

ECONOMICS

9772/01

Paper 1 Multiple Choice, Short Answers and Data Response

May/June 2013

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.

For Section A Multiple Choice mark your choice of answer clearly on your Multiple Choice Insert.
Write your Centre number, candidate number and name on the Insert.

You may use a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

Answer **all** questions.

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 ensuring that you also attach your answers for Section A which are on the Multiple Choice Insert.

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

This document consists of **20** printed pages and **1** Insert.

Section A

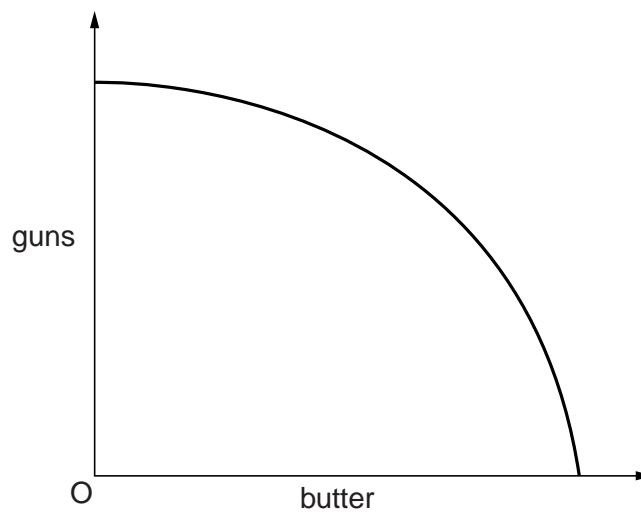
There are **thirty** questions in this Section. Answer **all** questions. For each question there are four possible answers, **A**, **B**, **C** and **D**.

Choose the **one** you consider correct and record your choice of answer clearly **on the Multiple Choice Insert**.

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

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

The diagram shows the economy's production possibility curve.



Why is the curve bowed outwards?

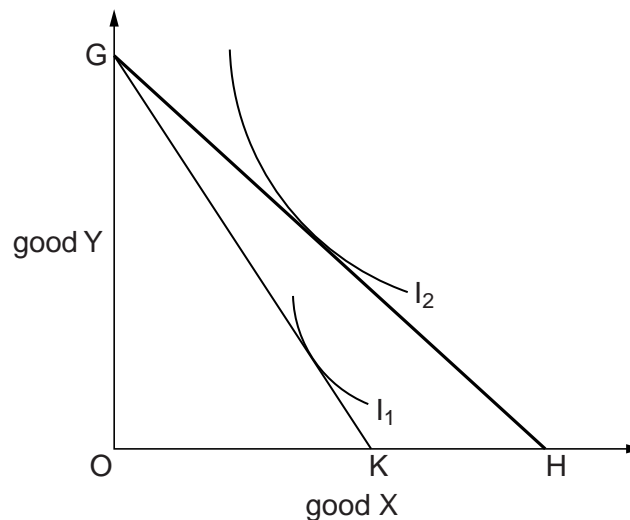
- A An increase in the resources devoted to gun production requires a reduction in the resources devoted to butter.
- B The resources available to the economy are in fixed supply.
- C There are economies of scale in the production of both goods.
- D The production of both goods is subject to diminishing returns.

- 2 A driver makes the following estimates in considering the purchase of a car which she intends to use only when she would otherwise have used public transport.

	£
purchase price of car	12 000
value of car after one year	9 000
car operating and repair costs, insurance and taxation for one year	3 600
cost of using public transport for one year instead of travelling by car	1 600
interest after tax on £12 000 invested for one year	1 000

What will be the opportunity cost in monetary terms to the driver over the year of travelling by car rather than by public transport?

- A** £3000 **B** £5000 **C** £6000 **D** £7600
- 3 In the diagram, I_1 and I_2 are an individual's indifference curves.

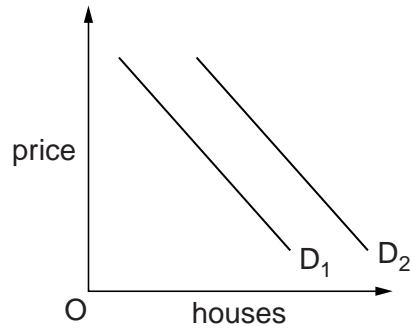


An increase in the price of good X causes the individual's budget line to shift from GH to GK.

What can be deduced about good X?

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

- 4 In the diagram, D_1 is the initial demand curve of first-time buyers for housing.



What could cause the demand curve to shift to D_2 ?

- A an expected increase in house prices
 - B an expected reduction in rents
 - C an increase in house building
 - D an increase in interest rates.
- 5 Why do increases in the rate of tax on cigarettes invariably produce an increase in tax revenue?
- A because cigarettes are an addictive good
 - B because cigarettes are an inferior good
 - C because of the relatively high price elasticity of demand for cigarettes
 - D because of the relatively low income elasticity of demand for cigarettes

- 6 An industry consists of two firms, X and Y.

The profit-payoff matrix shows how the profits of X and Y vary depending on the prices charged by the two firms.

		price charged by X	
		$P_X = \text{£}10$	$P_X = \text{£}5$
price charged by Y	$P_Y = \text{£}10$	$\text{£}12m_X$ $\text{£}12m_Y$	$\text{£}20m_X$ $-\text{£}6m_Y$
	$P_Y = \text{£}5$	$-\text{£}6m_X$ $\text{£}20m_Y$	0_X 0_Y

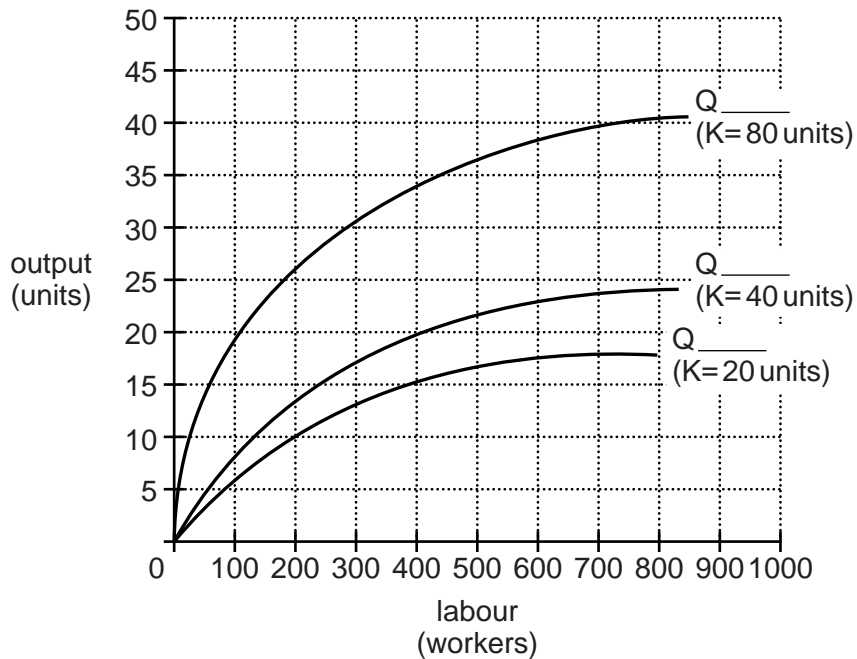
Both firms make a zero profit.

What could explain this outcome?

- A collusion
- B competitive oligopoly
- C price discrimination
- D product differentiation

- 7 A firm has only two factor inputs, capital (K) and labour.

The diagram shows how the firm's output (Q) changes in response to changes in the number of workers it employs and the number of units of capital it hires.



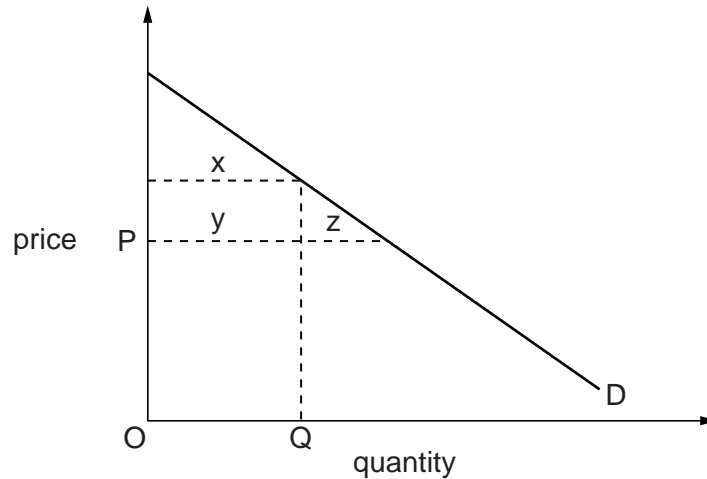
Initially, the firm hires 20 units of capital and employs 200 workers.

Assuming factor prices remain constant, what is the shape of the firm's long-run average cost curve?

- A** downward sloping **C** upward sloping
B horizontal **D** U-shaped
- 8 Which of the following would be classified as price discrimination?

	reduced fares for bus travel for those over 60	higher insurance premiums for young motorists
A	yes	yes
B	no	yes
C	no	no
D	yes	no

- 9 The diagram shows an individual's demand curve for a commodity.



The supplier of the commodity charges a price OP but limits the quantity available to each purchaser to OQ .

Which area measures the consumer's surplus?

- A** x **B** $x + y$ **C** $y + z$ **D** $x + y + z$
- 10 What would **not** be classified as an externality?
- A** the increased attractiveness of neighbouring houses resulting from older properties being renovated
- B** the increased traffic congestion resulting from the building of a new housing estate
- C** the reduction in the number of working days resulting from an increase in the amount of smoking
- D** the reduction in the profits of existing firms resulting from increased charges by a supplier
- 11 Commuters' choice of mode of transport depends on just two factors, journey time and financial cost.

The introduction of a number of lanes within the existing road network for use only by buses results in an increase in the number of bus passengers, but still leaves plenty of seats available on all bus services.

What is the most likely effect on the net economic welfare of each of the following groups?

	those who previously travelled by bus	those who switch from travelling by car to travelling by bus
A	gain	lose
B	gain	uncertain
C	uncertain	lose
D	uncertain	uncertain

12 Until recently a firm paid its employees on an hourly basis.

Even though the management was satisfied that its employees could not work any harder than they were already working, the firm decided to switch to a piece-rate system of payment, whereby the wage paid to each employee depends on his level of output.

What is the most likely explanation as to why over time this has led to a significant improvement in labour productivity?

- A an improvement in the quality of the workforce
- B an improvement in labour relations
- C an increase in the size of the workforce
- D an increase in demand for the final product

13 In a social cost-benefit study what would **not** be included when calculating the net social benefit of raising the maximum speed limit on motorways from 70 mph to 80 mph?

- A an increase in road deaths
- B an increase in fuel consumption
- C an increase in revenue from petrol tax
- D a reduction in journey times

- 14** The table shows for four countries the growth rate of nominal GDP, the population growth rate and the rate of inflation in one year.

Which country had the greatest growth in average living standards?

country	nominal GDP growth rate (%)	population growth rate (%)	inflation rate (%)
A	6	1	3
B	8	2	4
C	10	3	4
D	15	4	10

- 15** To prevent a surplus of milk, each milk producer is given a production quota which specifies the volume of milk he is allowed to supply.

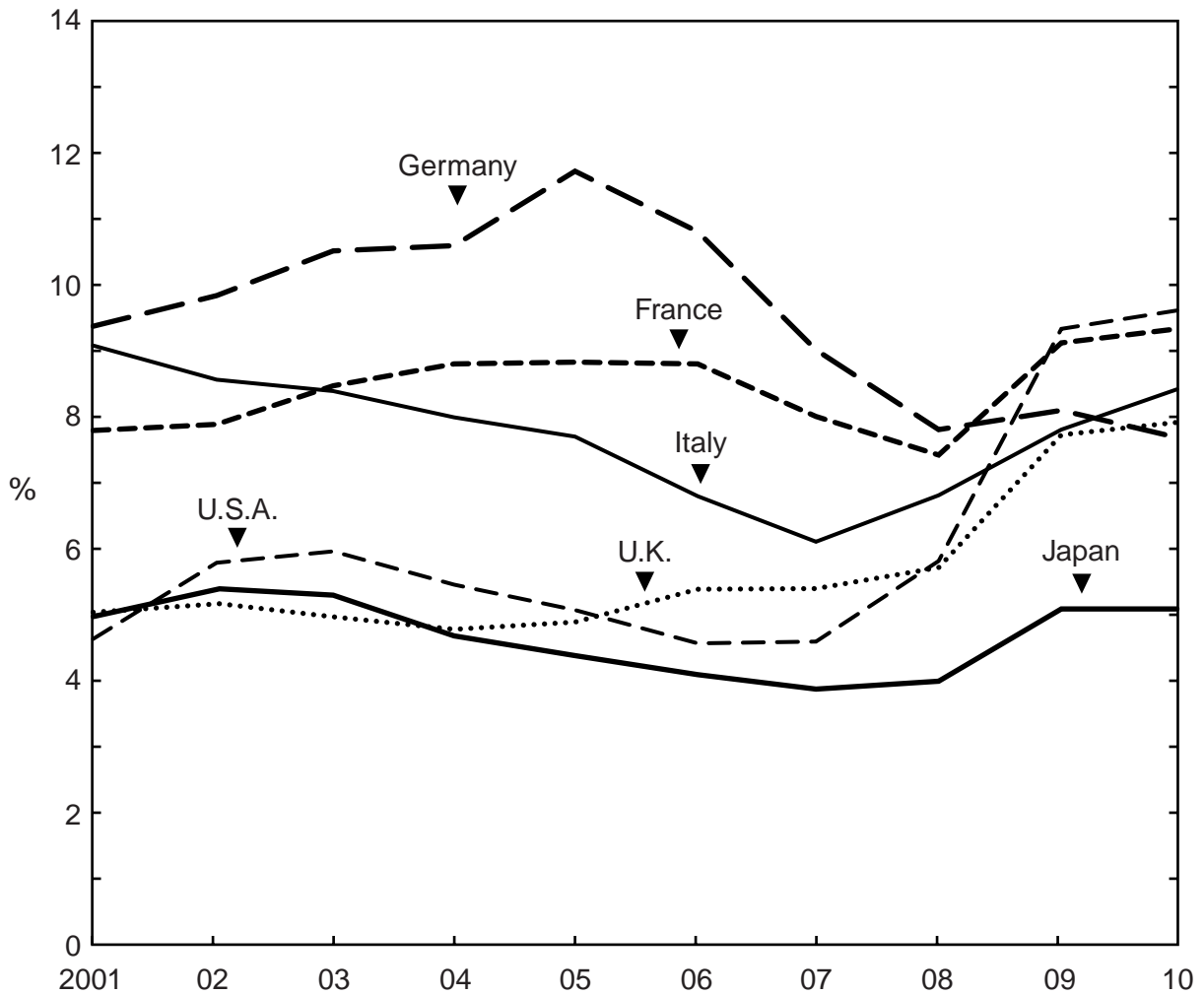
Initially the quotas are not tradable.

Who would gain or lose if producers were now permitted to buy quotas from other producers?

	purchasers of quotas	sellers of quotas
A	gain	gain
B	gain	lose
C	lose	gain
D	lose	lose

16 The graph shows countries' unemployment rates between 2001 and 2010.

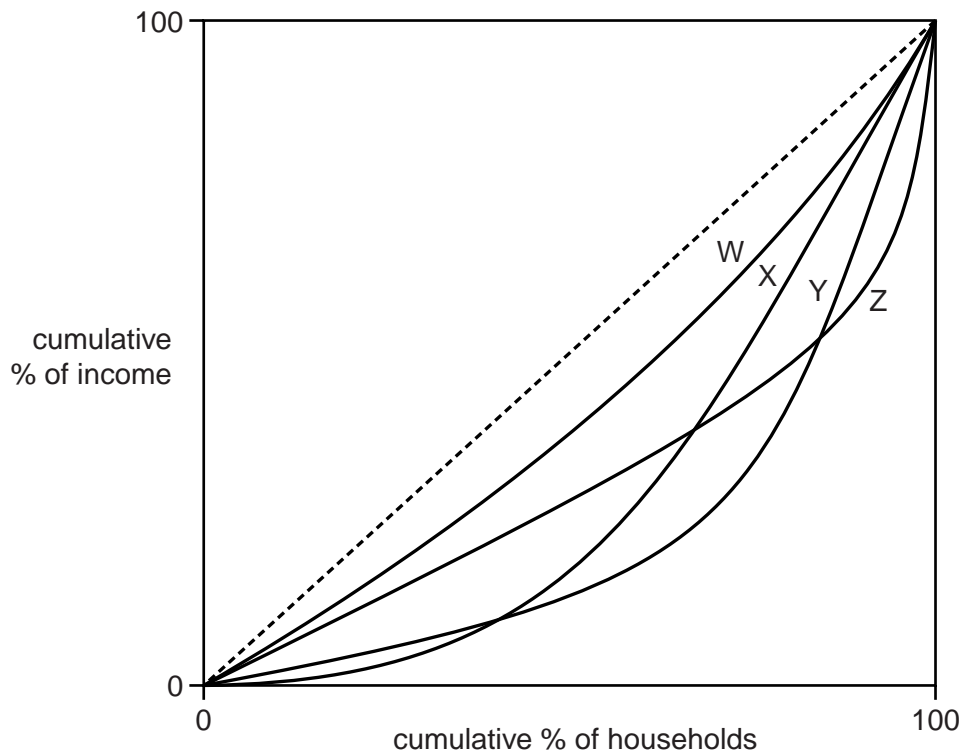
Unemployment rates by country 2001 – 2010



What can be concluded from the graph about unemployment over this period?

- A The country with the highest number of unemployed up until 2008 was Germany.
- B France recorded a bigger percentage increase in unemployment than the United Kingdom.
- C The country most badly affected by the aftermath of the 2007–8 banking crisis was the United States.
- D Over the course of the decade there was a marked divergence in countries' unemployment rates.

- 17 The four Lorenz curves in the diagram show the distribution of household income in four different countries.



Which statement about the degree of income inequality in the four countries, as measured by the Gini Coefficient, is correct?

- A Inequality is greater in Country Z than in Country Y.
 - B Inequality is greater in Country Z than in Country X.
 - C Inequality is greater in Country Y than in Country X.
 - D Inequality is greater in Country W than in Country Y.
- 18 In a closed economy, the marginal propensity to save increases and tax rates remain unchanged.

What effect will this have on the marginal propensity to consume and on the multiplier?

	marginal propensity to consume	multiplier
A	decreases	decreases
B	decreases	increases
C	increases	decreases
D	increases	increases

- 19** A country has a floating exchange rate and an independent central bank with the power to set interest rates.

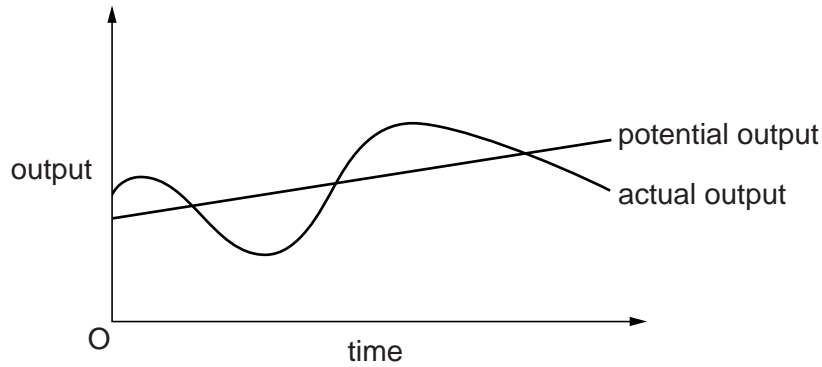
The inflation rate is currently stable at the central bank's target rate of 5%.

What is likely to happen to interest rates and to the exchange rate if the bank's target rate was reduced to 2%?

	interest rates	exchange rate
A	decrease	depreciate
B	decrease	appreciate
C	increase	depreciate
D	increase	appreciate

- 20** How might Quantitative Easing help to stimulate economic growth?
- A** by increasing the average price level
 - B** by increasing the demand for money
 - C** by reducing long-term interest rates
 - D** by reducing the price of government bonds
- 21** In which situation is it most likely that an increase in government spending will crowd out private investment?
- A** when the economy is growing very slowly
 - B** when unemployment is very low
 - C** when there is a large gap between actual and potential output
 - D** when the household saving ratio is at a high level
- 22** An increase in final government expenditure has a bigger impact on national output than an equivalent reduction in net taxes. What is the most likely reason for this?
- A** Consumers respond to a reduction in net taxes by saving part of the resulting increase in their disposable income.
 - B** Employees respond to a reduction in net taxes by increasing their hours of work.
 - C** A reduction in net taxes is likely to lead to higher interest rates.
 - D** The increase in government spending results in a bigger increase in the government's fiscal deficit.

- 23 The diagram shows the time path of actual output and of long-term potential output of an economy.



What would help to reduce the divergence of actual output from potential output?

- A automatic stabilisers
 - B a balanced budget
 - C a stable exchange rate
 - D stable interest rates
- 24 An economy has a high level of unemployment and a large current account balance of payments deficit.

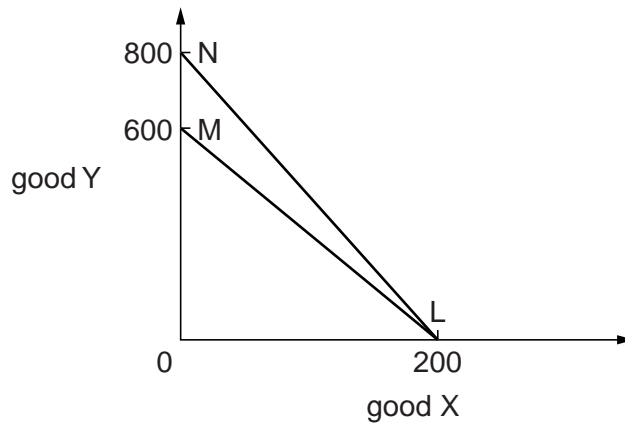
What would be the most suitable policy for a government to adopt?

- A decrease government spending
 - B devalue the currency
 - C increase direct taxation
 - D increase interest rates
- 25 The Human Development Index (HDI) measures three dimensions of human development.

What is **not** included as one of these dimensions?

- A access to knowledge
- B a decent standard of living
- C a long and healthy life
- D equal economic opportunity

- 26 The diagram shows a country's pre-trade (LM) and post-trade (LN) consumption possibilities of goods Y and X.



What can be deduced from the diagram?

- A The country's consumers prefer Y to X.
 - B The country's consumers prefer X to Y.
 - C The country enjoys a comparative advantage over its trading partner in the production of Y.
 - D The country enjoys a comparative advantage over its trading partner in the production of X.
- 27 Which policy is likely to promote economic development in a developing economy but may lead to a decline in the rate of economic growth?
- A a policy to increase female participation in the labour market
 - B a policy to increase immunisation rates
 - C a policy to reverse environmental degradation
 - D a policy to promote exports

- 28 The demand for a country's exports is price elastic.

What will be the effect of introducing export subsidies on its balance of trade and on its terms of trade?

	balance of trade	terms of trade
A	improve	improve
B	improve	worsen
C	worsen	improve
D	worsen	worsen

- 29** A Fair Trade scheme encourages consumers in developed economies to buy food items produced by farming cooperatives in low income countries at a higher price than that charged by commercial firms.

On what grounds could it be argued that this scheme may be harmful to economic development?

- A** It will cause a worsening in the balance of trade of developing economies.
- B** It will increase income inequality in developing economies.
- C** It will slow the process of economic diversification in developing economies.
- D** It will reduce the prices subsistence farmers receive for their produce.

- 30** Countries X and Y form a customs union. The level of import tariffs in countries X and Y was initially at the same level as the new customs union's common external tariff.

What is likely to be the effect on the volume of X's food imports from country Y and from country Z when X and Y form the customs union?

	imports from country Y	imports from country Z
A	increase	unchanged
B	increase	decrease
C	unchanged	decrease
D	unchanged	unchanged

[Total: 30]

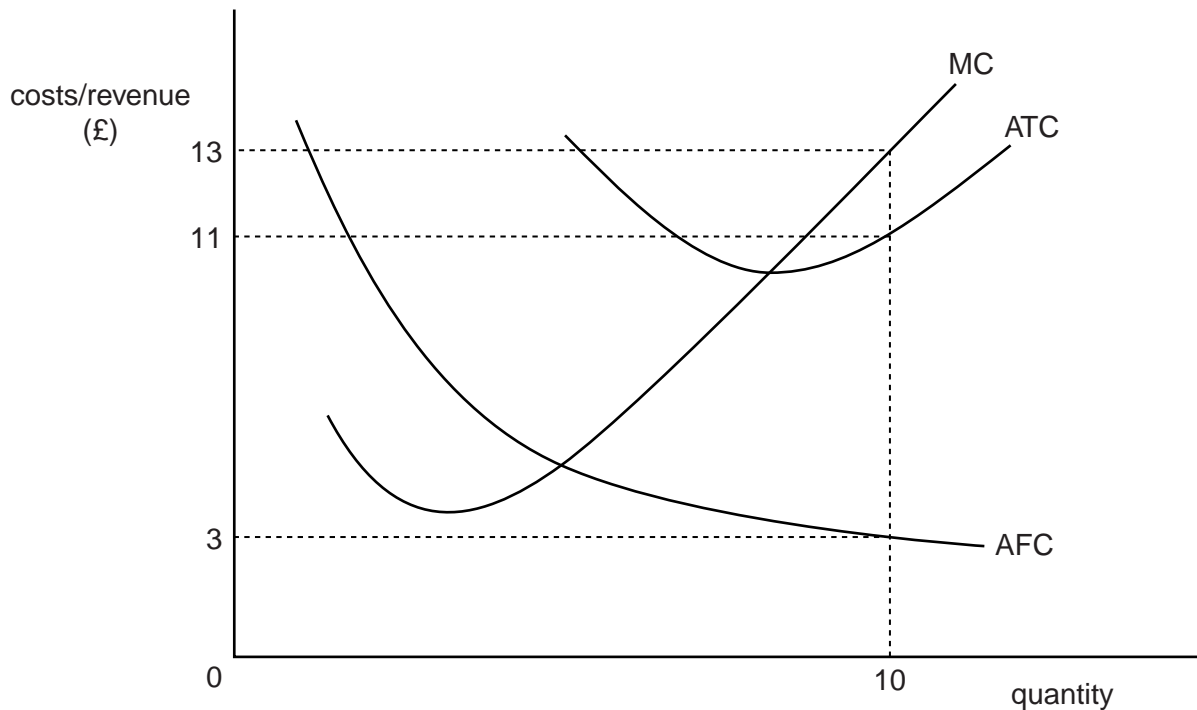
Section B

Answer **all** questions.

Question 1

- (a) State two characteristics of public goods. [2]
- (b) Explain why public goods suffer from the 'free rider' problem. [3]

Question 2



The diagram above represents the situation for a firm operating in a perfectly competitive industry where the market price is currently £13 per unit.

- (a) Calculate
- (i) The total fixed costs for the firm. [1]
- (ii) The level of supernormal profit earned in this time period by the firm. [1]
- (b) Explain why this diagram does not represent a long-run equilibrium for the firm. [3]

Question 3

- (a) Define inflation. [2]
- (b) Using an AS/AD diagram in your answer, identify what type of inflation would be caused by an increase in global raw material prices. [3]

Question 4

Explain the differences between a tariff and a quota as a means of protecting a domestic industry from overseas competition. [5]

[Total: 20]

Section C

Answer **all** questions.

Question 5

Read the following extracts, figure and table and then answer the questions that follow.

Extract 1

It's simply just a question of supply and demand – isn't it?

Conventional economic theory tells us that for the vast majority of goods and services, a fall in price results in an increase in the quantity demanded. Why then is it the case that whilst average house prices are lower now than in 2008 (see Figure 1), demand from first-time buyers is falling? Theory also suggests that a shortage in supply, relative to demand, should result in an increase in prices to bring the market back into equilibrium. Why then might prices be falling at a time when house building fails to keep up with increases in the demand for housing? For economists, what really matters is 'effective demand', where the desire to purchase is also matched by an ability to pay.

5

We need to consider whether the available housing is affordable. Over the last five decades house prices have risen on average by 2.7% per year, after allowing for inflation. This is greater than the 2% annual increase in average real earnings over the same period and so it would appear that houses are now less affordable. However, in the case of housing one has to take account not only of the price of the house but also the cost of the finance of the loan required to make the purchase.

10

Most house sales are funded by the buyer taking out a mortgage and paying back this loan plus interest over a set number of years. Mortgage rates are, however, currently much lower than has been the case over the past few decades. This should have helped balance out the affordability issues caused by higher real prices, shouldn't it?

15

The current issue for buyers, particularly first-time buyers, is that after all the recent problems in the banking industry, lenders have dramatically increased the deposit that they are requiring buyers to provide. Up until the last few years, a mortgage would often be secured for up to 95% of the purchase price of a property. This meant that to purchase a £160,000 property, a deposit of £8,000 would be needed. Lenders are now far more cautious and the average deposit required in the UK is around 25%. This means that to buy the same £160,000 house, a deposit of £40,000 is now required – a massive increase of £32,000.

20

25

Therefore, even though mortgage rates are relatively low at the moment and house prices are falling, the changes in the conditions for taking out a mortgage have resulted in a decline in the ability of many young individuals to make their demand effective.

When one considers that an increasing number of young people will find themselves facing the prospect of ever-increasing tuition fee repayments, not to mention pension scheme contributions, it is clear to see that the chances for first-time buyers to step on to the property ladder are looking pretty bleak for the considerable future.

30

Extract 2
from the House of Commons Housing Select Committee

The failure of housing supply to keep up with rising demand has had wide social and economic implications. Reasons for rising demand are improved life expectancy rates and a growing number of one-person households. There are almost 1.8 million households on waiting lists for English local authority housing and significant levels of overcrowding in the private and social housing stock. Poor housing impacts directly on residents' health and educational attainment, while difficulties in accessing affordable housing can also limit the ability of people to move to find work. The need to increase the supply of housing and tackle affordability issues is a key housing policy issue. Yet despite the critical social and economic role that housing plays, it has tended not to have the same political profile as, say, health and education.

5

(Source: adapted from www.parliament.uk)

Extract 3
Mortgage Equity Withdrawal – the decision of home owners to borrow money against the value of their homes.

Bank of England data released recently showed that homeowners are continuing to prefer to pay off and reduce their mortgages rather than borrowing more against the value of their homes (Mortgage Equity Withdrawal). Mortgage Equity Withdrawal for quarter two of 2011 was again a negative figure of more than £9.1bn. This, compared to –£8.9bn in quarter one, is another sign of the difficult conditions for the housing market.

5

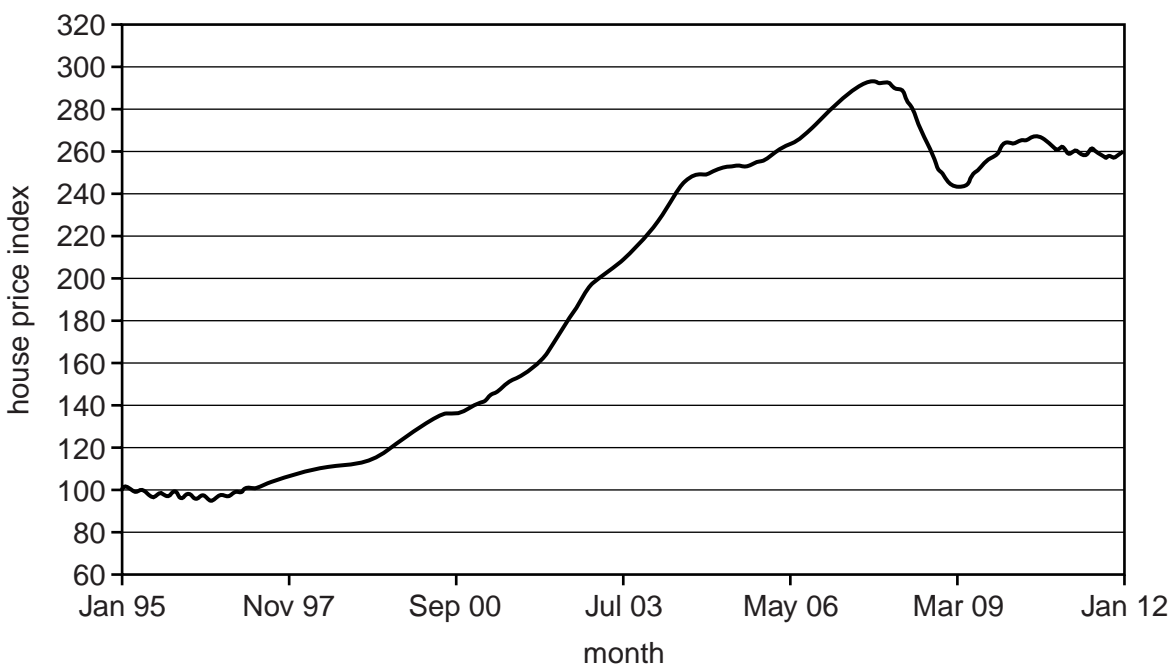
There is undoubtedly unwillingness amongst borrowers to increase the size of their debts and many are now taking a very different approach to their mortgage than they were a few years ago. When house prices were booming it was commonplace to withdraw equity to fund lifestyle purchases such as a new car or holiday as well as for the more traditional uses such as to fund home improvements.

10

(Source: Bank of England)

Figure: 1

House Price Index – All England & Wales



(source: www.landregistry.gov.uk)

Table 1: Stamp Duty rates – effective 30th September 2011

Purchase price value	Stamp Duty rate*	Stamp Duty rate for first-time buyers
Up to £125,000	Zero	Zero
Over £125,000 to £250,000	1%	Zero
Over £250,000 to £500,000	3%	3%
Over £500,000 to £1 million	4%	4%
Over £1 million	5%	5%

* If the value is above the payment threshold, Stamp Duty is charged at the appropriate rate on the whole of the amount paid. For example, a house bought for £130,000 (by someone who is not a first-time buyer) is charged at 1 per cent, so £1,300 must be paid in Stamp Duty. A house bought for £350,000 is charged at 3 per cent, so Stamp Duty of £10,500 is payable.

(source: www.hmrc.gov.uk)

- (a) Using the data in Table 1, calculate the Stamp Duty paid:
- (i) on a house costing £300,000.
 - (ii) by a first-time buyer on a house costing £200,000. [2]
- (b) Use the information provided in Extract 2 to explain why demand for housing has risen in recent years. [3]
- (c) Explain why lower mortgage rates ‘should have helped balance out the affordability issues caused by higher real prices’ – Extract 1, lines 17–18. [5]
- (d) ‘When house prices were booming it was commonplace to withdraw equity...’ Extract 3, lines 8–10. Using the information provided above and your own knowledge, evaluate the extent to which house price changes affect consumption spending. [10]
- (e) Using the information provided in the extracts and your own knowledge, evaluate the case for greater government intervention in the housing market. [10]

[Total: 30]

Copyright Acknowledgements:

Extract 2 © adapted: www.parliament.uk.
 Figure 1 © adapted: www.landregistry.gov.uk.
 Extract 3 © adapted: Bank of England.
 Table 1 © adapted: www.hmrc.gov.uk.

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