from S_1 to S_2 or as a steep, price-inelastic supply curve; the new equilibrium clearly marked at a higher price P_2 and lower quantity Q_2 . Explanation (up to 3 marks, requiring a chain of reasoning): planning restrictions limit the release of land and delay approval – fewer than half of large applications are decided within the statutory time limit – so fewer homes are supplied at every price and supply shifts left (or is kept price inelastic); at the original price there is now excess demand, so buyers bid the price up until the market clears at the new, higher equilibrium; because supply is price inelastic, the adjustment falls mainly on price rather than quantity – consistent with completions of 220,000 against a 300,000 target while the price-to-earnings ratio rose from 7.2 to 8.6.

(d) Marked by levels: knowledge, application and analysis (KAA) up to 6 marks; evaluation up to 4 marks. Indicative KAA: (1) The equity loan of up to 20 per cent (40 per cent in London) raises buyers' effective purchasing power, shifting housing demand to the right and enabling recipient households to buy sooner than otherwise – effective for those individuals. (2) However, the extract shows supply is price inelastic – 220,000 completions against a 300,000 target under a restrictive planning system – so the rightward demand shift raises price far more than quantity: much of the subsidy is capitalised into higher house prices. (3) The incidence of a subsidy on a good in inelastic supply falls largely on sellers: housebuilders capture the gain through higher new-build prices and margins, while affordability for non-recipients worsens – consistent with the price-to-earnings ratio rising from 7.2 to 8.6. (4) There is an opportunity cost: public funds tied up in equity loans could instead finance social housebuilding or planning reform, which target the supply constraint directly. Indicative evaluation: the outcome depends on the price elasticity of supply – over the long run, or combined with planning reform, supply is more elastic and less of the subsidy leaks into price; Help to Buy is restricted to new-build homes, so it may induce some additional construction rather than purely bidding up the existing stock; affordability for the marginal first-time buyer can improve even while average prices rise; and the counterfactual matters – prices were also driven by income growth and low interest rates, so

the deterioration in the ratio cannot be attributed to the subsidy alone. A supported judgement, e.g. that demand-side subsidies are at best a partial, second-best tool while the binding constraint is on the supply side, is required for the top level.

8. Indicative content — marked by levels, not by counting points; the strongest answers develop a small number of chains of reasoning fully and reach a supported judgement. Analysis supporting the view: (1) In a competitive labour market, a minimum wage set above the equilibrium wage causes a contraction of the quantity of labour demanded along the (marginal revenue product) demand curve and an extension of labour supply, creating an excess supply of labour — unemployment. (2) Higher labour costs encourage firms to substitute capital for labour — self-service checkouts, automation — especially where tasks are routine, so employment falls further in the long run. (3) Cost-push chain: firms pass higher wage costs into prices, losing competitiveness against imports; output falls, and because the demand for labour is derived from the demand for output, employment falls with it. (4) Small firms in low-margin, labour-intensive sectors — hospitality, social care — cannot absorb the cost and may cut hours, freeze hiring or exit, so the effect may appear in hours worked rather than headcount. Analysis against the view: (1) Monopsony: an employer with wage-setting power hires where the marginal cost of labour equals MRP, employing fewer workers at a lower wage than a competitive market; a minimum wage set between the monopsony wage and the competitive wage flattens the marginal cost of labour and can raise both wages and employment. (2) The employment effect depends on the wage elasticity of demand for labour: where labour is a small share of total costs and has no close substitutes, demand is wage-inelastic and job losses are small relative to the pay rise. (3) Efficiency-wage effects: higher pay reduces staff turnover and absenteeism and raises morale and productivity, shifting MRP outwards and offsetting the cost increase. (4) Demand-side feedback: low-paid workers have a high marginal propensity to consume, so a higher wage floor raises consumption and aggregate demand, increasing the derived demand for labour. (5) Empirical evidence is ambiguous: UK evaluations since the 1999 introduction of the minimum wage have found little robust evidence of significant job losses, echoing Card and Krueger's US findings — though critics respond that effects grow with the "bite" of the rate. Evaluation criteria: the size of the increase matters — a modest uprating differs from a rise taking the floor far above the median wage; the bite varies regionally, so a single national rate binds hardest in low-wage regions and sectors, concentrating any job losses there; short run versus long run — substitution towards capital takes time, so measured effects may understate eventual ones; the state of the economic cycle; and firms may adjust through channels other than redundancy (hours, non-wage benefits, prices, profit margins), so "employment" effects are subtler than the simple model predicts. What distinguishes the top levels: a Level 4–5 answer sustains chains of reasoning on both sides, applies the elasticity condition and the monopsony model explicitly rather than naming them, and reaches a final judgement contingent on the size of the rise and the structure of the labour market — for example, that modest increases in monopsonistic or wage-inelastic markets are unlikely to reduce employment, whereas large rises where labour demand is elastic will. Listing counterarguments without weighing them is capped at Level 3.

Worked Solutions

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