ECONOMICS **9772/01**

Paper 1 Multiple Choice, Short Answers and Data Response **May/June 2011**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper

READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.
Write your Centre number, candidate number and name on all the work you hand in.
Write in dark blue or black pen.
You may use a soft pencil for any diagrams, graphs or rough working.
Do not use paper clips, highlighters, glue or correction fluid.

Answer **all** questions.
You may use a calculator.

You are advised to spend 50 minutes on Section A, 35 minutes on Section B, and 50 minutes on Section C.

At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

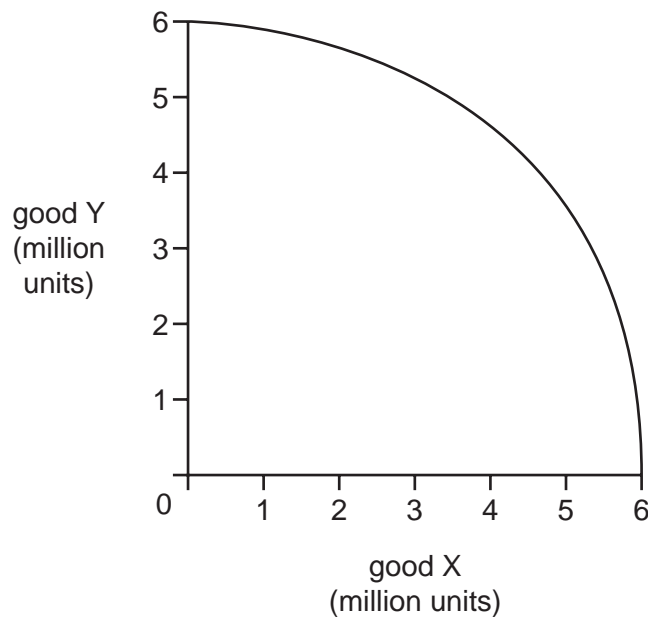This document consists of **17** printed pages and **3** blank pages.

UNIVERSITY *of* CAMBRIDGE
International Examinations

[Turn over

Section A

There are **thirty** questions in this Section. Answer **all** questions. For each question there are four possible answers, **A**, **B**, **C** and **D**.

Choose the **one** you consider correct and record both the number of the question and your choice of answer clearly **in your Answer Booklet**.

Each correct answer will score one mark. A mark will not be deducted for a wrong answer.

1   The diagram shows the production possibility curve for a country that produces just two goods: X, a consumer good, and Y, a capital good.

What can be concluded from the diagram?

A   the amounts of goods X and Y that the country will produce

B   the country's preference for present as compared to future consumption

C   the extent to which the country's resources are being fully utilised

D   the opportunity cost to the country of good X in terms of good Y

2   The steel required for the construction of a new car-assembly plant in a fully employed economy is obtained by increasing the output of the domestic steel industry.

What is the opportunity cost of producing the steel?

A   the alternative benefits forgone by diverting resources to additional steel manufacture

B   the alternative benefits forgone by increasing the capacity of the car industry

C   the alternative benefits that would have been obtained by putting the steel to other uses

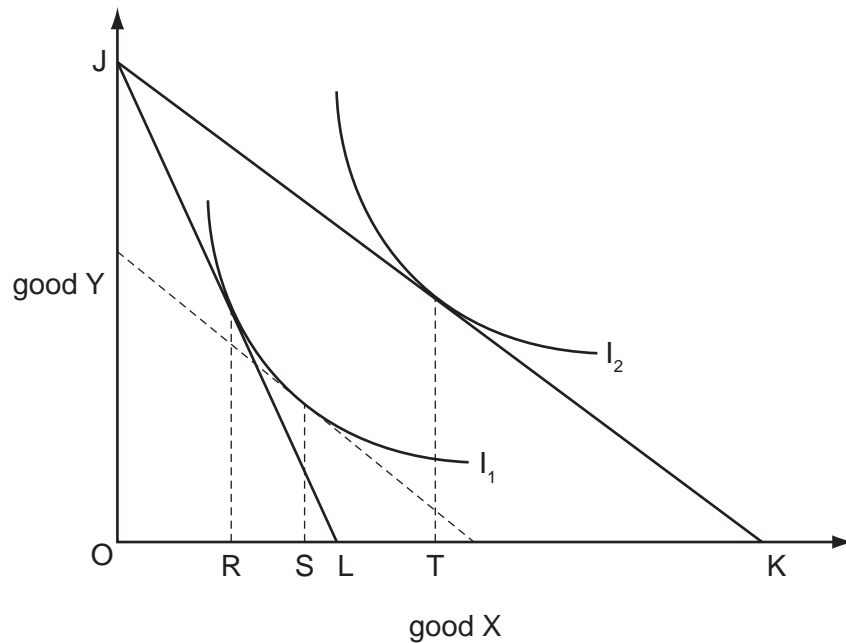**D**   zero, since there is no reduction in the steel supplied to other steel users

3 A firm runs a successful advertising campaign.

In order to pay for the advertising campaign, the firm has to increase the price of its product.

What will be the overall effect on the demand for the product and on the equilibrium quantity demanded?

	demand	equilibrium quantity demanded
A	increases	increases
B	increases	uncertain
C	uncertain	increases
D	uncertain	uncertain

4 In the diagram I_1 and I_2 are an individual's indifference curves and JK is her initial budget line.

An increase in the price of good X causes her budget line to shift to JL.

Which distances measure the resulting income and substitution effects on the quantity demanded of good X by the individual?
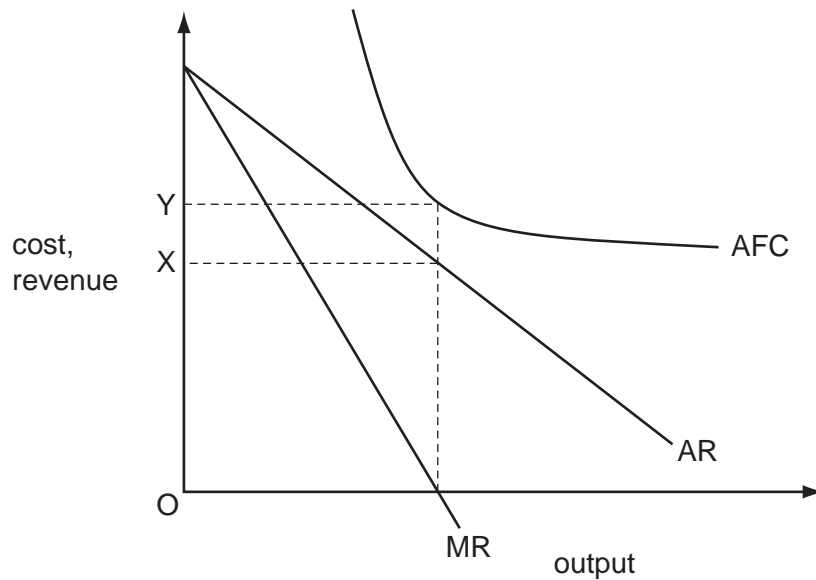
	income effect	substitution effect
A	RT	RS
B	RT	RL
C	ST	RS
D	ST	RL

5 A 5 % increase in the volume of a firm's sales results in a 5 % increase in its revenue.

What can be deduced about the price elasticity of demand for the firm's product?

A It is equal to unity.

B It is perfectly elastic.

C It is perfectly inelastic.

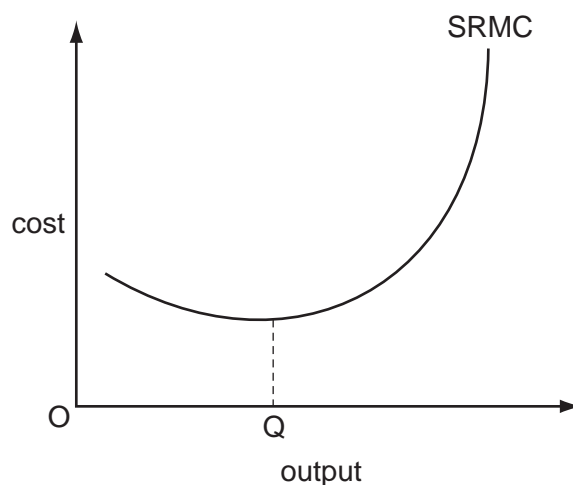**D** Nothing can be deduced without further information.

6 The diagram shows the cost and revenue curves of a monopoly producer whose only cost of production is a fixed cost.

What will such a monopolist do?

A set a price of OX in the short run and in the long run

B set a price of OX in the short run, but discontinue production in the long run

C set a price of OY in the short run and in the long run

D set a price of OY in the short run, but discontinue production in the long run

7   The diagram shows a firm's short-run marginal cost curve (SRMC).

What explains why the curve is upward sloping at output levels above OQ?
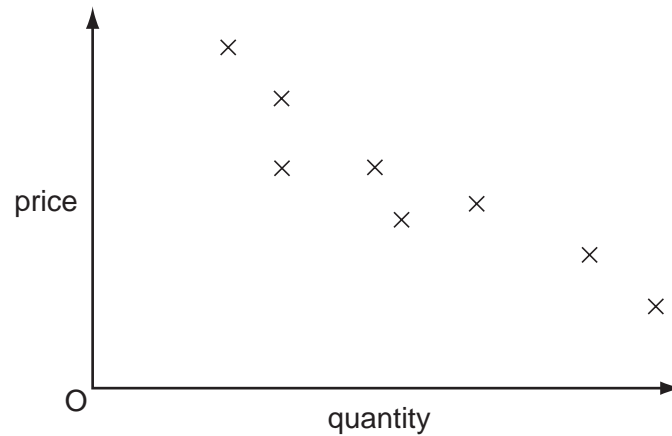
A   barriers to entry

B   diseconomies of scale

C   inelasticity of supply

D   the law of diminishing returns

8   The table shows the inputs of the two factors of production, capital and labour, needed to produce varying levels of output.

output	capital	labour
100	5	10
200	10	20
300	14	28
400	20	40
500	26	52

Over which output range do increasing returns to scale occur?

A   100 – 200   B   200 – 300   C   300 – 400   D   400 – 500

9   Which characteristic would make it easier for firms in an industry to collude?

A   a large number of firms

B   greater product similarity

C   low barriers to entry

D   rapid technological change

10 The points in the scatter diagram indicate the prices and quantities sold of an agricultural commodity in different time periods.
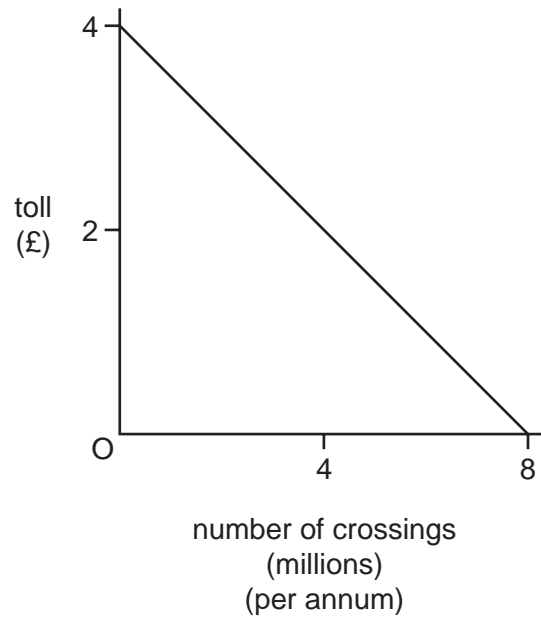

It may be concluded that these points were generated primarily by changes over time in

A advertising.

B consumers' incomes.

C supply.

D the price of a substitute commodity.

11 The introduction of a congestion charge significantly reduces the volume of traffic on inner-city roads, leading to shorter journey times.

What will be the net impact on the economic welfare of those motorists who continue to make their journeys by car and those who switch to travelling by bus?

	effect on those who continue to travel by car	effect on those who switch to travelling by bus
A	lose	gain
B	lose	uncertain
C	uncertain	gain
D	uncertain	uncertain

12 The diagram shows the estimated demand curve for crossing a proposed new road bridge.

The estimated annual capital and operational costs of the bridge amount to £10 million.

There are no expected external costs or benefits.

Assuming the bridge company sets out to maximise its revenue, what would be the estimated annual profit or loss to the bridge company and the net annual benefit to society?

	profit	net social benefit
A	-£2 million	-£2 million
B	-£2 million	£2 million
C	£2 million	£2 million
D	£2 million	-£2 million

13 A firm produces only one product.

Under which condition is it most likely to be able to pursue a policy of price discrimination?

A   Both price and marginal revenue are identical in all markets.

B   It is benefiting from economies of scale.

C   Its product has a low elasticity of demand.

D   There are separate and distinct markets for its product.

14 Under the European Union's emission trading scheme heavy industries are issued with a quota of carbon permits and companies that want more must buy spare permits from cleaner companies.

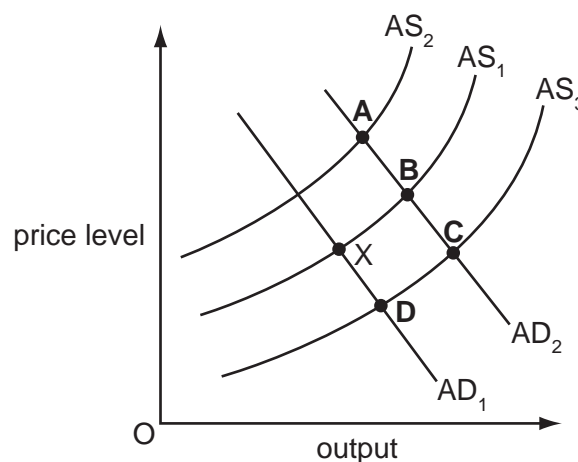Which combination of changes would be most likely to increase the price of permits?

	number of carbon permits issued	rate of growth of global GDP
A	lower	faster
B	lower	slower
C	higher	faster
D	higher	slower

15 Firms X and Y operate in unrelated markets.

The output of firm X depends not only on the quantities of factors of production employed by firm X but also depends directly on the production methods of firm Y.

What does this illustrate?

A an externality

B complementary goods

C cross-elasticity of demand

D horizontal integration

16 An economy is currently in equilibrium at point X.

Government expenditure is increased on retraining programmes for those out of work. This raises the productivity of the trainees.

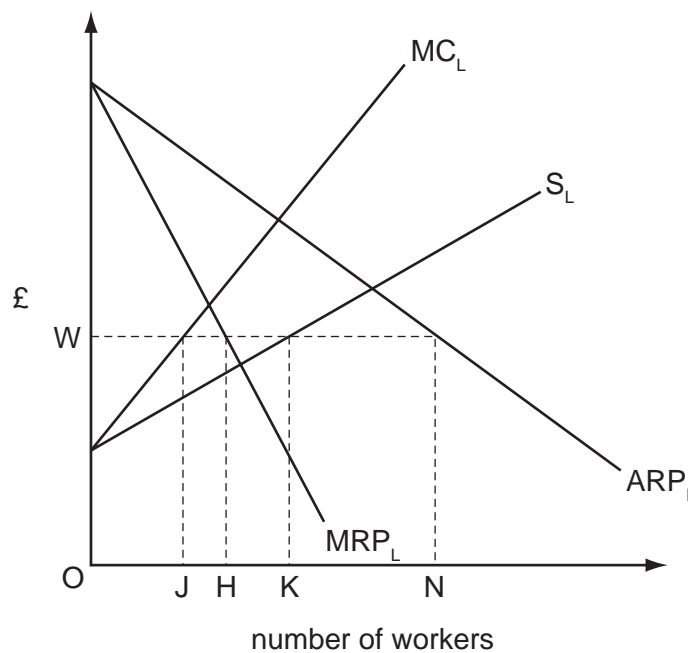Which point shows the new equilibrium in the economy?

17 In an economy average labour earnings increase by 5% while labour productivity increases by 3%.

What **must** increase as a direct result of these changes?

A labour cost per unit of output

B labour's share of the national income

C the level of unemployment

D the rate of inflation

18 The diagram shows the average and marginal revenue product of labour curves of a profit-maximising monopsonist together with its supply of labour and marginal cost of labour curves.

How many workers will the firm employ following the introduction of a minimum wage equal to OW?

A OJ **B** OH **C** OK **D** ON

19 The amount that retired workers are allowed to earn each week without losing any of their pension is increased. This leads to an increase in the number of pensioners in employment.

What will be the most likely effect on GDP per head and on the net welfare of pensioners?

	GDP per head	net welfare of pensioners
A	decrease	increase
B	decrease	uncertain
C	increase	increase
D	increase	uncertain

20 The average propensity to consume in a country is 0.75 and the marginal propensity to consume is 0.8.

What is the value of the multiplier?

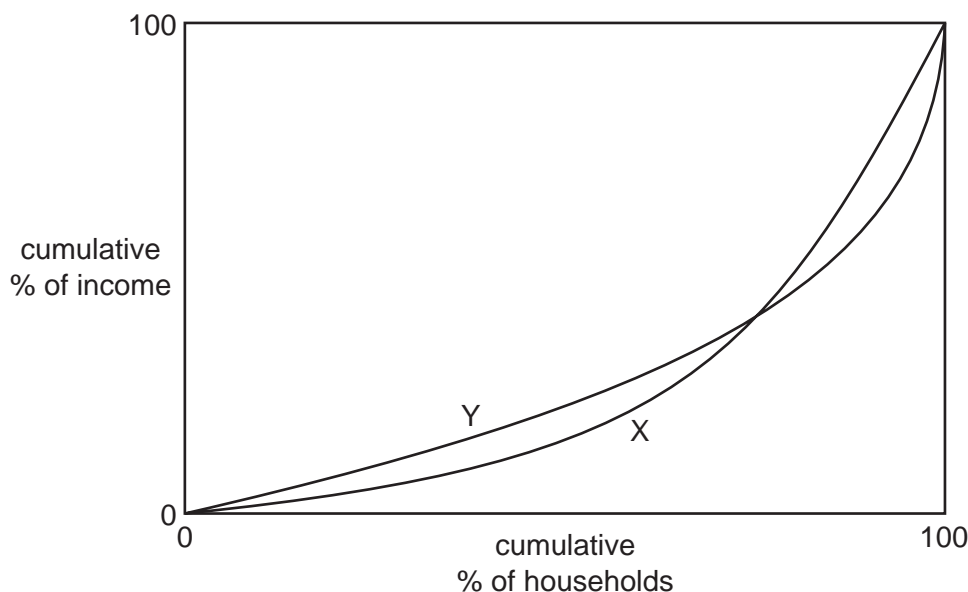**A** 1.25   **B** 1.5   **C** 4   **D** 5

21 What is the most likely short-run consequence of an increase in a country's balance of trade deficit?

A an increase in the level of national income

B an increase in the level of unemployment

C an increase in the money supply

D an increase in the rate of inflation

22 Which combination **must** result in an increase in a government's fiscal deficit?

	private sector surplus (savings minus investment)	trade deficit (imports minus exports)
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

23 Curve X in the diagram is an economy's initial Lorenz Curve.

Which combination of policy changes could cause the Lorenz Curve to shift to curve Y?

	state pension	higher rate of income tax
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

24 Why does manufacturing output usually fall by more than service sector output in a recession?

A A higher proportion of consumer spending on services is postponable.

B A higher proportion of manufactured goods are imported.

C Manufacturing in developed economies is usually smaller than the service sector.

D Manufacturers usually respond to a fall in consumer demand by destocking.

25 Country X's currency is pegged to the US dollar.

What will be the likely impact on Country X of a depreciation of the US dollar against other currencies?

A an improvement in its terms of trade

B an increase in its inflation rate

C an increase in its unemployment rate

D an increase in the trade-weighted value of its currency

26 What will be the impact of an appreciation of the £ sterling on the volume of UK imports and on their value measured in terms of the £ sterling?

	volume of imports	value of imports
A	increase	increase
B	increase	uncertain
C	uncertain	increase
D	uncertain	uncertain

27 Which combination of circumstances is most likely to result in an increase in the number of small business start-ups?

	house prices	interest rates
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

28 Country X forms a customs union with country Y.

Country X then ceases to produce its own cars and instead imports cars from country Y. Country Y diverts some of its car exports to X from country Z.
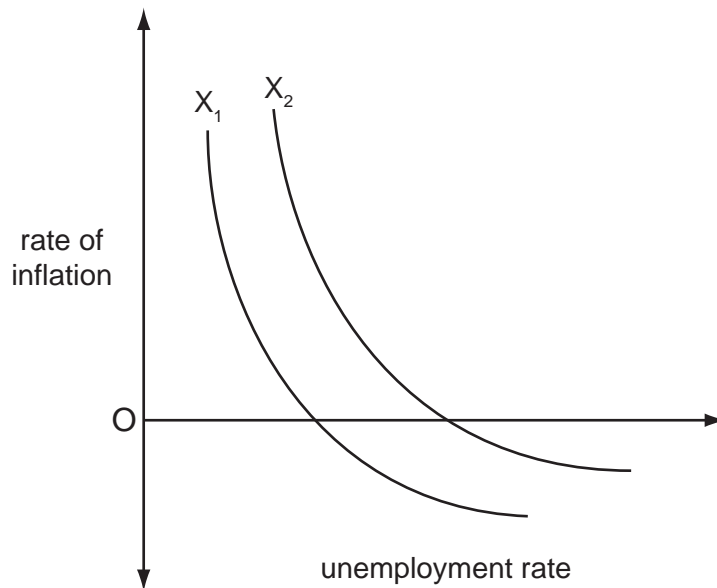
How is this likely to affect car prices in X and Z?

	country X	country Z
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

29 Critics of free trade point to the lack of realism of many of the assumptions underlying the theory of comparative advantage.

Which of the following observations about the real world might lead one to question the theory that **all** countries would benefit from a multilateral removal of import restrictions?

A Resources within countries are not perfectly mobile between different industries.

B Some countries are at an absolute disadvantage in the production of all goods.

C Resources are not perfectly mobile between different countries.

D The world does not consist of just two countries trading in two goods.

30 In the diagram, the curve X_1 shows an economy's initial trade-off between inflation and unemployment.

What could cause the curve to shift to X_2?

A a decrease in the money supply

B a decrease in the natural rate of unemployment

C an increase in labour productivity

D an increase in the central bank's inflation target

Section B

Answer **all** questions.

Question 1

The following table shows the output that could be produced by two countries if they were to use half their factors in the production of each good. Both countries possess exactly the same quantity of factors of production.

	Good A		Good B
Country X	200 units	**and**	100 units
Country Y	150 units	**and**	50 units

(a) Explain why country X is said to have an absolute advantage in the production of both goods.
[2]

(b) Calculate the maximum total outputs possible if each country were to totally specialise in the production of the good in which it possesses a comparative advantage. [3]

Question 2

The equation used to summarise the components of Aggregate Demand is usually written as

AD = C + I + G + (X – M)

Explain why only **two** of the following would be included in G when looking at Aggregate Demand.

- government spending on building a new hospital
- state pension payments to the elderly
- Job Seekers Allowance payments
- payment to teachers employed in state schools [5]

Question 3

The Bank of England's statement today that it expected its Base Rate to rise steadily over coming months caused the £ to jump 3 cents against the US$ from £1 = $1.50 to £1 = $1.53.

(a) What does the statement say about the change in the relative strength of the £ against the US dollar? [2]

(b) Explain why this change in the £:US$ exchange rate has occurred. [3]

Question 4

    (a) Using a Lorenz curve, illustrate how the Gini coefficient is calculated.   [2]

    (b) Explain why Gini coefficients are important when making international comparisons of living standards.   [3]

[Total: 20]

Section C

Answer **all** questions.

Question 5

Read the following article and table and then answer the questions that follow.

Who'd be a publican in today's climate? In the first half of 2009, figures from the British Beer and Pub Association showed that on average a staggering 52 pubs per week were closing. The downturn in the economy is cited as the main reason for the predicament that pubs found themselves to be in, but it is by no means a one-cause phenomenon as the list below outlines.

Reasons given by publicans for the decline in sales include: *5*

- economic downturn
- smoking ban
- rising competition from supermarkets
- growth of 'stay at home and watch TV culture'
- negative press about binge drinking   *10*
- swap to a 'Coffee shop' society

It is argued that those publicans who have been pro-active and who have adapted with the times are still able to do quite well. Pubs that serve food, offer events such as Quiz nights and Karaoke and who provide sporting events on large screen TVs have certainly been less badly hit than the traditional pub whose main trading takes place when workers drop in for a couple of   *15* drinks on the way home from work.

This latter group of pubs have suffered greatly and for them the smoking ban was probably most damaging. The ban on smoking in all enclosed public places and workplaces was introduced into England on July 1st 2007, bringing it into line with the rest of the United Kingdom. Whilst the ban is now well established and accepted within society, it was a highly   *20* contentious issue at the time. One of the main justifications given for the introduction of the ban was to reduce the numbers dying each year from the affects of 'passive smoking'.

A survey published in the British Medical Journal at the time concluded that around 30 people in Britain were dying every day specifically from the effects of passive smoking and that over 600 deaths a year were related to exposure to workplace smoke. It is interesting that prison   *25* officers complained of the fact that inmates were still allowed to smoke even after the ban, as the prison was deemed to be a 'home' rather than a workplace, whereas in Scotland the law went as far as to ban lorry drivers from smoking in their cabs as this was deemed to be a workplace.

Clearly this last example could be justified by an economist by using the argument of imperfect   *30* information and demerit goods. Even if no third party were affected in such cases, this would not mean that the free market outcome was optimal.

Another issue that should be considered when discussing the ban on smoking is that whilst there are many reports that attempt to put a financial saving from the reduction in deaths from smoking and smoke related illnesses, these often fail to look at the wider picture. For example,   *35* some Dutch research has found that smokers may actually save society money because they do not live as long. The study, conducted by the Erasmus University Department of Public Health in Rotterdam, compared the health costs of smokers to those of people of more advanced years. They concluded that in the long run, if many people stopped using tobacco products, costs for the State would actually rise as a healthier population lived longer and   *40*

therefore would be in receipt of greater state pensions and also would ultimately be afflicted by the relatively expensive diseases of old age.

To exacerbate the ever increasing 'Pensions Crisis' was never the aim of the ban on smoking in public places but is an interesting example of 'the law of unintended consequences'. This is not the only example connected to the ban where negative outcomes may occur. It is feared *45* that the incidence of childhood asthma will rise as more parents decide to drink and smoke at home as a result, rather than going to the pub. For many people, an evening drink and a cigarette would be seen as very close complements. As yet no data has been produced either to confirm or to refute this fear, but it is certainly a possibility. On the other hand it has also been claimed that if the ban results in more adult males spending time with their families in the *50* evenings, the presence of these male role models could have net beneficial effects.

When one starts to consider that dry-cleaning firms have reported a big slump in business as fewer people feel the need to remove the smells of having been in a smoky environment from their clothing, it becomes apparent that almost nothing is straightforward when it comes to looking at the overall effects of a change in legislation. *55*

Table 1: Potential financial implications for the economy arising from the ban on smoking

Advantages	Disadvantages
Reduction in deaths directly attributable to smoking related illnesses	Reduction in Government revenues from the sale of tobacco products
Less need for NHS treatment for those suffering from lung diseases – both smokers and non smokers	Increase in unemployment occurring in industries affected by the ban
Reduction in working days lost	Increase in average life expectancy

(a) With reference to the article, explain why a price war between supermarkets over alcoholic products might have a damaging effect on pub sales of alcohol. [2]

(b) Using the information provided in the article, explain why an increase in average life expectancy is shown as a financial disadvantage of the ban on smoking in Table 1. [3]

(c) Using one example from the article and one further example from your own study of economics, explain what is meant by the term 'the law of unintended consequences'. [5]

(d) With the use of a diagram, evaluate whether governments should intervene to curb smoking solely because of the effects of passive smoking. [10]

(e) 'Pubs are an integral part of community life and governments should ensure their survival.' Using economic justifications, to what extent do you agree with this view? [10]

[Total: 30]

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