

ECONOMICS (PRINCIPAL)

9772/01

Paper 1 Multiple Choice, Short Answers and Data Response

May/June 2017

2 hours 30 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.

DO NOT WRITE IN ANY BARCODES.

For Section A: Multiple Choice mark your choice of answer clearly on your Multiple Choice Answer Sheet (inserted).

Write your Centre number, candidate number and name on the Multiple Choice Answer Sheet.

You may use an HB pencil for any diagrams or graphs.

Do not use staples, paper clips, glue or correction fluid.

Answer **all** questions.

You are advised to spend **60 minutes** on **Section A**, **35 minutes** on **Section B**, and **55 minutes** on **Section C**.

At the end of the examination, fasten all your work securely together ensuring that you also attach your answers for Section A which are on the Multiple Choice Answer Sheet.

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

The syllabus is approved for use in England, Wales and Northern Ireland as a Cambridge International Level 3 Pre-U Certificate.

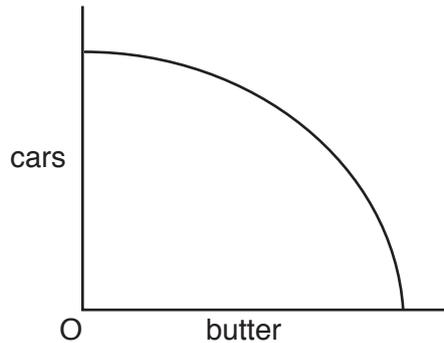
This document consists of **17** printed pages, **3** blank pages and **1** Insert.

Section A: Multiple Choice

There are **30** 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 your choice of answer clearly on the **Multiple Choice Answer Sheet** (inserted). Each correct answer will score one mark. A mark will not be deducted for a wrong answer.

- 1 An economy produces two goods, cars and butter.

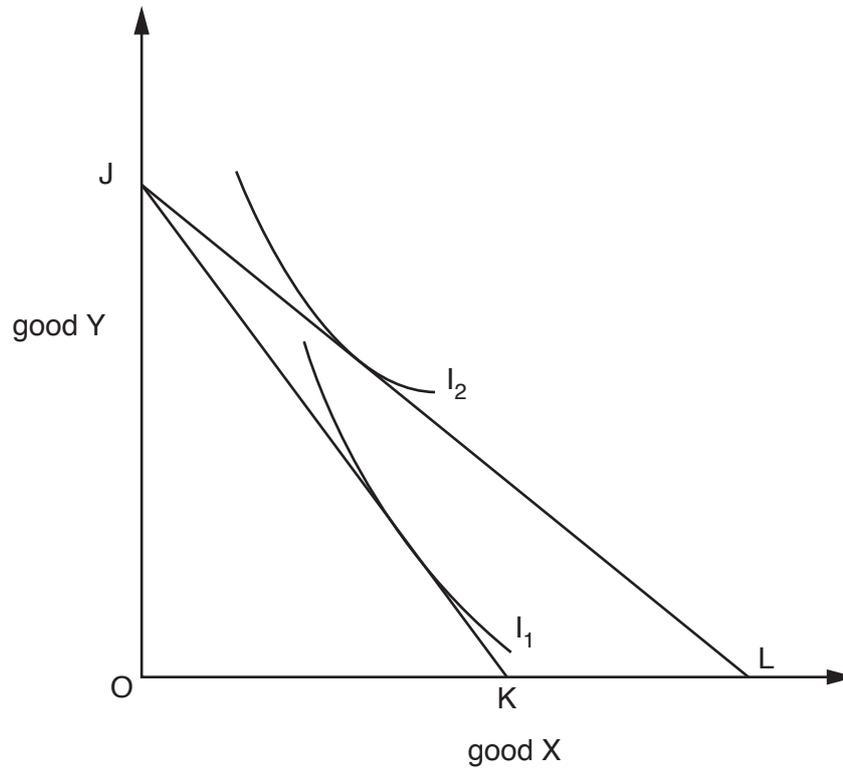
The diagram shows the economy's production possibility curve.



Why is the curve bowed outwards?

- A** An increase in the resources devoted to car production requires a reduction in the resources devoted to butter.
- B** Some resources are better suited to the production of cars and others to butter.
- C** There are economies of scale in the production of both goods.
- D** The resources available to the economy are in fixed supply.
- 2 Which of the following statements is normative?
- A** As a general rule people are happier in more equal societies.
- B** Despite a massive increase in income per head people are no happier today than they were 50 years ago.
- C** Happiness depends not on the absolute level of a person's income but on their relative income.
- D** The promotion of happiness is a more important goal than the maximisation of GDP.

- 3 In the diagram I_1 and I_2 are two indifference curves for an individual, and JK and JL are budget lines before and after a change in the price of good X.



What can be deduced from the diagram about the properties of good X?

	an inferior good	a Giffen good
A	no	no
B	no	yes
C	yes	no
D	yes	yes

- 4 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?

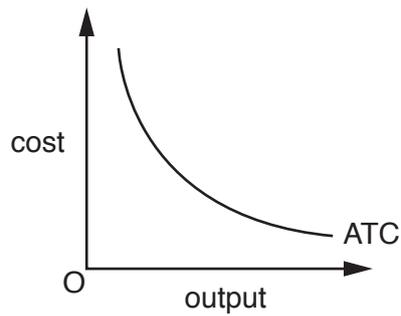
- A It is equal to unity.
- B It is perfectly elastic.
- C It is perfectly inelastic.
- D Nothing can be deduced without further information.

- 5 A firm's workers join a trade union which succeeds in negotiating an increase in the workers' wage rate. The increase in the wage rate results in an increase in the number employed by the firm.

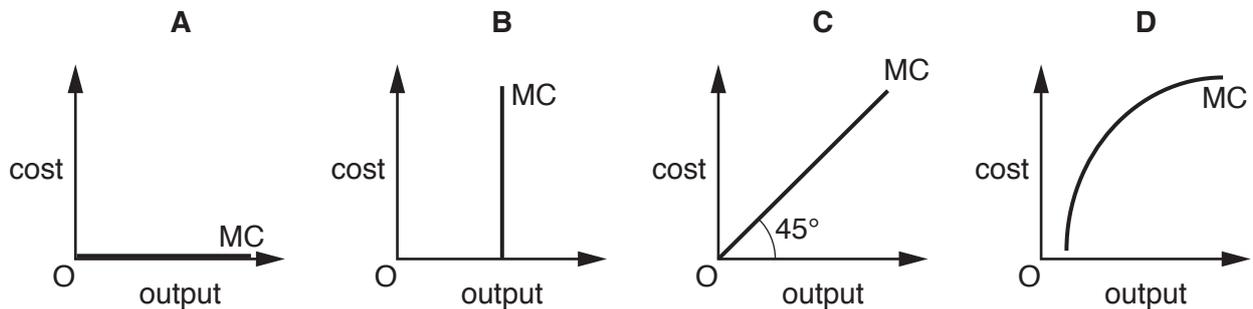
What is most likely to explain this?

- A The demand for the firm's product is price inelastic.
- B The firm is the only major employer in its locality.
- C The firm operates in a perfectly competitive labour market.
- D There is a high degree of substitutability between capital and labour.

- 6 The diagram shows a firm's average total cost curve (ATC).



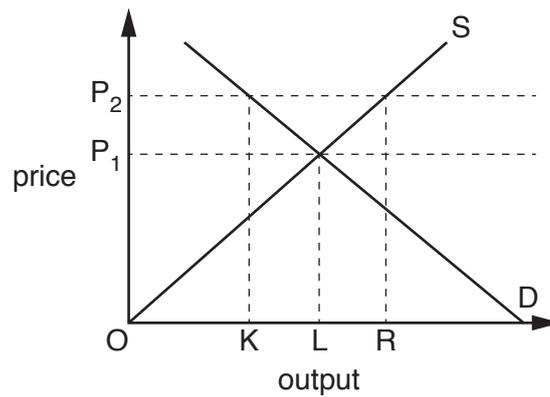
Which diagram shows the firm's corresponding short-run marginal cost curve?



- 7 What is the defining characteristic of a public good?

- A An increase in consumption by one individual leaves the quantity available to others unchanged.
- B Consumption of the good by one individual confers benefits on other individuals.
- C The benefits obtained by those who consume the good are greater than they realise.
- D The good is consumed jointly by all members of society.

- 8 The diagram shows the market supply and demand curves for corn.



What should a government do if it is to maintain a minimum price of OP_2 ?

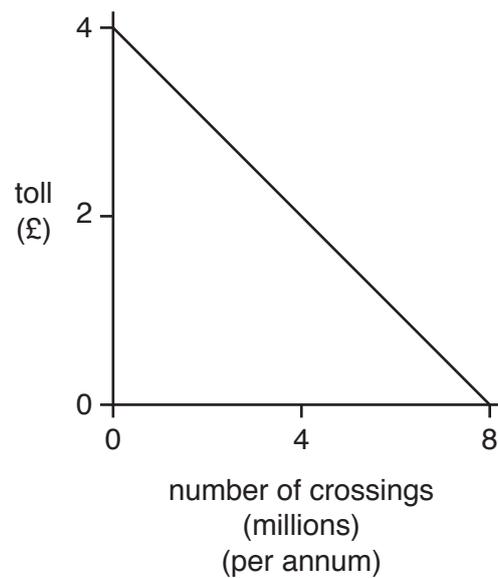
- A buy quantity KR
 - B buy quantity LR
 - C sell quantity KL
 - D sell quantity OL
- 9 A consumer spends the whole of her income on just two goods, X and Y.

Her demand for good X is price-elastic.

What will be the effect of an increase in the price of X on her expenditure on good X and on the quantity she purchases of good Y?

	expenditure on good X	quantity purchased of good Y
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

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



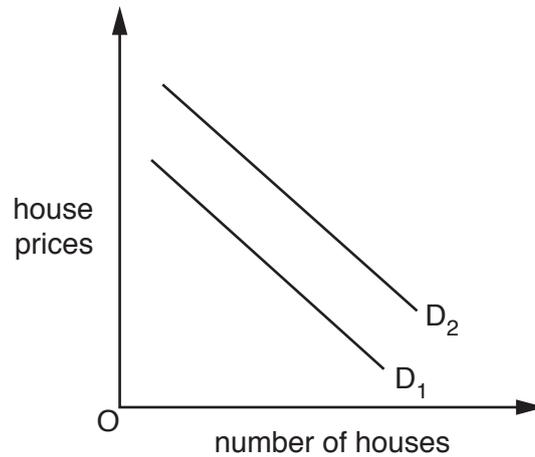
The estimated annual capital and operational costs of the bridge amount to £10 million.

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

- 11 In the diagram, D_1 is the initial demand curve for owner-occupied housing.



What could cause the demand curve to shift to D_2 ?

- A** a decrease in the availability of loans
B a decrease in the cost of renting
C an increase in mortgage interest rates
D an increase in predicted house prices
- 12 What increases the likelihood that an individual producer who is a member of an industry cartel will be tempted to cheat by exceeding his production quota?
- A** Information about industry output is widely available.
B The number of producers who are members of the cartel is relatively small.
C The producer accounts for only a small proportion of the industry's output.
D The producer currently operates at its minimum efficient scale.
- 13 The table shows the inputs of the two factors of production a firm needs in order to produce different levels of output.

output	capital	labour
100	6	12
200	10	15
300	15	30
400	20	40
500	30	60

Given constant factor prices, over which range of output does the firm encounter constant average costs of production?

- A** 100 to 200 **B** 200 to 300 **C** 300 to 400 **D** 400 to 500

14 **Question discounted from the assessment.**

15 What would be classified as price discrimination?

	charging lower air fares to economy class passengers	free bus travel for citizens over 60
A	no	no
B	no	yes
C	yes	no
D	yes	yes

16 A country's terms of trade currently stands at 150 (2015 = 100).

Since 2015 the average price the country has received for its exports has increased by 20%.

What has been the change in the average price it has paid for its imports?

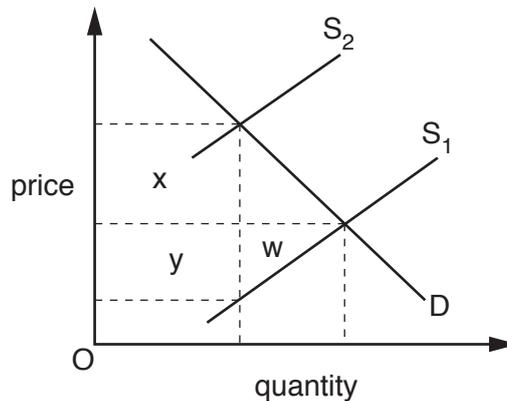
- A** -25%
- B** -20%
- C** +20%
- D** +25%

- 17 Policies to correct a current account deficit fall into two categories: expenditure-reducing policies and expenditure-switching policies.

Which pair of policies in the table is classified correctly?

	expenditure-reducing policy	expenditure-switching policy
A	an increase in the rate of income tax	the imposition of import tariffs
B	an increase in the rate of value added tax	an increase in the rate of income tax
C	devaluation of the currency	an increase in the rate of value added tax
D	the imposition of import quotas	devaluation of the currency

- 18 In the diagram, D is the demand curve for Indian tea exports and S_1 is the initial supply curve.



The Indian government imposes a tax on tea exports, which causes the supply curve to shift to S_2 .

Which areas in the diagram show the resulting gain in tax revenue to the Indian government and the resulting loss in producer surplus to its tea producers?

	gain in tax revenue	loss in producer surplus
A	x	w + y
B	x + y	y
C	x	y
D	x + y	w + y

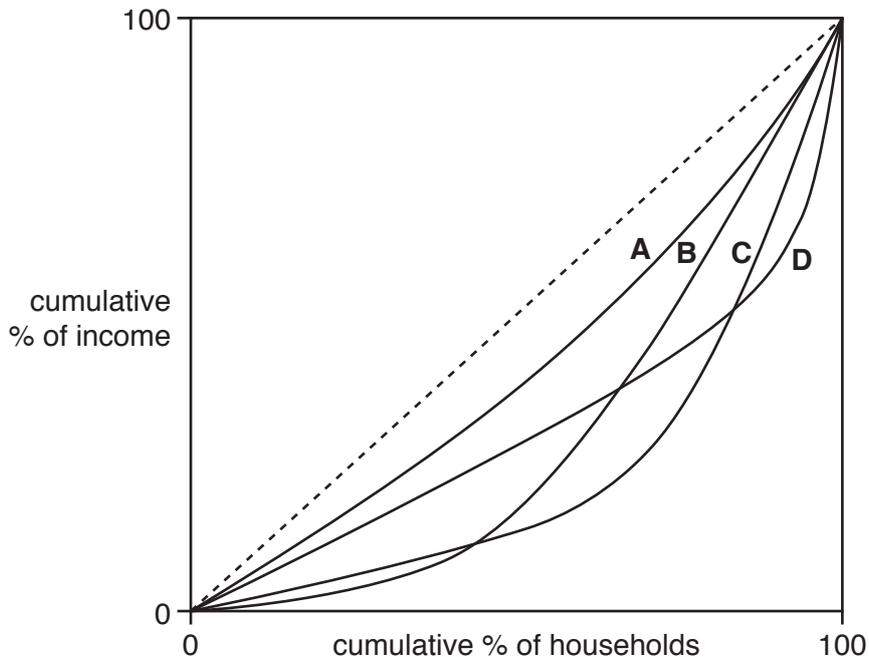
- 19 A country’s central bank is charged by the government with setting interest rates with a view to meeting a given inflation target.

Inflation is currently just above the target rate.

What will increase the likelihood that the bank will decide to raise interest rates?

- A a fall in the country’s exchange rate
 - B a fall in the country’s trade balance
 - C a rise in the inflation target
 - D a rise in the unemployment rate
- 20 The four Lorenz curves in the diagram show the distribution of household income in four different countries.

Which country has the greatest degree of income inequality as measured by the Gini coefficient?



- 21 An independent forecasting body estimates that a country’s negative output gap is smaller than it had previously estimated.

How is this likely to affect its estimates of the government’s cyclical and structural deficits?

	estimate of cyclical deficit	estimate of structural deficit
A	revised downwards	revised downwards
B	revised downwards	revised upwards
C	unchanged	revised downwards
D	unchanged	revised upwards

22 What is taken into account for the purposes of measuring net national income (NNI)?

	net property income from abroad	an allowance for capital depreciation	an estimate of environmental degradation
A	no	no	no
B	no	yes	yes
C	yes	no	no
D	yes	yes	no

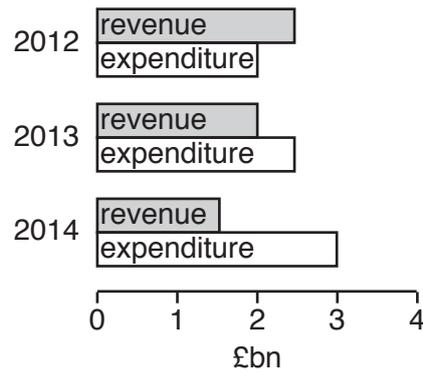
23 What is likely to result from foreign direct investment in a developing economy?

- A** an improvement in the developing economy's trade balance
- B** an increase in the developing economy's net investment income
- C** a reduction in the developing economy's government tax revenue
- D** a reduction in wage levels in the developing economy

24

Question discounted from the assessment.

- 25 The diagram shows a government's revenue and expenditure for three years.



What can be concluded from the diagram?

- A** A budget deficit was replaced by a budget surplus.
B A government borrowing requirement emerged.
C The economy moved from a recession into a boom period.
D The government privatised some state-owned companies.
- 26 A country's government issues permits to all major companies which specify the maximum amounts of CO₂ gases each company is permitted to emit. The permits are issued free of charge and are not transferable or tradable.

What would be the effect on company profits if the restriction on tradability was lifted?

	profits of buyers of permits	profits of sellers of permits
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

- 27 In an economy there is no government sector. The marginal propensity to save is $\frac{1}{8}$ and the marginal propensity to import is $\frac{1}{4}$.

What is the value of the multiplier?

- A** $\frac{5}{8}$ **B** $1\frac{3}{5}$ **C** $2\frac{2}{3}$ **D** 8

- 28 Why might the discovery of oil reserves in a developing country turn out to be an economic curse rather than a blessing?
- A It will cause a depreciation of the exchange rate.
 - B It will lead to an increase in imported inflation.
 - C It will lead to a worsening in the terms of trade.
 - D It will make manufactured goods for export less competitive.

- 29 On average, labour productivity in an economy grows by 2.5% per annum and the labour force grows by 0.5% per annum.

What will be needed to bring about a reduction in unemployment?

- A a rate of growth of actual output of more than 2%
 - B a rate of growth of actual output of more than 3%
 - C a rate of growth of potential output of more than 2%
 - D a rate of growth of potential output of more than 3%
- 30 The European Union imposes a quota on the volume of garments imported from China.

What is likely to be the effect on the average prices received by Chinese garment producers and on the prices paid by the consumers of Chinese garments in Europe and the United States?

	prices received by Chinese producers	prices paid by European consumers	prices paid by US consumers
A	decrease	decrease	decrease
B	decrease	decrease	increase
C	increase	increase	decrease
D	increase	increase	increase

Section B: Short Answers

Answer **all** questions.

- 1 (a) Use a diagram to show the difference for a monopolist between the profit maximising output level and the revenue maximising output level. [3]
- (b) Explain the term 'profit satisficing'. [2]
- 2 (a) Identify **two** key characteristics of a public good. [2]
- (b) With the aid of an example, explain how an advance in technology can affect a key characteristic of public goods. [3]
- 3 (a) Identify **two** key features of an oligopolistic market structure. [2]
- (b) A duopoly is a market structure where just two firms operate. Using a payoff matrix, show how collusion, rather than competition, can increase the profits of both firms in such a market structure. [3]
- 4 (a) Identify **three** determinants of price elasticity of supply. [3]
- (b) Give **two** reasons why the price elasticity of supply of manufactured goods is likely to be more elastic than the price elasticity of supply of fresh flowers. [2]

[Total: 20]

Section C: Data Response

Answer all questions.

Question 5

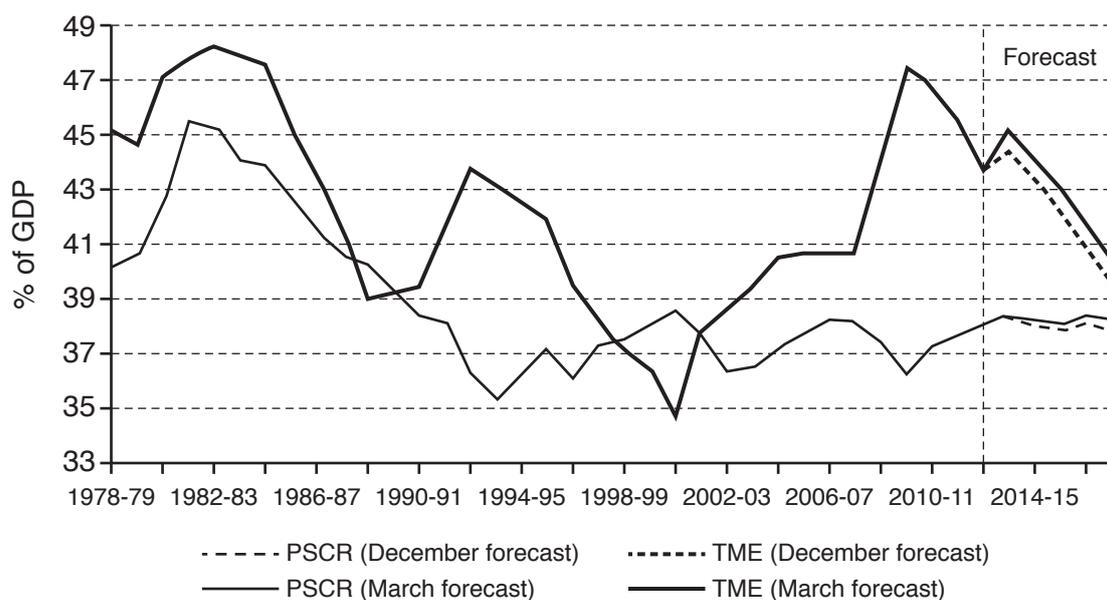
Extract 1 – Austerity or Otherwise

The debate about austerity has rumbled on for much of the last five years, with the government’s initial pledge to get rid of the budget deficit within the 2010–2015 parliament coming under scrutiny from all sorts of places: Conservative backbenchers, critics on the Opposition benches and in the left-leaning media.

Those on the Conservative right, notably Liam Fox MP, attacked the government’s spending plans and questioned the commitment of the government to reducing the budget deficit. He delivered a speech which attacked welfare spending, pledged to freeze public expenditure for at least three years, and questioned the ring-fencing of certain departmental budgets. According to Fox, a five year freeze on public spending would have meant that annual spending would have been £91.2 billion lower in 2017/18 and resulted in cumulative savings of £345 billion. His view was that austerity is a pre-requisite for renewed economic growth, but that there hasn’t been much in the way of austerity. 5

In contrast, others, notably Jonathan Portes, the Director of the National Institute of Economic and Social Research (NIESR), attacked the view that austerity can stimulate recovery. In posts on his “Not the Treasury View” blog, he consistently challenged the view that there hasn’t been much in the way of austerity and was critical of the proposition that austerity would necessarily promote growth. He has highlighted the fact that the budget deficit has not fallen as much as was forecast, but attributes this to the fact that overly harsh initial fiscal consolidation has had a detrimental effect on growth and, by definition, tax revenues. However, his position is a fairly balanced one, suggesting that other factors – the eurozone crisis and global economic uncertainty – have also limited growth. 10

Figure 1 – Public Sector Current Receipts (PSCR) and Total Managed Expenditure (TME)



Source: Office of Budgetary Responsibility, Economic and Fiscal Outlook, March 2016

Extract 2 – Austerity in Greece

Austerity has been all the rage across Europe. However, there is evidence to suggest that the IMF, EU and ECB may have been overly harsh in the spending cuts they required Greece to make in order to deal with its national debt crisis. Indeed, an IMF report went as far as to suggest that Greek austerity and the associated bailouts were largely designed to discourage excessive borrowing in other economies in order to avert a wider crisis. Unfortunately for Greece, this is little consolation: youth unemployment was at 48% in December 2015. 5

The original predictions of the IMF, EU and ECB were that the implementation of austerity would see the Greek economy shrink by 2.6% in 2010 before recovering to post growth of 1.1% in 2011 and 2.1% in 2012. In the event, the Greek economy continued to decline: by 7.1% in 2011 and 6.4% in 2012, giving a total decline of 25% since the crisis broke. The EU's own officials admitted that the negative multiplier was bigger than might have been expected. 10
The externally imposed Greek austerity targets proved impossible to attain as Greek GDP continued to decline. However, it took 18 months for these targets to be relaxed.

- (a) Explain the term 'austerity'. [2]
- (b) With reference to Figure 1, assess whether the UK government achieved its aim to 'get rid of the budget deficit within the 2010–2015 parliament'. (Extract 1, line 2) [3]
- (c) Using an AD/AS diagram, explain the possible impact of austerity on an economy in both the short run and the long run. [5]
- (d) With reference to Extract 2 and your own economic knowledge, assess the view that austerity is an inappropriate solution to the economic problems facing Greece. [10]
- (e) Using the information, and your economic knowledge, assess the view that a nation's economic growth will be adversely affected by an increase in the nominal value of the national debt. [10]

[Total: 30]

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