Cambridge International Examinations
Cambridge Pre-U Certificate

ECONOMICS **9772/01**

Paper 1 Multiple Choice, Short Answers and Data Response **May/June 2014**

2 hours 15 minutes

Additional Materials: Answer Booklet/Paper/Multiple Choice Insert sheet

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 an HB pencil for any diagrams or graphs.
Do not use staples, paper clips, glue or correction fluid.
DO **NOT** WRITE IN ANY BARCODES.

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 **17** printed pages, **3** blank pages and **1** insert.

International Examinations

[Turn over

Section A

1 What is one of the advantages of the division of labour?

    A   less reliance on other workers

    B   a reduction in labour costs

    C   greater job satisfaction

    D   increased geographical mobility

2 The winner of a TV quiz show is offered a choice of either £1000 or the contents of one or the other of two sealed boxes. She is told that one box contains £2500 and that the other box is empty.

What is the opportunity cost to the individual of opting to open one of the boxes?

    A   £500

    B   £1000

    C   a 50% chance of losing £1500

    D   a 50% chance of winning £1500

3 An individual responds to a 5% increase in the price of good X by reducing the proportion of his income he spends on good X by 3%.

In the absence of any other changes, what can be deduced from this about the individual's demand for good X?

    A   It is income elastic.

    B   It is income inelastic.

    C   It is price elastic.

    D   It is price inelastic.

4 What characteristic is **always** present in an oligopolistic industry?

    A   mutual interdependence

    B   non-price competition

    C   price rigidity

    D   price leadership by a dominant firm

5 What would be taken into account in a social cost-benefit assessment of a proposal to raise the maximum speed on motorways from 70 mph to 80 mph?

|	an increase in carbon emissions	an increase in fuel consumption	a reduction in time spent travelling to work	a reduction in travel time during working hours
A	yes	no	no	yes
B	yes	yes	yes	yes
C	yes	yes	no	no
D	no	no	yes	yes

6 What constitutes a deadweight loss?

A the supernormal profit earned by monopoly suppliers

B the loss to consumers when a specific tax is imposed on a commodity

C the loss to workers when they are paid a wage below the value of their marginal product

D the net loss in welfare resulting from a failure to impose an optimal tax on road users

7 In the diagram, I_1 and I_2 are an individual's indifference curves.

His initial budget line is JK.
A reduction in the price of good Y causes his budget line to shift to JL.
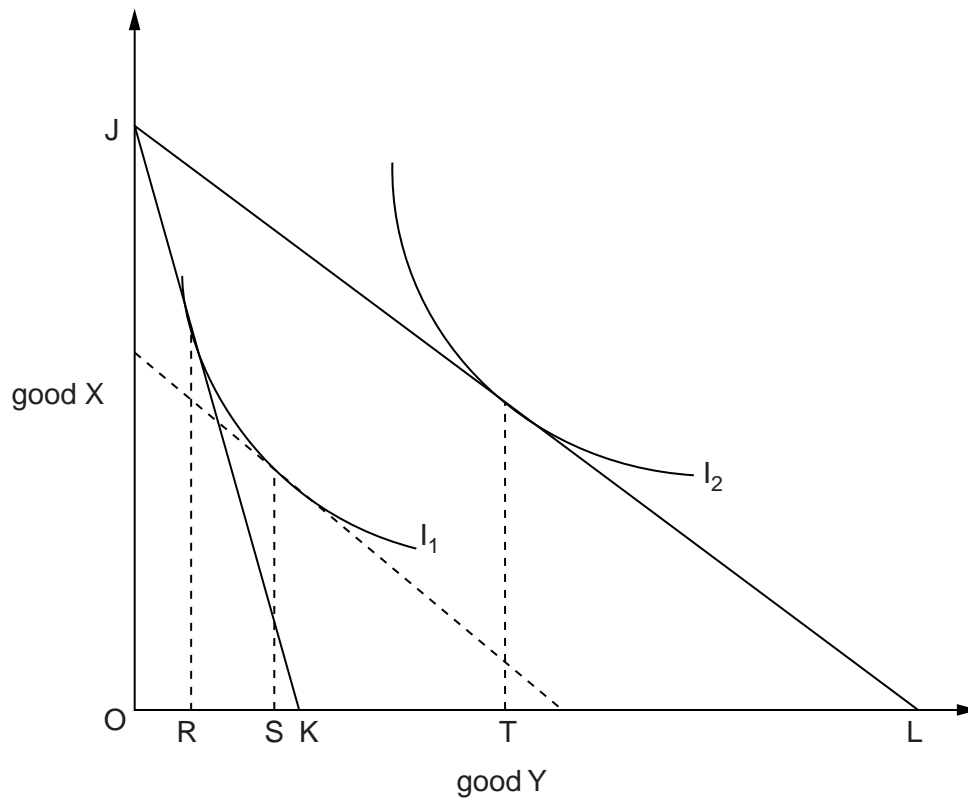
Which distances measure the income and substitution effects of the reduction in the price of good Y?

|	income effect	substitution effect
A	RS	ST – RS
B	RS	ST
C	ST	RS – ST
D	ST	RS

8 At present a £2 toll is charged for crossing a road bridge in either direction. A number of the people using the bridge are daily commuters.

The Department of Transport decides to abolish the toll charge for crossing from east to west but to increase the charge for crossing from west to east to £5.

What effect will this have on the number of crossings?

	east to west crossings	west to east crossings
A	increase	decrease
B	increase	uncertain
C	uncertain	decrease
D	uncertain	uncertain

9 In the diagram, S is the supply curve and D_1 is the initial demand curve for places at university.
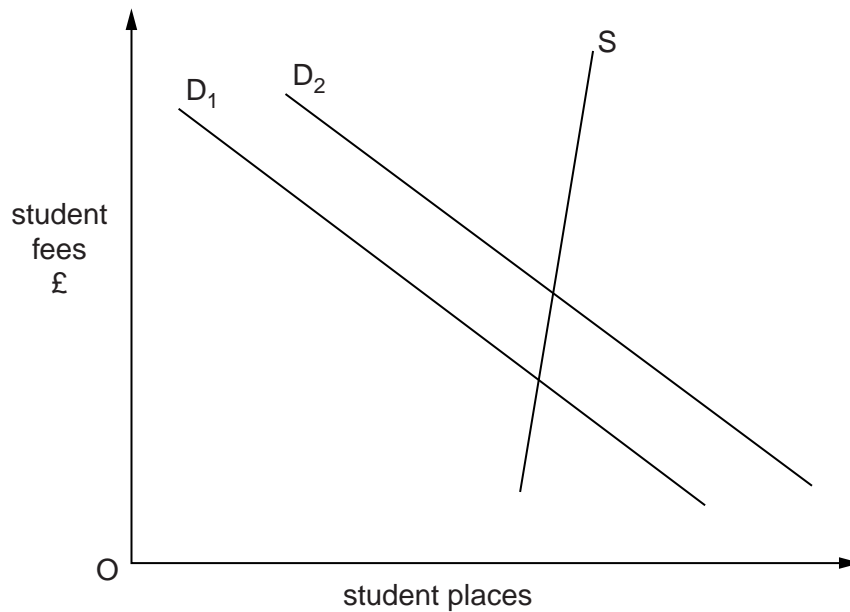

What could cause the demand curve to shift to D_2?

A   a decrease in student fees

B   a decrease in the level of youth unemployment

C   higher A level entry grades demanded by universities

D   a greater difference between graduate and non-graduate earnings

10 Food prices in a country increased by 20% between 1987 and 2013. The weighting given to food in the construction of the country's Consumer Price Index fell from 16.7% in 1987 to 11.8% in 2013.

What would help to explain this?

A Demand for food is price inelastic.

B Fewer people have grown their own food.

C The income elasticity of demand for food is less than one.

D There was an increase in the amount of junk food eaten.

11 In the diagram, MC and AC are a profit-maximising monopolist's marginal and average cost curves, and MR and AR, its initial marginal and average revenue curves.
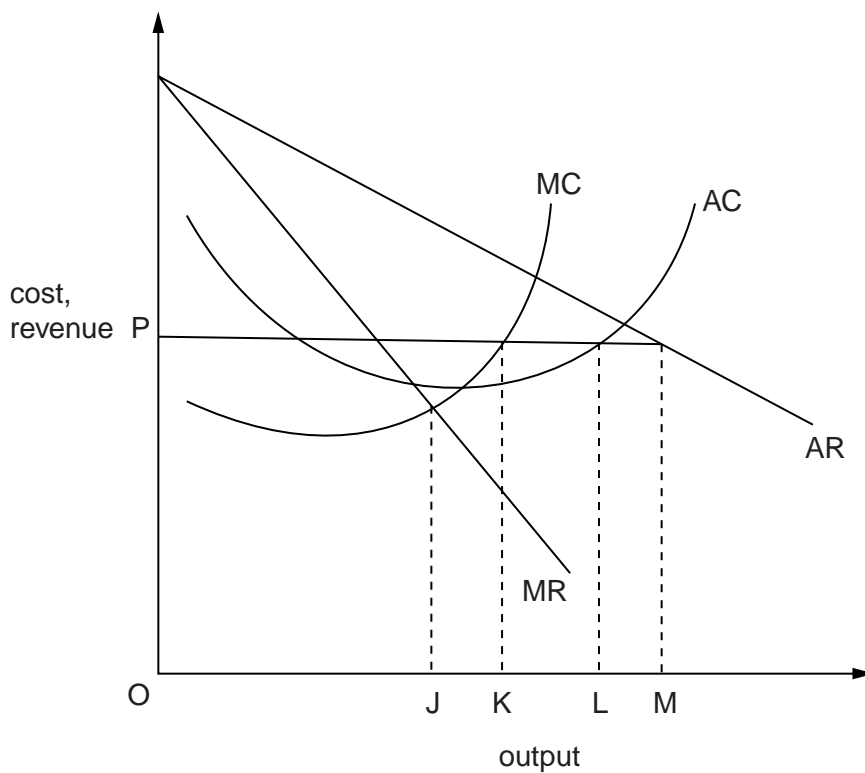
Which output will the firm produce if the government sets a maximum price of OP?

A OJ

B OK

C OL

D OM

12 The graph shows the annual percentage changes in the prices of newly constructed houses and pre-owned dwellings in the United Kingdom between 2010 and 2012.
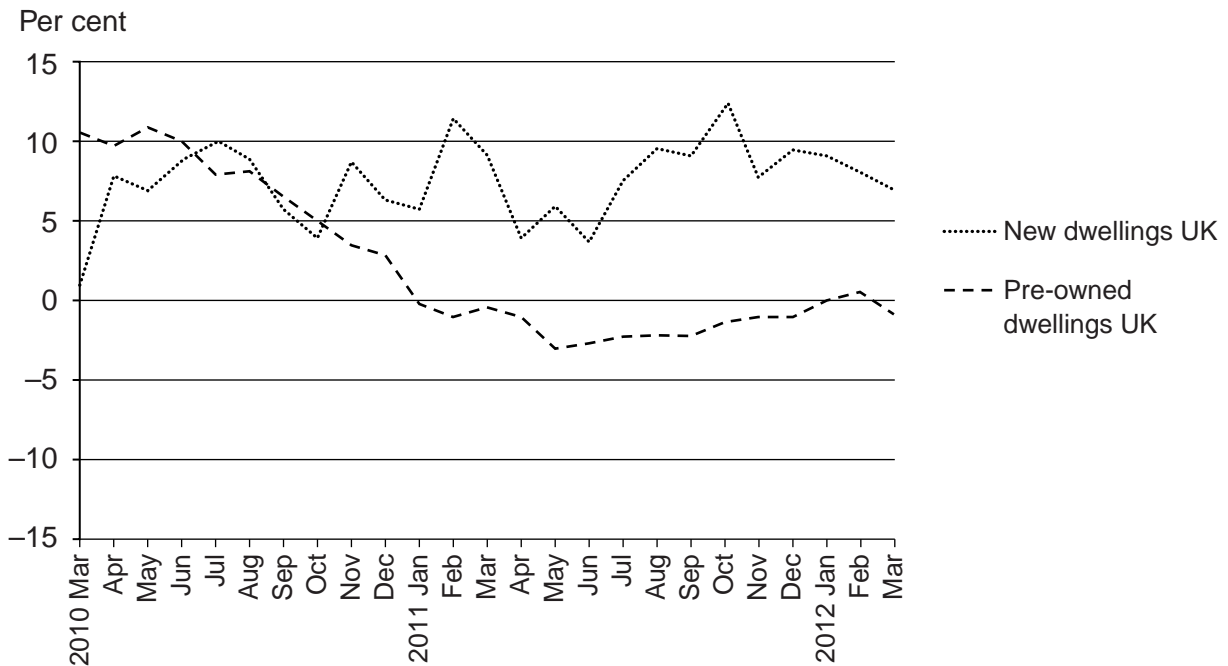

Source: ONS

What can be concluded from the graph?

A In the period after October 2010 new dwellings were more expensive than pre-owned dwellings.

B In the period up until May 2011 there was a steady fall in the prices of pre-owned dwellings.

C The prices of new dwellings continued to rise throughout the period.

D The average price of pre-owned dwellings was lower in March 2012 than two years earlier.

13 The curve in the diagram shows the minimum combinations of capital and labour that are technically capable of producing 100 units of output.
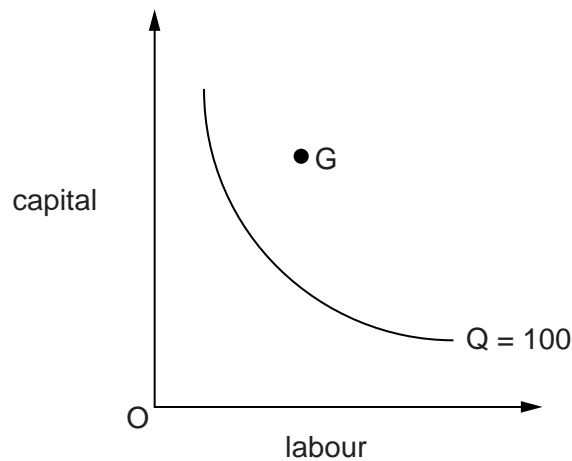
What might explain why the firm's management hires the combination of capital and labour indicated by point G to produce 100 units of output?

A   a shortage of skilled labour

B   a government subsidy to boost capital investment

C   an absence of competitive pressure

D   excess demand for the firm's product

14 What should make it easier for a small firm to survive?

A   a large minimum efficient scale

B   production of a differentiated product

C   the absence of effective barriers to the entry of potential competitors

D   the existence of increasing returns to scale

15 The table shows the current position of a firm in a perfectly competitive industry.

	Factor X	Factor Y
Marginal physical product	2	4
Factor price	£12.00	£20.00

If the market price is £4 what should the firm do to maximise its profit?

A   employ less of both X and Y

B   employ more of X and less of Y

C   employ more of Y and less of X

D   employ more of both X and Y

16 What represents an injection into an economy's circular flow of income?

    A   a government budget deficit

    B   a trade deficit

    C   an increase in companies' retained profits

    D   a reduction in household debt

17 In a closed economy with no government, the equilibrium level of income is £22 billion, the full employment level of income is £25 billion. To reach full employment would require an injection of £1 billion.

What can be deduced from this information?

    A   The marginal propensity to consume is ⅓.

    B   The marginal propensity to consume is ⅔.

    C   The value of the multiplier is ⅓.

    D   The value of the multiplier is 1½.

18 How is the pursuit of quantitative easing by a country's central bank likely to affect the price of government bonds and the country's foreign exchange rate?

	price of government bonds	exchange rate
A	increase	appreciate
B	increase	depreciate
C	decrease	appreciate
D	decrease	depreciate

19 What could explain why the terms of trade of most developing economies tend to worsen over time?

    A   Their currencies are over-valued in foreign exchange markets.

    B   They impose lower barriers on imports than developed economies.

    C   They produce a narrower range of goods than developed economies.

    D   They produce goods with a low income elasticity of demand.

20 Which combination of changes is most likely to result in a fall in a country's inflation rate?

	exchange rate	indirect taxes	growth of money supply
A	higher	higher	faster
B	higher	lower	slower
C	lower	higher	slower
D	lower	lower	faster

21 Which combination of circumstances is most likely to result in a **decline** in the number of small business start-ups?

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

22 Which policy will have the effect of reducing both unemployment and a current account surplus?

A a devaluation of the currency

B an increase in interest rates

C an increase in the fiscal deficit

D the removal of import quotas

23 What will be the impact of a depreciation of the £ sterling on the value of UK exports and imports measured in terms of the £ sterling?

	value of exports	value of imports
A	increase	decrease
B	increase	uncertain
C	decrease	decrease
D	decrease	uncertain

24 What is the principal aim of supply side policies?

  A   to eliminate the business cycle

  B   to increase the trend rate of growth

  C   to maintain price stability

  D   to reduce income inequality

25 An economy is initially in equilibrium at point E in the diagram.
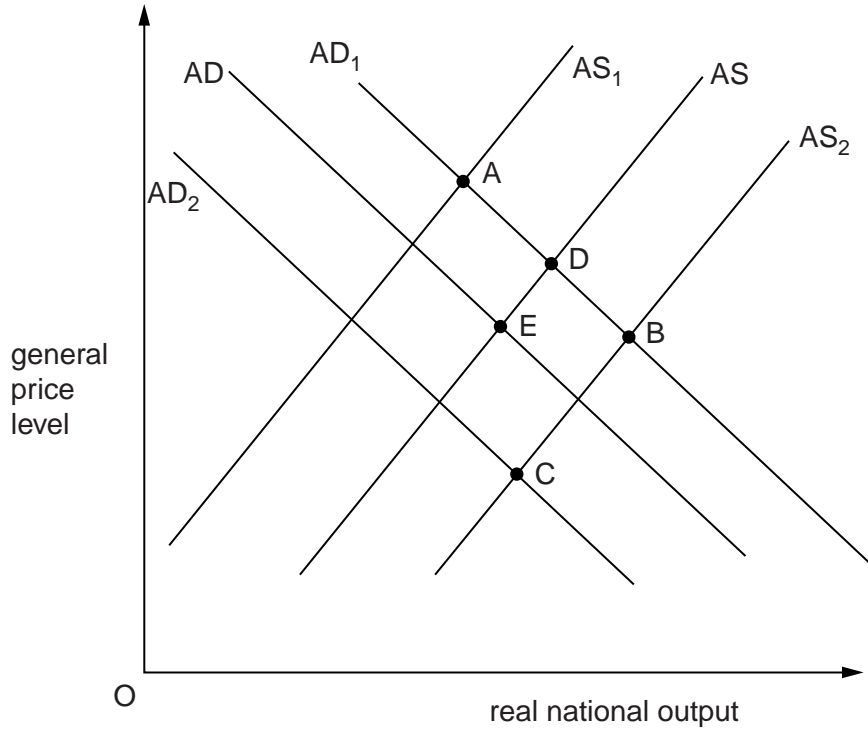
At present unemployed workers are eligible to receive unemployment benefits for a period of up to 12 months.

Which point could mark the new equilibrium position if this time period was extended to 18 months?

26 What is most likely to result from a depreciation in the foreign exchange value of the £ sterling?

  A   an increase in the number of UK residents taking holidays abroad

  B   an increase in the number of UK students applying for places in North American universities

  C   a decrease in the supply of foreign workers seeking temporary employment over the summer in the UK

  D   a decline in foreign direct investment in the UK by global manufacturing firms

27 Increased international competition leads to a worsening in a country's trade balance.

In the absence of any offsetting factors, how is this likely to affect domestic inflation and unemployment?

	inflation	unemployment
A	increase	increase
B	increase	decrease
C	decrease	increase
D	decrease	decrease

28 Cuba has attained health and education standards as high as those found in leading developed economies. Yet, in 2005, its Human Development Index (HDI) placed it 51st out of the 177 countries surveyed in that year.

What might explain its relatively low HDI score?

A It has a relatively high level of gender equality.

B It has a relatively large population.

C It has a relatively low gross national income per head.

D It has relatively few people with access to safe water.

29 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.

30 The diagram shows the relationship between different countries' Gini Coefficients and their income per head.
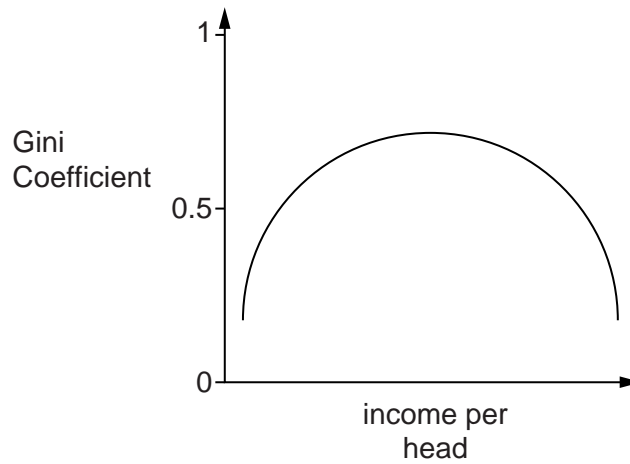
What is implied by the curve?

A Income distribution is more equal in rich countries than in poor countries.

B Income distribution is more unequal in rich countries than in poor countries.

C Economic growth is accompanied by increasing inequality in the early stages and to increasing equality in the later stages of economic development.

D Economic growth is accompanied by increasing equality in the early stages and to increasing inequality in the later stages of economic development.

Section B

Answer **all** questions.

1 **(a)** Define the term Gross Domestic Product. [2]

(b) **(i)** Identify the difference between Gross National Income (GNI) and Gross Domestic Product (GDP). [1]

(ii) Using an example, explain one factor that may cause a difference between these two figures. [2]

2 **(a)** Give the International Labour Organisation (ILO) definition of unemployment used in the Labour Force survey. [2]

In the three months to May 2012 labour market statistics for the UK economy were as follows:

Total number employed	29 000 000
Total number unemployed according to the Labour Force Survey Measure	2 500 000

(b) **(i)** Using the data above, calculate the ILO unemployment rate. [2]

(ii) State **one** reason why it may be preferred by economists as a measure of unemployment. [1]

3 **(a)** State **two** examples of expenditure switching policies, apart from exchange rate adjustment, that governments can use to correct a current account deficit. [2]

(b) Explain why a depreciation might not correct a current account deficit in the short term, but might correct it in the long term. [3]

4 **(a)** The table shows the quantities of Good X and Good Y that can be produced given the same factor inputs in two countries. Identify and explain which country has a comparative advantage in the production of Good X.

	Good X (units)	Good Y (units)
Country A	100	100
Country B	200	800

[3]

(b) State **two** reasons why this country might not, in practice, be able to benefit fully from its comparative advantage. [2]

[Total: 20]

Section C

Answer **all** questions.

Question 5

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

Extract 1: A Brief History of Transition Economies

In the twenty-five years that have passed since the fall of the Berlin Wall, it has seemed obvious that the free market is the most efficient way of allocating resources. However, it hasn't always seemed so obvious that allocating resources via the price mechanism would prove to be the best approach. Some economists argued that, under certain circumstances, central planning would inevitably prove to be more efficient than the free market. Most would agree with this in the case   5
of pure public goods, for example, but in the majority of cases it seems self-evident that market-based solutions are best.

The experience of the so-called 'transition economies' of Central and Eastern Europe was not straightforward, however. The immediate aftermath of the process of rapid economic reform, sometimes called 'shock therapy', saw dramatic collapses in GDP, runaway inflation, mass   10
unemployment and Balance of Payments crises.

Yet over time most of these economies, especially those with limited experience of the free market, such as Poland and Hungary, have recovered. Gone are the days of the state fixing prices and wages, and determining output targets for individual firms.

Consequently shortages of consumer goods have been eradicated and situations which, in   15
the former Soviet Union, saw the price of black bread being kept beneath that of its principal ingredient, corn, no longer exist. The triumph of the market has been such that almost all these economies are now based on free market principles and the remaining few that aren't, are moving in that direction.

Table 1: Theoretical Advantages and Disadvantages of Centrally Planned Economies

Advantages of Centrally Planned Economies	Disadvantages of Centrally Planned Economies
The state makes decisions based on overall economic welfare.	The opportunity cost of the bureaucracy required to administer the economy.
Central planning ensures a more equitable distribution of income.	The absence of the price mechanism making it impossible to value goods because prices don't reflect relative scarcity.
The state can take into account the social costs and benefits of economic activities.	The lack of incentives for workers and firms to be efficient.
The state is better placed to provide public goods.	The absence of consumer sovereignty.

The experience of Cuba   *20*

The movement towards the free market in Cuba is referred to as 'updating' rather than 'reform', but it is clear that the government of President Raul Castro has changed the emphasis of economic policy. The state no longer feels compelled to direct markets and attitudes that hinder private initiative are changing. Perhaps the dramatic growth of self-employment is the most obvious example of the economic reforms of the Cuban government.   *25*

Table 2: The Number of Entrepreneurs in Cuba, 2001–2012

Year	Entrepreneurs	Total Workforce
2001	152 300	4 700 000
2007	138 880	4 960 000
2012	388 360	5 110 000

Raul Castro has been blunt in his assessment of Cuba's economic weaknesses highlighting overly generous state benefits, an oversized state role in economic activity and a need 'to erase forever the notion that Cuba is the only nation in the world where one can live without working'. Consequently, he has resolved to reduce by 500 000 the number of state sector employees by 2015, accepting that the state must close down unprofitable businesses and allow a larger private *30* sector. Vice President Esteban Lazo predicted in April 2012 that the private sector's share of gross domestic product would grow from 5% to 45% within 5 years. However, many speculate that this will merely reclassify the shadow economy within official statistics.

In allowing entrepreneurs to hire workers, the government is moving away from its position as the nation's dominant employer. Citizens accustomed to lifelong state employment, heavily subsidised *35* foodstuffs, free public services and an absence of choice are having to adapt, albeit slowly.

An example of the relaxation of state control is the raising of the maximum size of private restaurants from 12 to 50 seats. However, the legal distribution network to support these establishments is limited: ingredients are meant to come from state-owned retailers. Nevertheless, successful Cuban restaurant owners often source their products from the shadow economy. The prices they can now *40* charge mean they are able to pay two or three times the average public sector wage to recruit staff. As a result, some teachers, accountants and doctors are now working as waiters in Havana.

In the long term, it seems that Castro is keen to promote increased output and productivity, therefore raising average incomes in order that there are fewer incentives for Cubans to emigrate.

(a) What is meant by the term 'transition economies' (Extract 1 line 8)? [2]

(b) Using Table 2, calculate the increase in the number of entrepreneurs in the Cuban economy as a proportion of the workforce between 2007 and 2012. Briefly comment on the implications of this for the productivity of the Cuban economy. [3]

(c) Extract 1 states that 'Gone are the days of the state fixing prices…' (line 13). Using a supply and demand diagram, explain the likely effects of removing a price ceiling and allowing the market to determine the price of a good. [5]

(d) Using the information provided and your own knowledge, evaluate which of the disadvantages of centrally planned economies highlighted in Table 1, in your view, is the most significant. [10]

(e) 'Teachers, accountants and doctors are now working as waiters in Havana' (line 42). With reference to the Extracts and your own knowledge, evaluate the effects on the labour market of movement towards a free market in Cuba. [10]

[Total: 30]

BLANK PAGE

BLANK PAGE

20

BLANK PAGE