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SECTION A

Answer ALL questions in this section.

**Write the letter of your chosen answer in the box and then
explain your choice in the space provided.**

You are advised to spend 30 minutes on this section.

You are encouraged to use a diagram in your explanation where appropriate.

1. Which of the following statements, referring to the price mechanism in a free market economy, is true?
- A The price mechanism rations out scarce goods in accordance with consumer wants.
 - B Falling prices will encourage resources to enter a market.
 - C The price mechanism acts as a signalling device to indicate changes in consumer demand or producer supply.
 - D Excess demand for a good can be eliminated by allowing its price to decrease.

(a) Answer

(1)

(b) Explanation

(4)

(Total 5 marks)

Q1



2. A country has two economic sectors, agriculture and manufacturing.

Agricultural goods Output (million units)	Manufactured goods Output (million units)
0	90
10	88
20	84
30	78
40	70
50	60
60	48
70	34
80	18
90	0

The production possibility frontier for agricultural and manufactured goods is shown in the table. From the table it can be deduced that

- A there is a constant opportunity cost in forgoing manufactured goods to produce more agricultural goods.
- B the opportunity cost of producing agricultural goods increases, the greater the output of agricultural goods.
- C the opportunity cost of producing manufactured goods decreases, the greater the output of manufactured goods.
- D the higher the level of agricultural production, the lower will be the opportunity cost of a further increase in agricultural output.

(a) Answer (1)

(b) Explanation

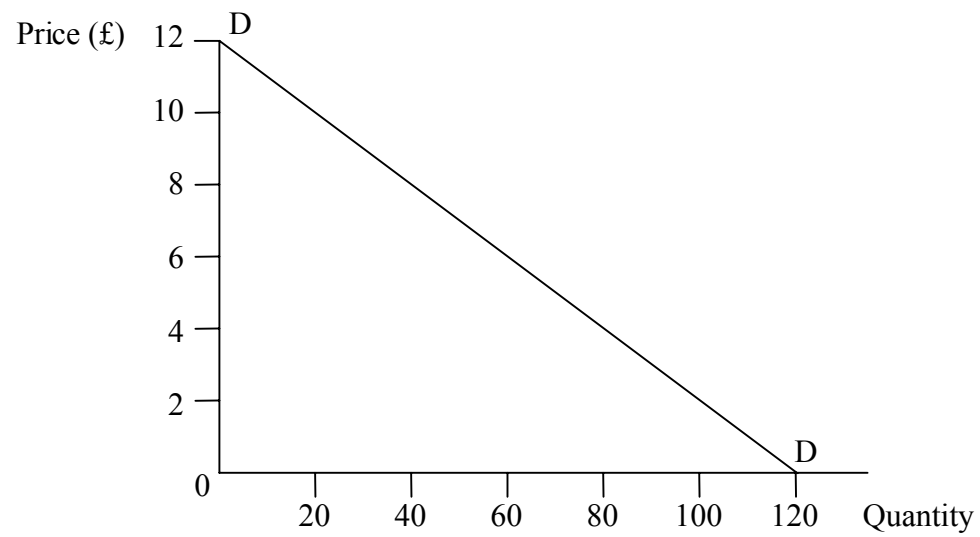
(4)
(Total 5 marks)

Q2



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3.



The diagram shows the demand curve for a good. The demand for this good

- A is unit price elastic along the whole length of the demand curve.
- B changes from being price inelastic to price elastic as price falls from top left to bottom right along the demand curve.
- C is price inelastic along the whole length of the demand curve.
- D varies in price elasticity over the whole length of the demand curve.

(a) Answer

(1)

(b) Explanation

(4)

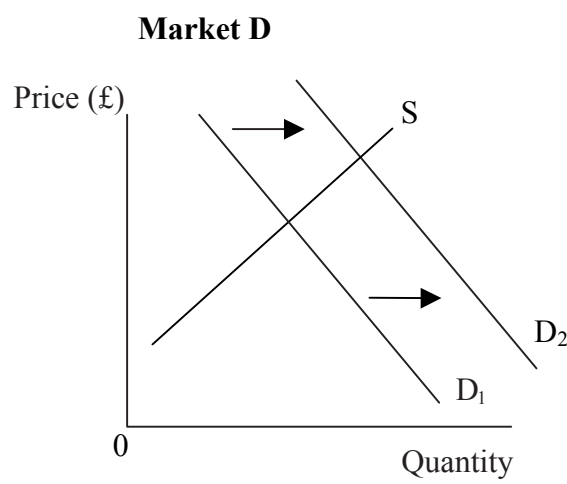
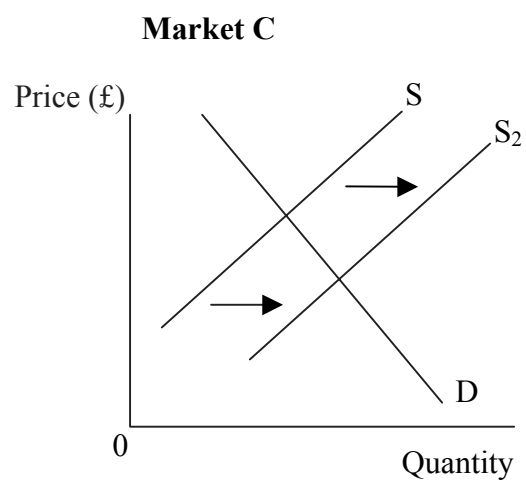
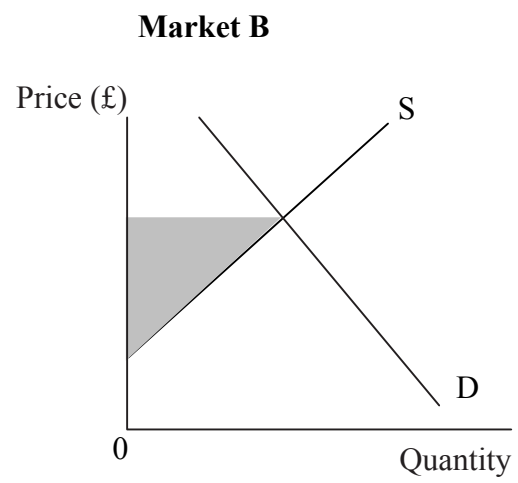
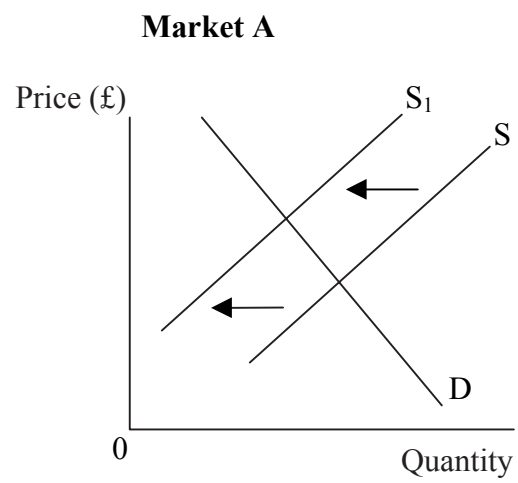
Q3

(Total 5 marks)



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4.



Which of the markets, labelled **A**, **B**, **C** and **D**, illustrates the effects of a subsidy paid to the producers of a good?

(a) Answer

(1)

(b) Explanation

(4)

(Total 5 marks)

Q4

5

Turn over



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5. Which of the following pairs of goods is likely to have a positive cross price elasticity of demand between them?

- A Tea and coffee
- B Leather and beef
- C CD players and CDs
- D Bus travel and potatoes

(a) Answer

(1)

(b) Explanation

(4)

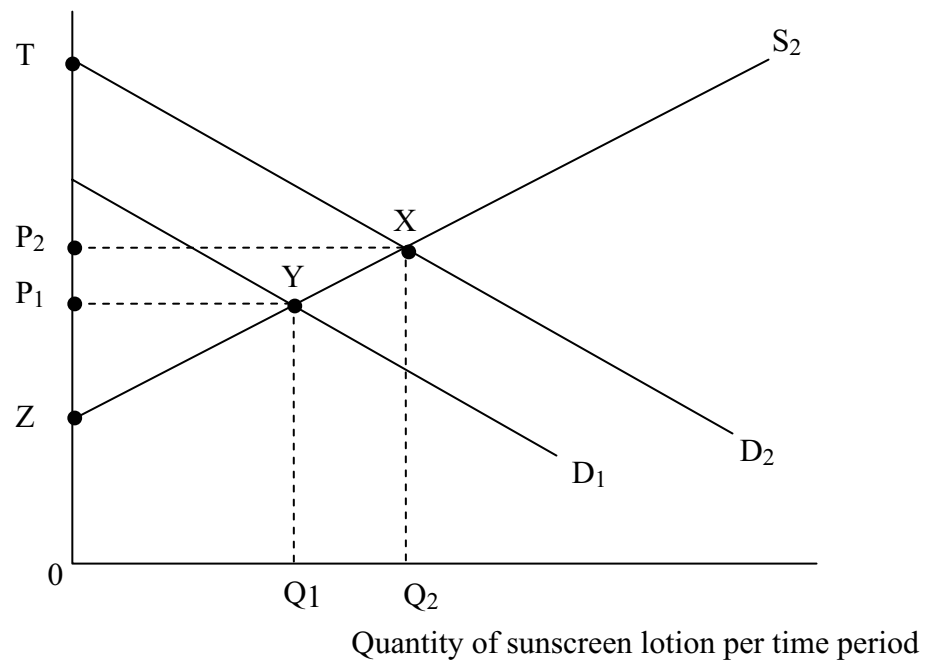
(Total 5 marks)

Q5



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6. Price of sunscreen lotion



The diagram shows the market for sunscreen lotion. In the summer demand is represented by D_2 and supply by S_2 , with the equilibrium price at OP_2 . In the winter demand decreases to D_1 , lowering price to OP_1 and causing a decrease in the producer surplus equal to the area:

- A P_2XZ
- B OP_1YQ_1
- C P_1P_2XY
- D P_2XT

(a) Answer (1)

(b) Explanation

(4)

(Total 5 marks)

Q6



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7. An individual with a monthly income of £2000 regularly visits the cinema four times a month. His monthly income then falls to £1000 and he reduces the number of visits to the cinema to three times per month. The best estimate for income elasticity of demand is:

A 0.5

B -0.33

C 2.0

D -0.5

(a) Answer

(1)

(b) Explanation

(4)

(Total 5 marks)

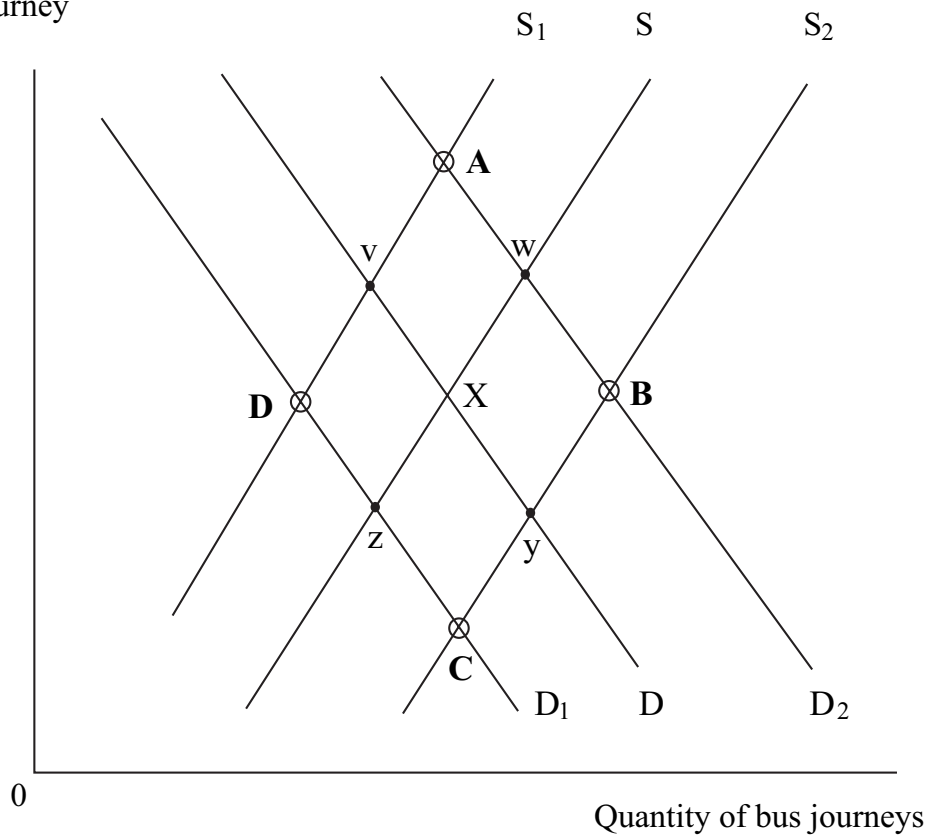
Q7



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8. The Market for Bus Transport in Harchester

Price per bus journey



The diagram shows the supply and demand for bus travel in Harchester. In this town, bus travel is an inferior good. Real incomes increase and, at the same time, there is a significant increase in fuel costs for operating buses. If the initial equilibrium position is indicated by point X, what will be the new equilibrium position, A, B, C or D?

(a) Answer (1)

(b) Explanation

(4)

Q8

(Total 5 marks)

TOTAL FOR SECTION A: 40 MARKS



SECTION B

Answer EITHER Question 9 OR Question 10.

Indicate which question you are answering by marking the box (☒). If you change your mind, put a line through the box (☒) and then indicate your new question with a cross (☒).

You are advised to spend 30 minutes on this section.

If you answer Question 9 put a cross in this box ☒.

Question 9

The Price of Tin

The price of tin has more than doubled to \$7,820 a tonne since February 2002 as speculators rushed into purchasing the metal. The metal was once written off because of the competition from plastic and aluminium in the packaging industry.

5 Tighter environmental laws in Japan and Europe have been favourable to tin. These laws have eliminated the use of lead solder in electronics replacing it with tin soldering. The tin price has also been driven by strong demand from China, a factor that underpins the current world metal price boom, and by export restrictions on the metal by Indonesia, the world's second biggest tin producer.

10 Ingrid Sternby, a metal analyst at Barclays Capital, said that the Indonesian government's restriction on tin exports, a measure brought in to reduce smuggling, has created a market where demand persistently exceeds supply. 'The market is likely to remain in deficit until at least 2006,' she said. This is bad news for the major consumers of tin – the canning, construction and electronics industries.

Source: adapted from Kevin Morrison, 20 March 2004, *Financial Times*.

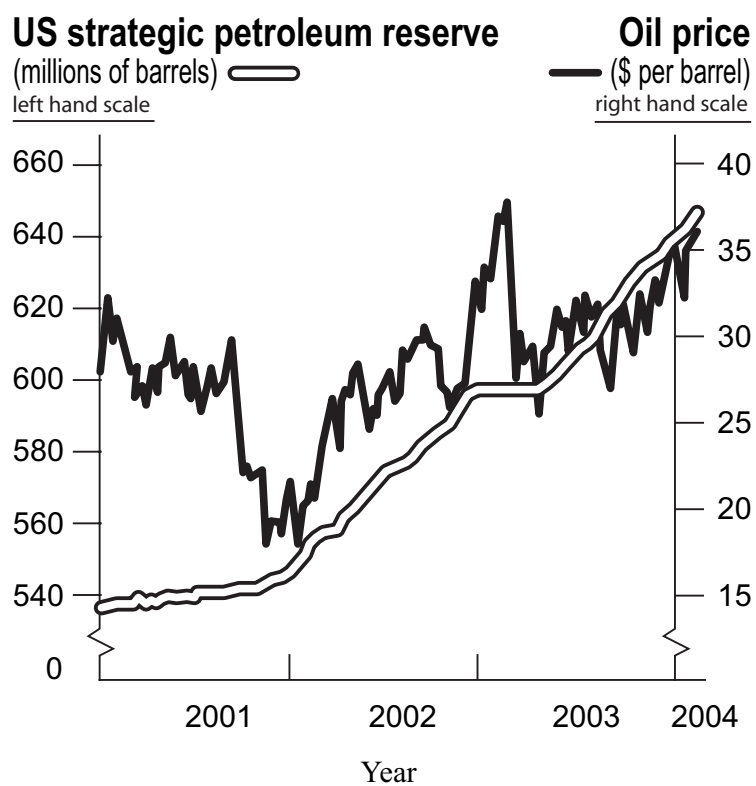


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If you answer Question 10 put a cross in this box .

Question 10 **The Price of Oil**

Figure 1



The Saudi Arabian government has insisted that Opec (Organisation of Petroleum Exporting Countries) cut oil output by 1 million barrels per day, despite its current high price. Ali Naimi, Saudi Arabia's energy minister and Opec's most important member, believes there is a danger of an excess supply in the oil market and that a serious price drop may occur in the coming months.

His fears are based on two factors: first, the build-up of strategic petroleum oil reserves in the USA, the world's largest consumer of the commodity; second, the beginning of spring in the northern hemisphere and the start of a seasonal drop in demand by major American and European consumers.

10 However, in the meantime, oil prices remain high. This has led to complaints from the US airline and road haulage industries, prompting the American government to halt its programme of purchases for the strategic petroleum oil reserve.

Source: adapted from C Hoyos & J Blas, 30 March 2004, *Financial Times*, and K Morrison, 15 March 2004, *Financial Times*.



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(b) (i) With reference to Figure 1, explain the relationship between the United States' strategic petroleum oil reserves and the price of oil.

(3)

(ii) To what extent might the build-up of strategic petroleum oil reserves in the United States undermine the effectiveness of Opec in fixing high oil prices?

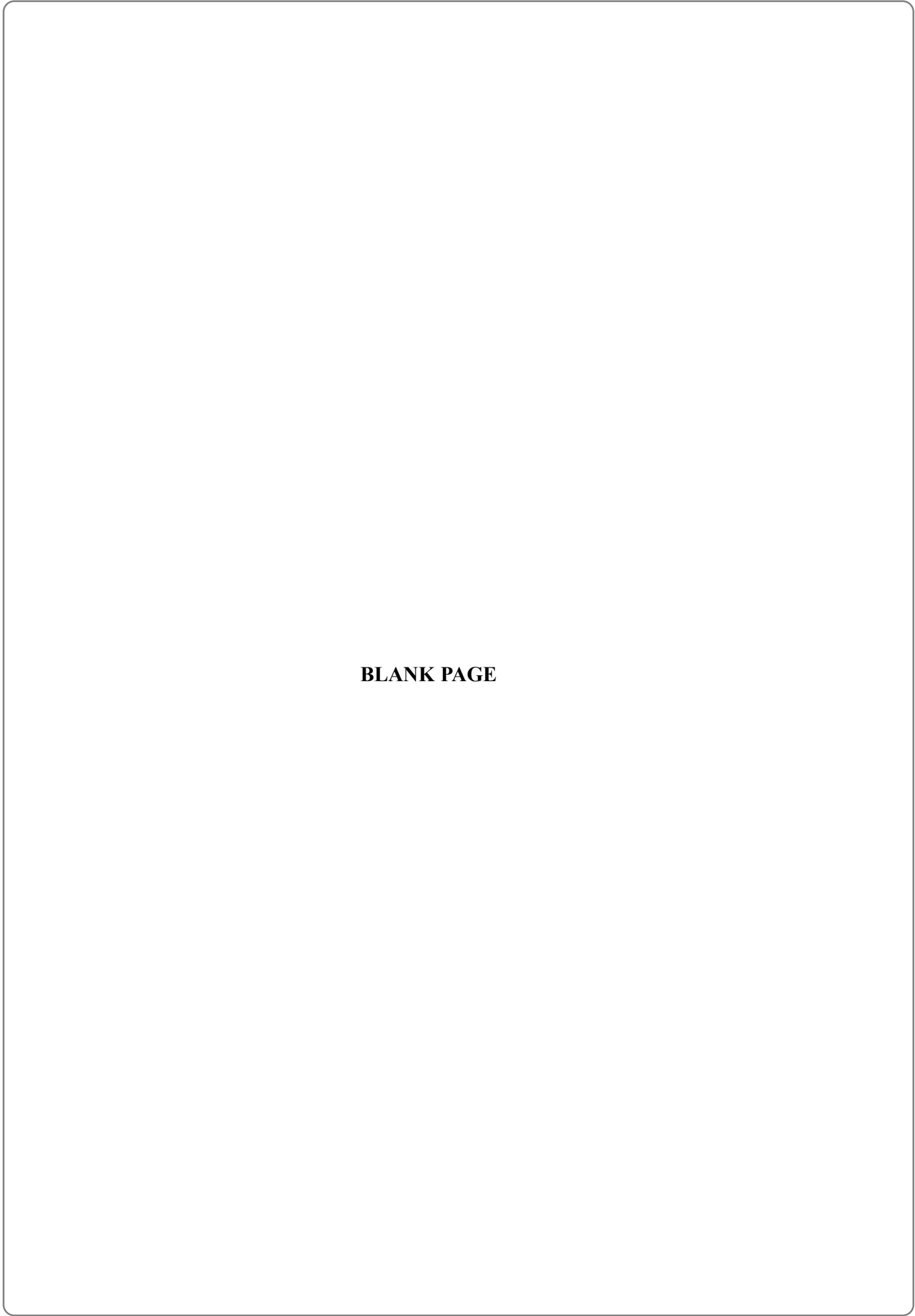
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