



**ECONOMICS (PRINCIPAL)**

**9772/01**

Paper 1 Multiple Choice, Short Answers and Data Response

**May/June 2016**

**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 Insert.

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.

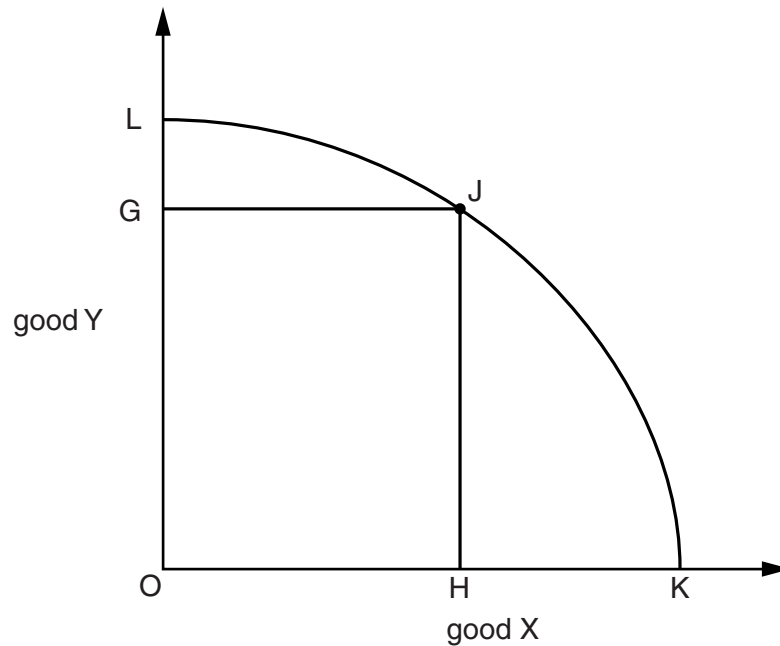
The syllabus is approved for use in England, Wales and Northern Ireland as a Cambridge International Level 3 Pre-U Certificate.

This document consists of **19** printed pages, **1** blank page 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.

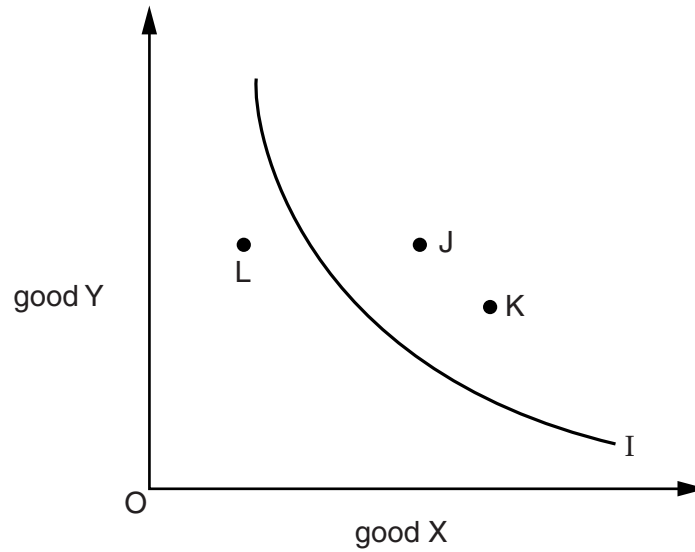
- 1 In the diagram, an economy produces the combination of goods X and Y indicated by point J on its production possibility frontier.



What is the opportunity cost to the economy of producing quantity OH of good X?

- A quantity HK of good X
- B quantity OG of good Y
- C quantity LG of good Y
- D quantity OL of good Y

2 The diagram shows an individual's indifference curve.

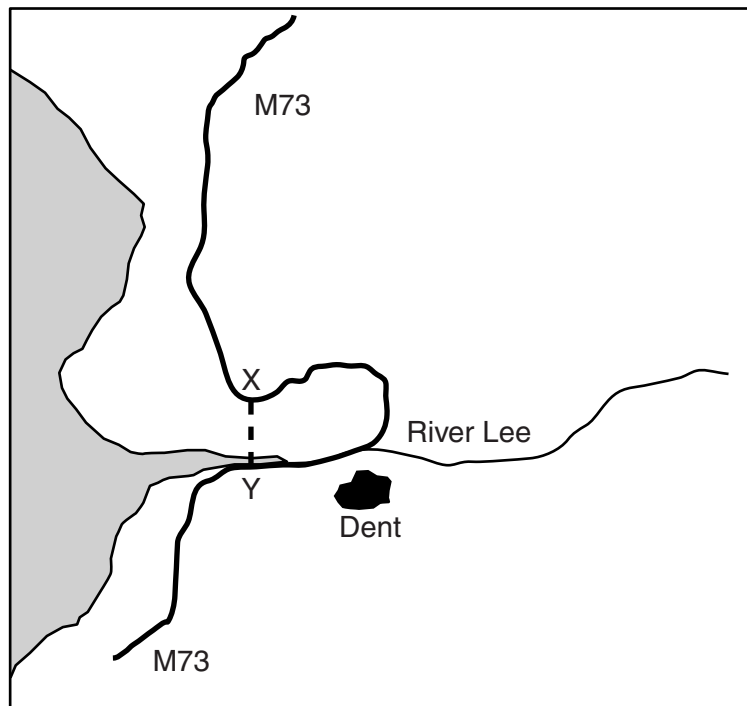


What can be deduced from the diagram?

- A** The combinations of X and Y indicated by points J and K are not attainable.
- B** The individual is indifferent between the combinations of X and Y indicated by points J and K.
- C** The amount of Y the individual would be willing to give up to obtain an additional unit of X is the same at points J and L.
- D** The individual prefers the combination of X and Y indicated by point K to the combination indicated by point L.

- 3 Some of the motorists who use the M73 motorway make use of the toll bridge which links points X and Y on the map.

Others avoid the toll charge by crossing the River Lee further up the river near the town of Dent.



All else remaining unchanged, what will be the effect of an increase in petrol duty on the number of motorists who use the toll bridge and on the number who make the round journey via Dent?

|          | number who use the toll bridge | number who travel via Dent |
|----------|--------------------------------|----------------------------|
| <b>A</b> | increase                       | decrease                   |
| <b>B</b> | increase                       | uncertain                  |
| <b>C</b> | uncertain                      | decrease                   |
| <b>D</b> | uncertain                      | uncertain                  |

- 4 A consumer spends the whole of his income on just two goods, X and Y.

His demand for good X is price-elastic.

All else remaining unchanged, what will be the effect of an increase in the price of X on his expenditure on good X and on the quantity he purchases of good Y?

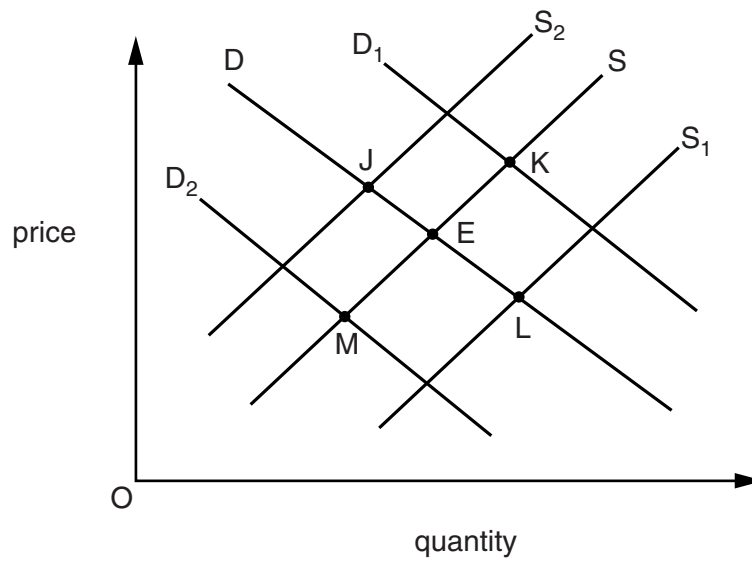
|          | expenditure on good X | quantity purchased of good Y |
|----------|-----------------------|------------------------------|
| <b>A</b> | increase              | increase                     |
| <b>B</b> | increase              | decrease                     |
| <b>C</b> | decrease              | decrease                     |
| <b>D</b> | decrease              | increase                     |

- 5 A government sets a maximum price for a good below its equilibrium market price.

What will be the net effect on the economic welfare of the consumers and producers of the good?

|          | net effect on consumers | net effect on producers |
|----------|-------------------------|-------------------------|
| <b>A</b> | gain                    | lose                    |
| <b>B</b> | gain                    | uncertain               |
| <b>C</b> | uncertain               | lose                    |
| <b>D</b> | uncertain               | uncertain               |

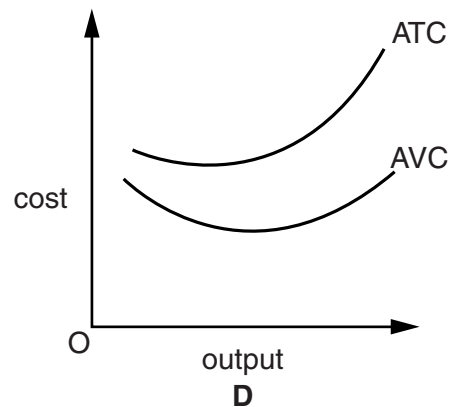
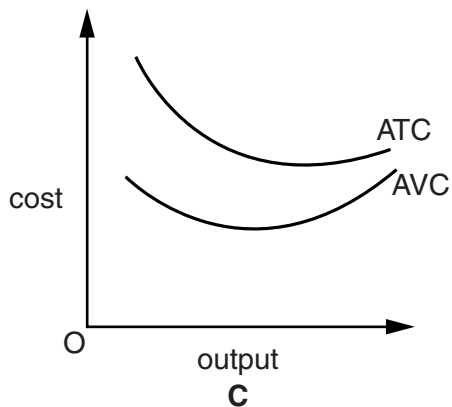
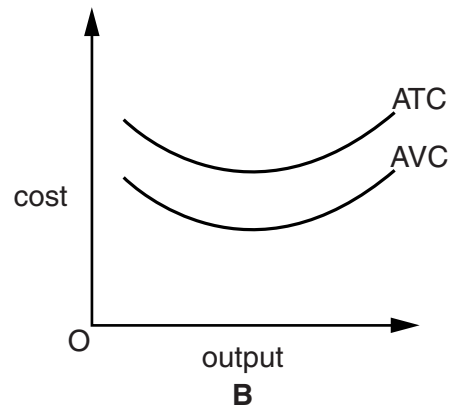
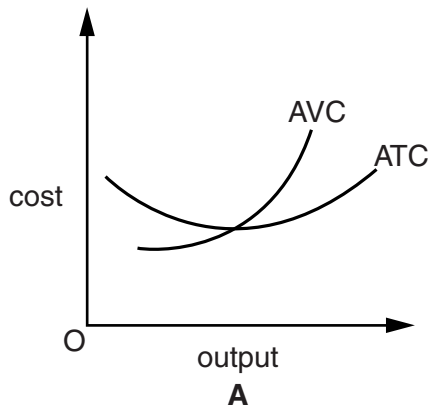
- 6 The market for good X is initially in equilibrium at point E in the diagram.



Which point could be the new equilibrium following a decrease in the price of a complementary good?

- A J
- B K
- C L
- D M

- 7 Which diagram shows the correct relationship between a firm's average total cost and its average variable cost curves?



- 8 Firms X, Y and Z are all profit-maximising firms.

X operates in a perfectly competitive industry.  
 Y operates in a monopolistically competitive industry.  
 Z is a monopolist.

Which statement about these firms is correct?

- A Only X can be productively efficient.
- B X and Y are both allocatively efficient.
- C Y and Z are both price takers.
- D Only Z will be able to make super-normal profits in the long run.

- 9 Jones is informed by the publishers of 'The World Economy' that her annual subscription is due and that £50 will be taken automatically from her bank account by direct debit on 1st December.

At the same time, a newspaper advertisement appears stating that the magazine is available to new subscribers for £40.

What are the publishers seeking to achieve?

- A to charge a price that equates to marginal cost
  - B to deter entry by potential competitors
  - C to maximise the number of subscribers
  - D to take advantage of price discrimination
- 10 In a country where labour markets are perfectly competitive, the government reduces the rate of income tax paid by female workers. What effect will this have on the wages before tax paid by employers to both male and female workers?

|          | wage of male workers | wage of female workers |
|----------|----------------------|------------------------|
| <b>A</b> | increase             | increase               |
| <b>B</b> | reduce               | reduce                 |
| <b>C</b> | increase             | reduce                 |
| <b>D</b> | reduce               | increase               |



- 11 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.

**Profit-Payoff Matrix**

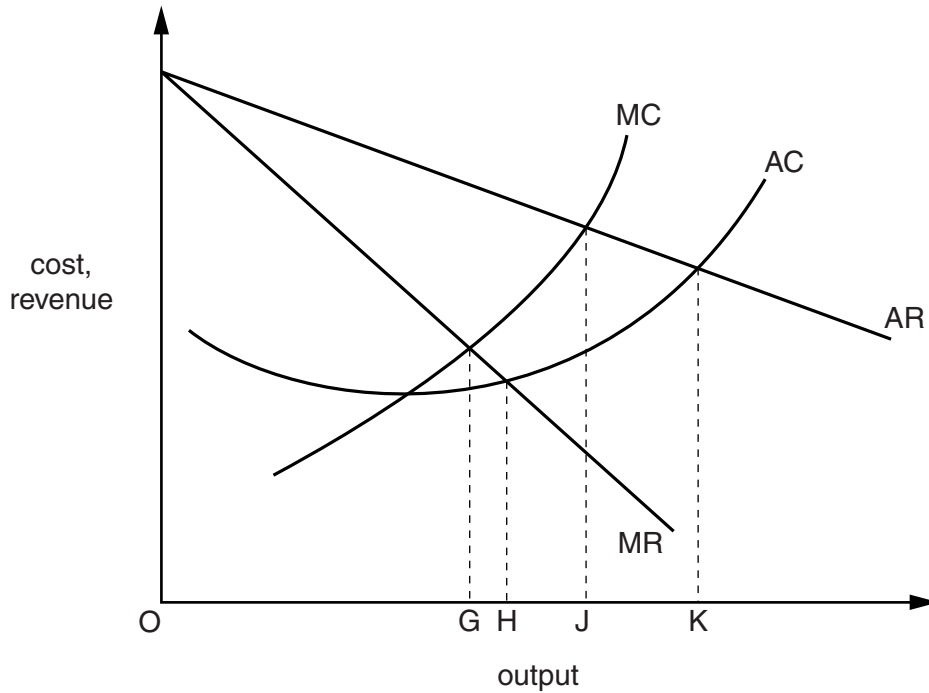
|                    |                    | price charged by X                 |                                    |
|--------------------|--------------------|------------------------------------|------------------------------------|
|                    |                    | $P_X = \text{£}10$                 | $P_X = \text{£}5$                  |
| price charged by Y | $P_Y = \text{£}10$ | $\text{£}6m_X$<br>$\text{£}6m_Y$   | $\text{£}10m_X$<br>$-\text{£}3m_Y$ |
|                    | $P_Y = \text{£}5$  | $-\text{£}3m_X$<br>$\text{£}10m_Y$ | $0_X$<br>$0_Y$                     |

Up until recently the firms have colluded with a view to maximising their joint profits.

What will be the decline in their joint profits if mutual distrust leads both firms to start acting competitively?

- A £3 million
- B £6 million
- C £10 million
- D £12 million

12 The diagram shows a firm's cost and revenue curves.



Initially the firm aims to maximise its profits.

Faced with the threat of potential competition, it abandons profit maximisation and aims instead to achieve a normal profit.

What will be the resulting increase in the firm's output?

- A GJ
- B GK
- C HJ
- D HK

13 The introduction of a congestion charge leads to a significant reduction in traffic congestion but has no effect on overcrowding on the tube.

Following the introduction of the charge some car drivers switch to travelling by tube while some of those who previously travelled by tube now switch to travelling by bus.

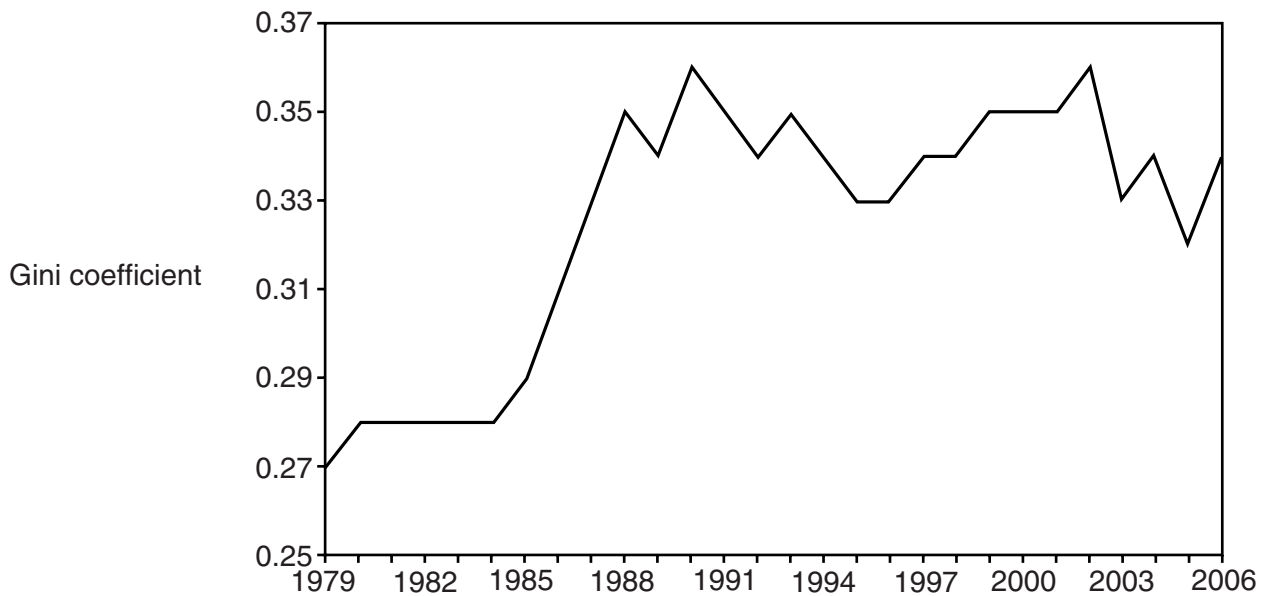
What will be the net impact on the economic welfare of these two groups?

|          | those who switch from cars to the tube | those who switch from the tube to buses |
|----------|--|---|
| <b>A</b> | gainers                                | gainers                                 |
| <b>B</b> | losers                                 | gainers                                 |
| <b>C</b> | gainers                                | losers                                  |
| <b>D</b> | losers                                 | losers                                  |

14 What would increase the demand for higher education?

- A a reduction in youth unemployment
- B an increase in interest rates
- C an increase in the gap between graduate and non-graduate earnings
- D an increase in the higher rate of income tax

15 The graph shows the value of the Gini coefficient for the United Kingdom, based on the distribution of household disposable income, between 1979 and 2005–6.



Source: Office of National Statistics

What could explain the change in the value of the coefficient during the 1980s?

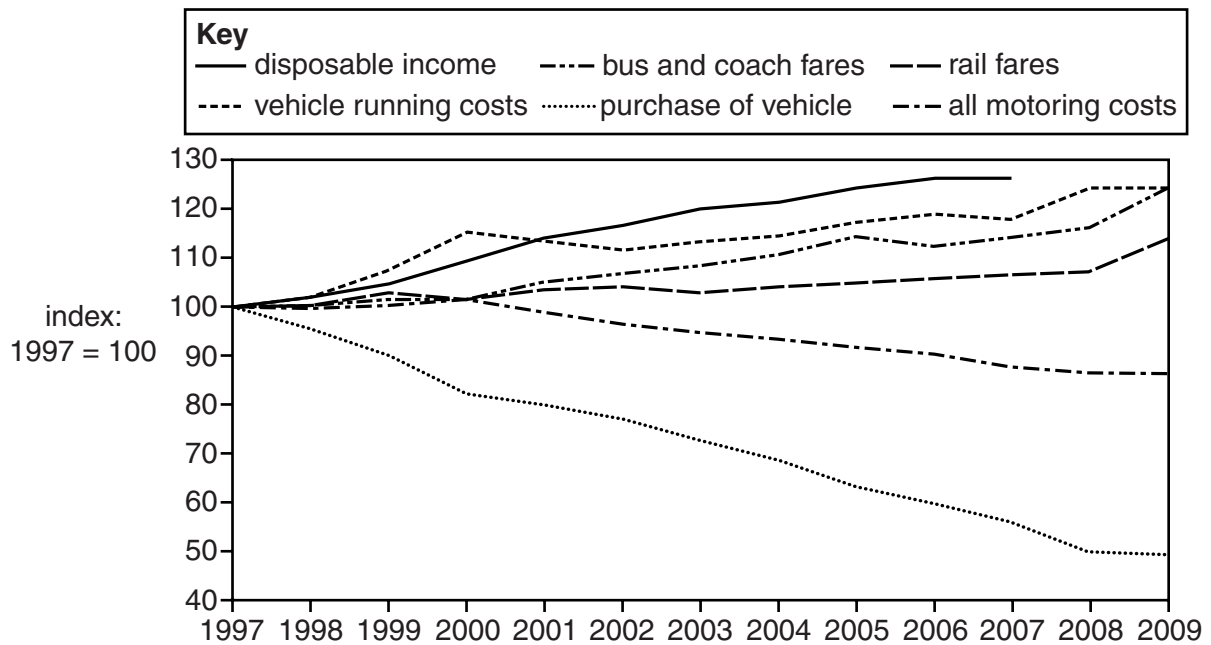
- A an increase in the rate of income tax
- B the introduction of a minimum wage
- C an increase in wage differentials between skilled and unskilled labour
- D a decrease in the level of dividends received by shareholders

- 16 A country's government increases the proportion of its tax revenue that it obtains from income tax and reduces the proportion it obtains from Value Added Tax.

What is likely to be the impact on the distribution of income and on work incentives?

|          | distribution of income | work incentives |
|----------|------------------------|-----------------|
| <b>A</b> | more equal             | increase        |
| <b>B</b> | more equal             | decrease        |
| <b>C</b> | less equal             | increase        |
| <b>D</b> | less equal             | decrease        |

- 17 The graph shows the changes in the real costs of transport and in real household disposable income in the United Kingdom between 1997 and 2009.



Source: Office of National Statistics

What can be concluded from the graph?

- A** Between 1997 and 2007 the costs of all forms of personal transport fell in real terms.
- B** Between 1997 and 2007 all forms of personal transport became less affordable.
- C** Between 2000 and 2008 there was a bigger percentage increase in vehicle running costs than in bus and coach fares.
- D** Between 2000 and 2008 there was a steady fall in all motoring costs after adjusting for inflation.

- 18** What might reduce the effectiveness of fiscal expansion in raising national output?
- A** It is likely to lead to a depreciation of the currency.
  - B** It is likely to lead to an increase in the money supply.
  - C** It is likely to result in higher interest rates.
  - D** It is likely to lead to an expectation of lower future levels of taxation.
- 19** Which problem might an extension of property rights help to resolve?
- A** a divergence between private and social costs
  - B** conflicts between equity and efficiency
  - C** the existence of barriers to entry
  - D** the instability of agricultural prices
- 20** What is most likely to increase both demand-pull and cost-push inflation?
- A** an appreciation of a country's currency
  - B** an increase in the price of oil
  - C** an increase in the cost of borrowing
  - D** an imposition of import quotas
- 21** All else remaining unchanged, what would directly improve the UK's current account on the balance of payments?
- A** an increase in the number of UK students studying in the USA
  - B** a reduction in the profits repatriated from the UK by foreign-owned banks
  - C** a reduction in the rate of economic growth within the Eurozone
  - D** the purchase of UK government bonds by overseas investors
- 22** Why are high rates of inflation likely to be harmful to the economy?
- A** They increase the real burden of household debt.
  - B** They lead to a rise in the export of goods and services.
  - C** They obscure relative price changes leading to a misallocation of resources.
  - D** They result in a reduction of nominal interest rates.

- 23 A country's government reduces its budget deficit from £250 billion to £180 billion.

What will be the direct effect on aggregate expenditure and the national debt?

|          | aggregate expenditure | national debt |
|----------|-----------------------|---------------|
| <b>A</b> | decrease              | increase      |
| <b>B</b> | decrease              | decrease      |
| <b>C</b> | increase              | decrease      |
| <b>D</b> | increase              | increase      |

- 24 What will be the impact of a depreciation of the £ sterling on the volume of UK imports and on their value measured in terms of the £ sterling?

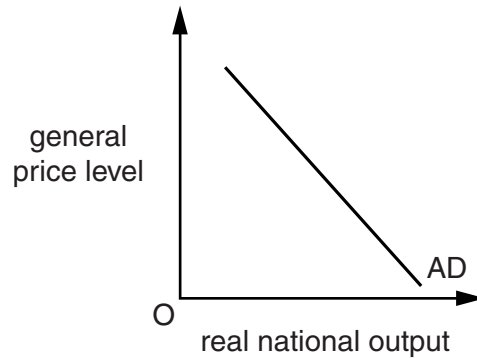
|          | volume of imports | value of imports |
|----------|-------------------|------------------|
| <b>A</b> | decrease          | decrease         |
| <b>B</b> | decrease          | uncertain        |
| <b>C</b> | uncertain         | uncertain        |
| <b>D</b> | uncertain         | decrease         |

- 25 In an economy, the volume of output increases by 4% and the money supply increases by 7%.

According to the Quantity Theory of Money, if the velocity of circulation remains constant, what will be the increase in the nominal value of national income and the approximate increase in the price level?

|          | increase in nominal national income | approximate increase in the price level |
|----------|-------------------------------------|---|
| <b>A</b> | 3%                                  | 11%                                     |
| <b>B</b> | 3%                                  | 3%                                      |
| <b>C</b> | 7%                                  | 11%                                     |
| <b>D</b> | 7%                                  | 3%                                      |

- 26 The diagram shows an economy's aggregate demand curve.



What could explain why the curve slopes downwards?

- A A fall in the price level increases the real value of net exports.
  - B A fall in the price level leads to an increase in interest rates.
  - C A fall in the price level leads to an increase in the demand for money.
  - D A fall in the price level results in a rise in the real exchange rate.
- 27 The world consists of two countries, Country 1 and Country 2, both of which produce just two goods, X and Y.

Country 1 has a relative shortage of labour.

Country 2 has plentiful supplies of both labour and land.

The production of X requires a lot of land but very little labour.

The production of Y requires a lot of labour but very little land.

What can be deduced from the above about Country 1?

- A It will have an absolute advantage in the production of X.
- B It will be at an absolute disadvantage in the production of both X and Y.
- C It will have a comparative advantage in the production of Y.
- D It will have a comparative advantage in the production of X.

- 28 The United Kingdom exports mass market cars to Germany and Germany exports mass market cars to the United Kingdom.

Which combination of factors explains this pattern of trade?

|          | Vehicle purchasers attach a high value to product differentiation. | There are significant economies of scale in car production. |
|----------|--|---|
| <b>A</b> | no   | yes   |
| <b>B</b> | no   | no  |
| <b>C</b> | yes  | yes   |
| <b>D</b> | yes  | no  |

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

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

- A** an appreciation of the country's currency
  - B** a decrease in the household saving ratio
  - C** an increase in the country's long-run trend rate of growth
  - D** an increase in the inflation target
- 30 Countries X, Y and Z are currently members of a customs union.

All three countries trade processed food products amongst themselves.

Country Z decides to leave the customs union but sets an import tariff at the same level as the customs union's common external tariff.

What will be the most likely impact of country Z's departure from the customs union on the pattern of trade in processed food products?

|          | Country X's exports to Country Y | Country Z's imports from Country Y |
|----------|----------------------------------|------------------------------------|
| <b>A</b> | increase                         | decrease                           |
| <b>B</b> | increase                         | unchanged                          |
| <b>C</b> | unchanged                        | decrease                           |
| <b>D</b> | unchanged                        | unchanged                          |

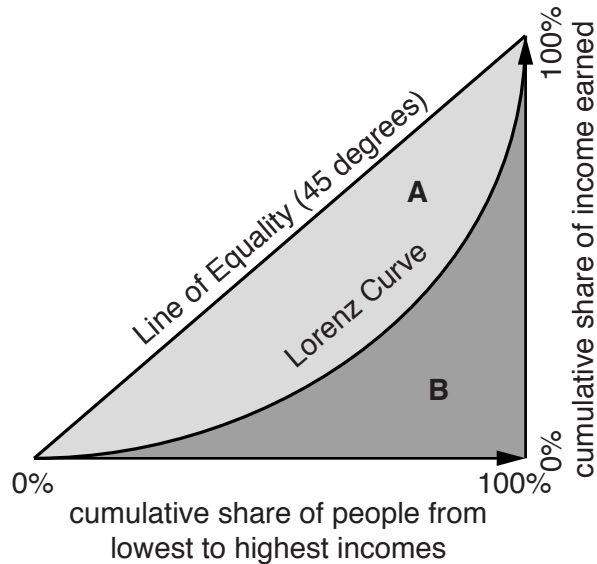
[Total: 30]



## Section B: Short Answers

Answer **all** questions.

- 1 (a) Referring to the diagram of the Lorenz curve shown below, explain how the Gini coefficient is calculated. [2]



- (b) With reference to an example, explain why there is likely to be a close relationship between household income and household wealth. [3]
- 2 For a country, the Marshall-Lerner condition is satisfied in the long run but not in the short run. Other things being equal, how would we expect a fall in the country's exchange rate to affect net exports in the short run and in the long run? [5]
- 3 (a) If the marginal propensity to consume for a country is 0.8, calculate the value of the national income multiplier. [2]
- (b) 'Robin Hood was the first Keynesian economist.' Explain why taking from the rich to give to the poor might raise the equilibrium level of national income in a country. [3]
- 4 Giving an example of each type, explain the difference between structural unemployment and demand-deficient unemployment. [5]

[Total: 20]

### Section C: Data Response

Answer **all** questions.

#### Question 5

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

#### Extract 1: Minimum alcohol price planned for England and Wales

The government is proposing a minimum price of 40p per unit<sup>1</sup> of alcohol in England and Wales in an effort to ‘turn the tide’ against binge drinking. It believes this could transform the behaviour of those who cause the most problems for hospitals and police.

A new alcohol strategy also aims to help local areas tackle problems and work with the drinks industry to encourage responsible drinking. Plans are outlined to work with the drinks industry on ‘changing the drinking culture, from one of excess to one of responsibility; and from one where alcohol is linked to bad behaviour to one where it is linked to positive socialising.’

5

Under a minimum price proposal, such as the suggested 40p level, this would act as a floor and retailers would not be allowed to offer alcohol cheaper than that. While most prices would be unaffected, it could significantly alter the price of cheap spirits and super-strength lager, for example. It is estimated that around 20% of all alcohol sold would be affected by introducing a 40p minimum price.

10

Prime Minister David Cameron said the government wanted to tackle a drinking culture that last year had contributed to one million alcohol-related violent crimes and 1.2 million hospital admissions. Mr Cameron said: ‘Binge drinking isn’t some fringe issue, it accounts for half of all alcohol consumed in this country. The crime and violence it causes drains resources in our hospitals, generates mayhem on our streets and spreads fear in our communities.’

15

He added: ‘We’re consulting on the actual price, but if it is 40p that could mean 50,000 fewer crimes each year and 900 fewer alcohol-related deaths per year by the end of the decade, then that would be justification enough. What we need to do is to set a price that is actually going to ensure that we don’t damage responsible drinkers. People who like a drink or two, who like going down their local pub, have nothing to fear from this policy.’

20

*Adapted from an article on [www.bbc.co.uk/news/uk](http://www.bbc.co.uk/news/uk), accessed 12 March 2015*

**Table 1**

| Type of alcohol      | Estimated price elasticity of demand |
|----------------------|--------------------------------------|
| Cheap spirits        | –1.6                                 |
| Super-strength lager | –1.2                                 |
| Vintage wines        | –0.7                                 |

<sup>1</sup>A unit of alcohol is equivalent to 10 ml of pure alcohol, so a 250 ml glass of 10.0% strength wine would be equal to 2½ units of alcohol.

**Extract 2: Tax increases are all well and good, but do they work?**

'Recent reports about trying to push up the tax on alcohol, in an attempt to prevent consumption, are all well and good, but often prices to consumers stay unchanged and it is either the retailer or the supplier who has to take the hit.

When the government puts up the tax on a bottle of wine by just a few pence, shops aren't going to change the price on the shelves to, say, £5.07 a bottle. The price stays at £4.99 and profits are inevitably squeezed. The supermarkets will probably renegotiate with their suppliers so that the impact is at least shared, if not wholly transferred. Small retailers will have to bear the cost themselves.

5

Only minimum retail price legislation can guarantee that consumers will pay more.'

**Extract 3: Suggested ways to curb binge drinking**

- Force suppliers to make drinks less alcoholic
- Enforce minimum prices
- Encourage people back into pubs rather than drinking at home
- Ban 'Happy Hours'<sup>2</sup> and '2 for 1' offers on alcohol
- Ban all alcoholic advertising and sponsorship – especially of sporting teams / events
- Raise the minimum legal drinking age to 21
- Spend more on promoting advice concerning health and alcohol consumption, especially with regard to 'units per week'

5

- (a) Using the information in Table 1, showing your working, calculate the impact on the quantity of vintage wines demanded if there is a 10% increase in the price. [2]
- (b) Explain one reason why, if duty is increased by 8p as stated in Extract 2, the price of a bottle of wine is expected to remain unchanged. [3]
- (c) Using a diagram, explain why the consumption of alcohol leads to market failure. [5]
- (d) Using the information from Extract 3 and your own knowledge, evaluate the proposition that the best way to solve the problems caused by alcohol is to introduce a minimum price per unit of alcohol. [10]
- (e) 'The drinks industry in the UK is worth more than £30bn per annum in tax revenue to the government and there are more than one million "drink related" jobs in the UK'. Given this information, evaluate the view that the government should be looking to boost the industry rather than adopting measures aimed at limiting consumption. [10]

**[Total: 30]**

<sup>2</sup> 'Happy Hours' are where the price of drinks are discounted for a period of time and hence people are encouraged to drink more quickly to take advantage of these time-related offers.

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