

CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

ECONOMICS

PAPER 3 Multiple Choice (Extension)

9708/3

MAY/JUNE SESSION 2002

1 hour

Additional materials:

Multiple choice answer sheet

Soft clean eraser

Soft pencil (type B or HB is recommended)

TIME 1 hour

INSTRUCTIONS TO CANDIDATES

Do not open this booklet until you are told to do so.

Write your name, Centre number and candidate number on the answer sheet in the spaces provided unless this has already been done for you.

There are **thirty** questions in this paper. 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 in **soft pencil** on the separate answer sheet.

Read very carefully the instructions on the answer sheet.

INFORMATION FOR CANDIDATES

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

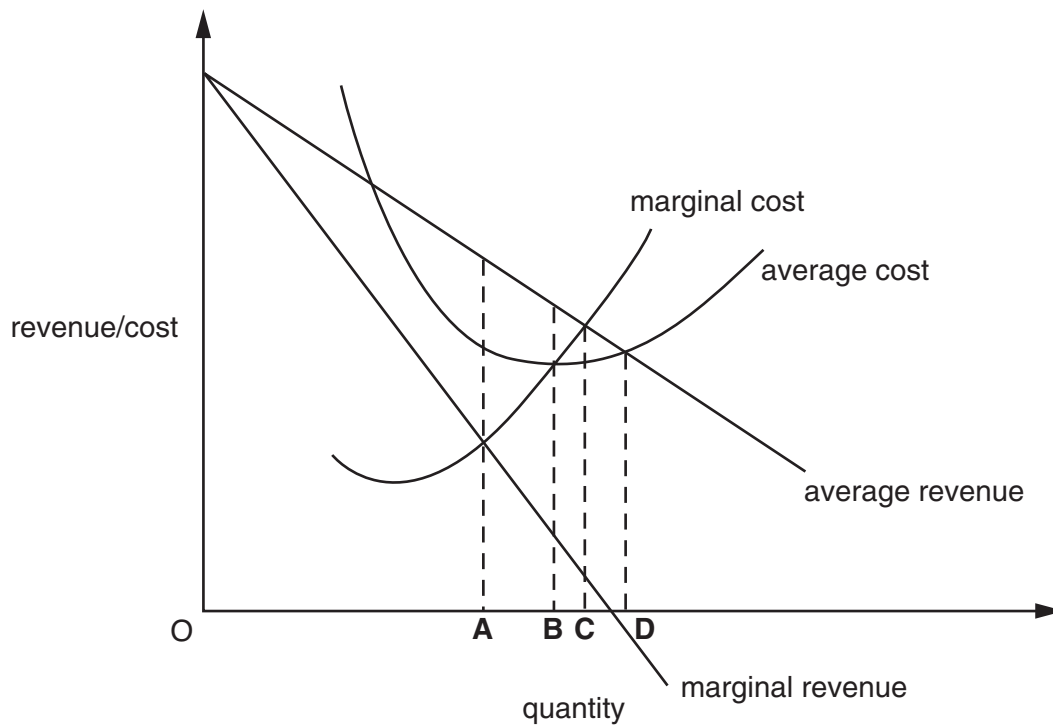
Any rough working should be done in this booklet.

This question paper consists of 12 printed pages.



- 1 Which condition defines productive efficiency?
- A All factors of production are fully employed.
 - B All firms are producing at their profit maximising levels of output.
 - C The output of all goods is produced at minimum cost.
 - D There are no further opportunities for substituting capital for labour.
- 2 The diagram shows a firm's cost and revenue curves.

At which level of output will the firm be making only normal profit?



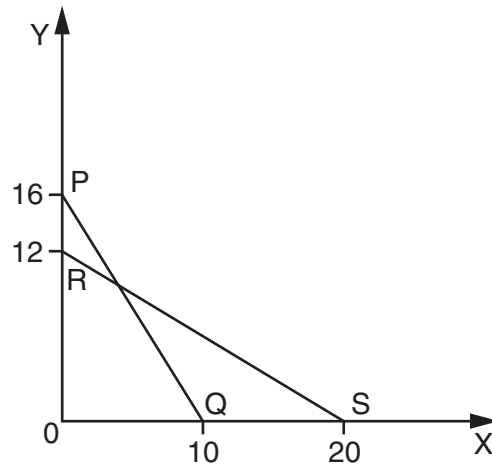
- 3 The table shows the marginal utility derived by a consumer who devotes the whole of his weekly income of \$32 to two goods X and Y, whose unit prices are \$2 and \$4 respectively.

unit	marginal utility of X (units)	marginal utility of Y (units)
1	9	28
2	8	26
3	7	24
4	6	22
5	5	20
6	4	18
7	3	16
8	2	14

In order to maximise his utility, which quantities of X and Y should the consumer purchase?

	X	Y
A	2	7
B	4	6
C	6	4
D	8	3

- 4 The diagram shows a consumer's budget line PQ when the consumer's income was \$20 per day and the prices of X and Y were \$2 and \$1.25 respectively.



The consumer's income increases to \$30 and, at the same time, the prices of X and Y change.

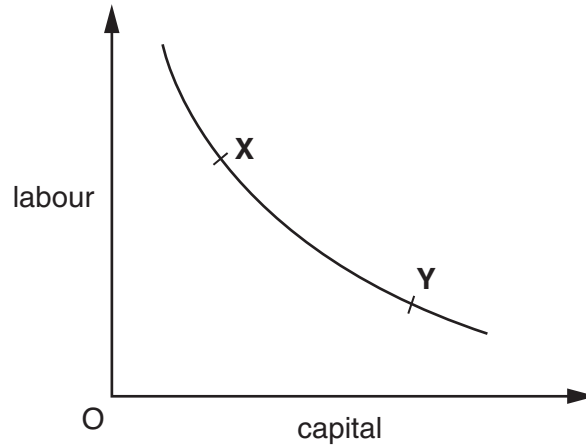
If the consumer's budget line is now RS, what are the new prices of X and Y?

	X	Y
A	\$1.50	\$2.50
B	\$1.80	\$1.00
C	\$2.50	\$1.50
D	\$3.00	\$2.50

- 5 In the diagram, the curve shows the various combinations of labour and capital that can be employed to produce a given volume of output.

A firm initially chooses the combination of labour and capital shown by point X on the curve.

In a subsequent period the firm chooses the combination of labour and capital shown by point Y.



What could explain this change?

- A a decrease in capital productivity
 - B an increase in labour productivity
 - C an increase in the cost of labour
 - D an increase in the cost of capital
- 6 What could cause a perfectly competitive firm's marginal revenue product of labour curve to shift to the right?
- A an increase in wages
 - B a higher rate of sales tax
 - C an increase in labour supply
 - D a rise in the price of the final product
- 7 The workers in a firm have not previously belonged to a trade union but now join one.
- In which circumstance is this most likely to raise their wages?
- A Capital is highly substitutable for labour.
 - B Labour costs constitute a large fraction of the firm's costs.
 - C The demand for the firm's product is price-elastic.
 - D The firm has enjoyed monopsony power in the market for its labour.

- 8 Which of the following is an assumption underlying the kinked demand curve in oligopoly?
- A A firm will increase its price in response to a price increase by a rival.
 - B A firm will not match a price cut by a rival.
 - C Consumers are less sensitive to price increases than price decreases.
 - D Rivals are expected to match any reduction in price.
- 9 What is the essential feature of a contestable market?
- A ease of entry and exit
 - B interdependence between firms
 - C large number of buyers and sellers
 - D product homogeneity
- 10 A firm earns supernormal profit when its profit is above that
- A earned by competing firms.
 - B needed to cover its fixed costs.
 - C needed to keep the firm in production in the short run.
 - D required to keep its resources in their present use.
- 11 A firm is producing at the level of output at which its average variable cost is equal to its marginal cost.

What will happen initially to its average variable cost and to its average total cost if it increases its output?

- | | <i>average
variable
cost</i> | <i>average
total
cost</i> |
|---|--------------------------------------|-----------------------------------|
| A | decreases | decreases |
| B | decreases | increases |
| C | increases | decreases |
| D | increases | increases |

- 12 The table below shows the relationship between total output and total costs of a firm given constant factor prices and fixed factor proportions.

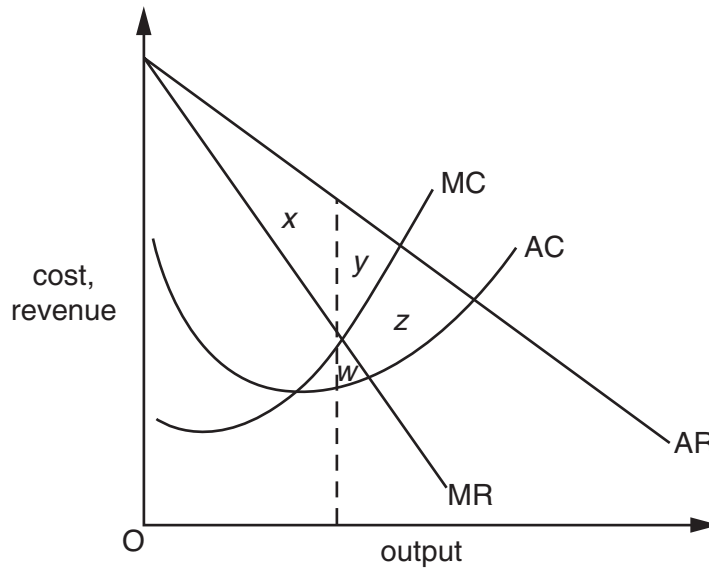
<i>output</i>	<i>costs (\$)</i>
100	80
200	180
300	300
400	440
500	600

It follows that, over this range of output, the firm experiences

- A decreasing returns for output between 100 and 300 and increasing returns for output larger than 300.
 - B increasing returns for output between 100 and 300 and decreasing returns for output larger than 300.
 - C decreasing returns throughout.
 - D increasing returns throughout.
- 13 Which of the following characteristics is most likely to be present when collusion occurs between firms in an industry?
- A low barriers to entry
 - B a large number of firms
 - C the absence of significant economies of scale
 - D product homogeneity
- 14 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.

15 The diagram shows the cost and revenue curves of a profit-maximising monopolist.

Which area measures the deadweight loss arising from the exercise of monopoly power?



- A $x + y$
- B y
- C $y + z$
- D $w + y + z$

16 Which of the following elements of a tax and benefits system is regressive?

- A the taxation of capital gains
- B the payment of child benefits to families
- C specific taxes on beer and tobacco
- D rent subsidies to tenants of publicly owned housing

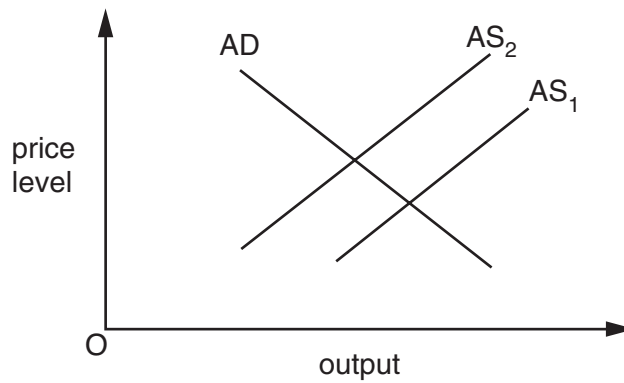
17 Over a given period, the nominal value of a country's national income increased by 20% and the rate of inflation was 10%.

Which of the following statements is correct?

- A There was an increase in the volume of output.
- B There was an increase in the income velocity of circulation.
- C There was a reduction in the demand for money.
- D The country's money supply increased by 10%.

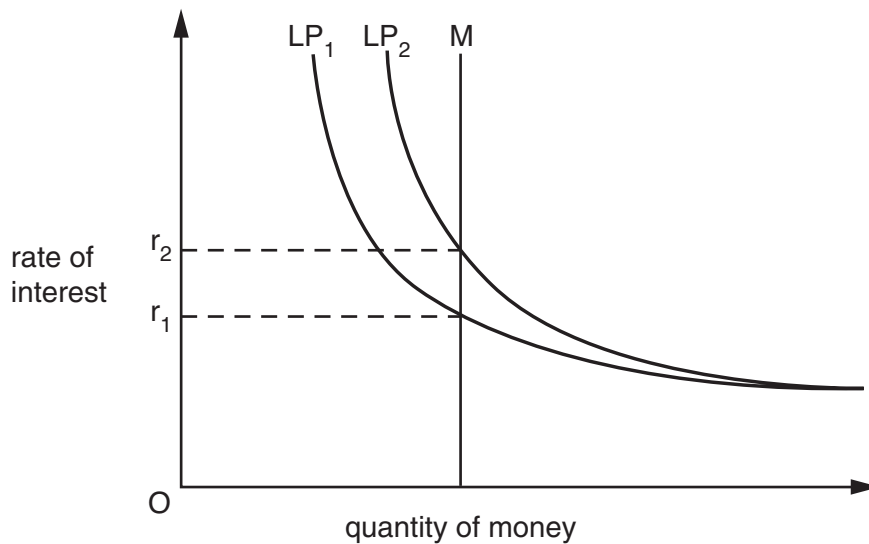
- 18 In which circumstance will an increase in the public sector deficit **not** lead to an increase in the money supply, other things being equal?
- A The deficit is financed by an increase in government borrowing from private individuals.
 - B The rate of interest is held constant.
 - C There is large-scale unemployment.
 - D Commercial bank lending to the private sector is held constant.
- 19 Why might GNP per capita of different countries, measured in US\$, be a poor indicator of their comparative standards of living?
- A Their exchange rates are different from purchasing power parities.
 - B Their population growth rates are different.
 - C Their rates of inflation are different.
 - D Their ratios of imports to national income are different.
- 20 Which of the following is **not** a leakage from the circular flow of income?
- A corporation tax
 - B expenditure on foreign goods
 - C personal saving
 - D retirement pensions
- 21 The marginal propensity to consume in a country is 0.9 and the average propensity is 0.8.
- What is the value of the multiplier?
- A 1.1 B 1.25 C 5 D 10
- 22 An aggregate demand curve slopes downwards from left to right. One reason for this is that a reduction in the average price level will lead to
- A a reduction in the real value of money balances.
 - B a reduction in interest rates.
 - C a decline in the country's international competitiveness.
 - D the expectation of further price falls.

- 23 The diagram shows the aggregate demand and aggregate supply curves for an economy.



What could cause the aggregate supply to shift from AS_1 to AS_2 ?

- A an increase in the balance of payments deficit
 - B an increase in the price level
 - C an increase in raw material costs
 - D an increase in labour market flexibility
- 24 The diagram shows the determination of the rate of interest in the economy where M represents the money supply and LP represents liquidity preference.



What could cause the rise in the rate of interest from r_1 to r_2 ?

- A an increase in national income
- B an increase in the money supply
- C a reduction in investment expenditure
- D a reduction in the loans made by the private sector

25 Which of the following combinations is usually found in less developed economies?

	low	high
A	capital:output ratio	saving ratio
B	external debt	capital:output ratio
C	population growth	external debt
D	saving ratio	population growth

26 An economy is operating initially at its natural rate of unemployment.

According to monetarist theory, compared to the initial position, what will be the effect on unemployment in the short run and in the long run of an unanticipated increase in the money supply?

	short run	long run
A	no change	no change
B	no change	reduction
C	reduction	no change
D	reduction	reduction

27 What is likely to increase a country's actual output but may reduce its long-run rate of growth of potential output?

- A** an increase in the size of the labour force
- B** increased government spending on education
- C** an increase in the size of the government's budget deficit
- D** increased female participation in the labour force

- 28** A country has a floating exchange rate, full employment and an expansionary fiscal policy. The government decides to make the central bank independent with the power to determine monetary policy.

If the central bank adopts a zero inflation target, what is likely to happen to interest rates and the exchange rate?

	interest rates	exchange rate
A	fall	fall
B	fall	rise
C	rise	fall
D	rise	rise

- 29** Which measure could be expected to reduce the pressure of demand-pull inflation in an open economy?
- A** a depreciation of the foreign exchange rate
 - B** a reduction in interest rates
 - C** a reduction in the rate of tax on goods and services
 - D** a removal of import controls
- 30** What is most likely to increase as a result of a rise in interest rates in a country?
- A** the level of house prices
 - B** the inflow of short-term foreign capital
 - C** the level of private investment
 - D** the return on capital investment