UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

ECONOMICS **9708/03**

Paper 3 Multiple Choice (Extension)

May/June 2005

1 hour

Additional Materials: Multiple Choice Answer Sheet
Soft clean eraser
Soft pencil (type B or HB is recommended)

READ THESE INSTRUCTIONS FIRST

Write in soft pencil.
Do not use staples, paper clips, highlighters, glue or correction fluid.
Write your name, Centre number and candidate number on the answer sheet in the spaces provided unless this has been done for you.

There are **thirty** questions on 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 the instructions on the answer sheet very carefully.

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 document consists of **12** printed pages.

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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 relative prices of goods reflect their marginal utilities rather than their total utilities.

What is explained by this statement?

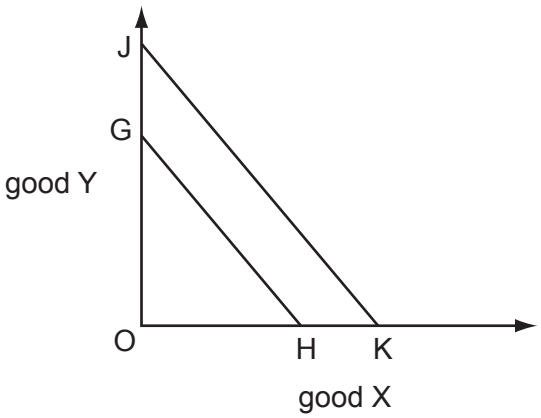
A the law of diminishing returns

B the limitations of marginal utility theory

C the paradox of value

D the role of prices as a rationing mechanism

3 In the diagram a consumer's budget line shifts from GH to JK.



Regardless of any other changes that might occur, what **must** be correct?

A There has been an increase in the consumer's money income.

B There has been an increase in the consumer's real income.

C There has been an equal proportionate increase in the price of X and Y.

D There has been an equal proportionate decrease in the price of X and Y.

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4 According to the law of diminishing returns, what happens as more of a variable factor is combined with a fixed factor?

A An increase in the price of the variable factor will eventually result in an increase in production costs.

B A reduction in the quality of the variable factor will eventually result in an increase in production costs.

C Fewer units of the variable factor will be needed to produce equal increases in output.

D The proportions in which the factors are combined will eventually result in progressively smaller increases in output.

5 When would a trade union be **most** likely to secure a wage rise for its members?

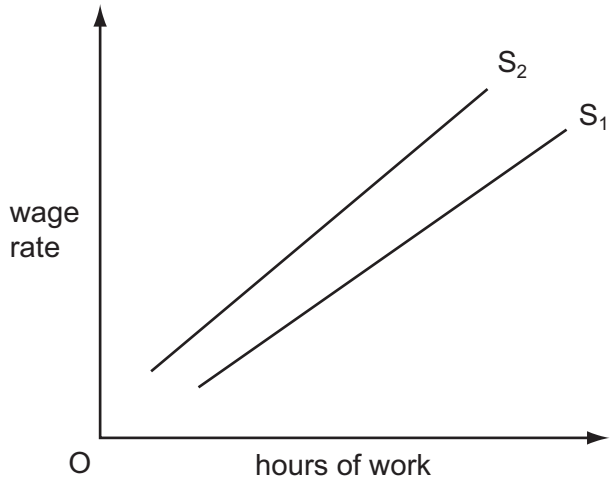
A when labour costs are a small proportion of total costs

B when the demand for the product is price-elastic

C when there are a large number of small producers

D when the supply of labour is elastic

6 In the diagram S_1 is an individual worker's initial supply of labour curve.



What could cause the curve to shift to S_2?

A an increase in the hourly wage rate

B an increased preference for leisure

C an increase in the opportunity cost of leisure

D an increase in work satisfaction

7 Wages in industry X are significantly higher than in industry Y.

What could explain this difference?

A Workers in industry Y are highly mobile.

B Trade union organisation in industry Y is relatively strong.

C Industries X and Y compete with each other for workers.

D There are non-pecuniary advantages to working in industry Y.

8 What is generally thought to be the main reason why firms might experience decreasing returns to scale when they grow beyond a certain size?

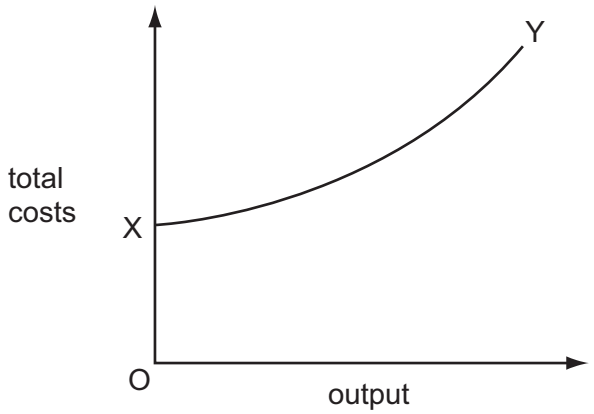
A financial diseconomies

B managerial diseconomies

C marketing diseconomies

D technical diseconomies

9 In the diagram, XY is a firm's total cost curve.



What happens to the firm's costs as output is increased?

	average fixed costs	marginal costs
A	decrease	constant
B	decrease	increase
C	constant	constant
D	constant	increase

10 What is the shape of the long run average cost curve for a firm with economies of scale?

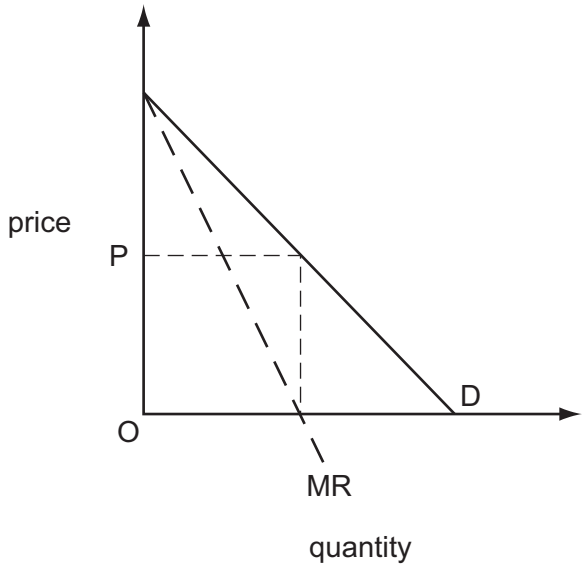
A It is horizontal.

B It is 'U' shaped.

C It slopes downwards.

D It slopes upwards.

11 The diagram shows a firm's demand curve and its marginal revenue curve.



What is the price elasticity of demand at price OP?

A zero

B 0.5

C 1.0

D infinity

12 What determines the contestability of a market?

A the degree of differentiation of the product

B the costs of entry and exit

C the price elasticity of demand for the product

D the number of firms in the industry

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13 The government imposes a specific tax equal to \$0.20 per unit on the output of a monopoly producer.

What will be the effect on the price charged by the monopoly and on the quantity it produces?

	price	quantity
A	increases by \$0.20	decreases
B	increases by less than \$0.20	decreases
C	increases by \$0.20	unchanged
D	increases by less than \$0.20	unchanged

14 In an economy no one can be made better off without making others worse off.

What can be deduced from this?

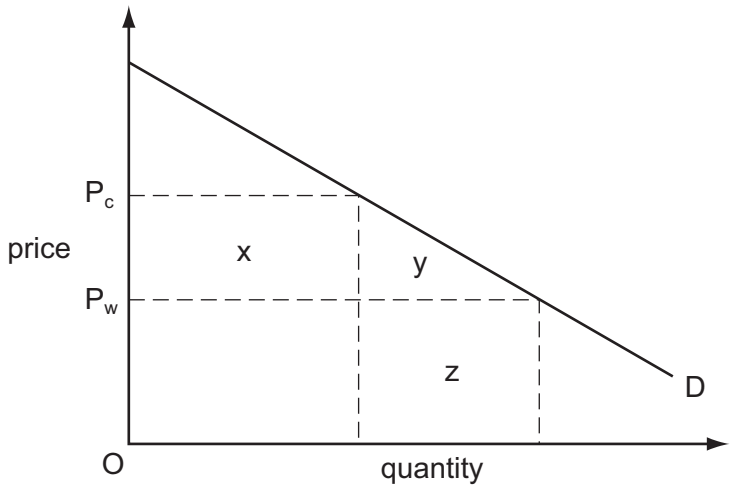
A All markets are perfectly competitive.

B There are no externalities.

C The economy is operating on its production possibility curve.

D The distribution of income reflects what each individual deserves.

15 In the diagram D is a country's demand curve for an imported good. The world price of the good is OP_W.



Which area measures the deadweight loss to the country of imposing an import tariff equal to $P_W P_C$ on the good?

A x **B** y **C** x + y **D** y + z

16 The information in the table is taken from a country's national income accounts.

	$ million
national income	500
consumer spending	200
investment spending	75
government spending	150
taxation	140
exports	125

What is the value of imports?

A $125 million **B** $75 million **C** $50 million **D** $25 million

17 According to monetarist theory, which policy objectives are in conflict in the short run, but not in the long run?

A economic growth and full employment

B economic growth and price stability

C full employment and price stability

D price stability and equilibrium in the balance of payments

18 In a closed economy with no government, consumption is three-quarters of income at all levels of income.

The present equilibrium level of income is $220 million.

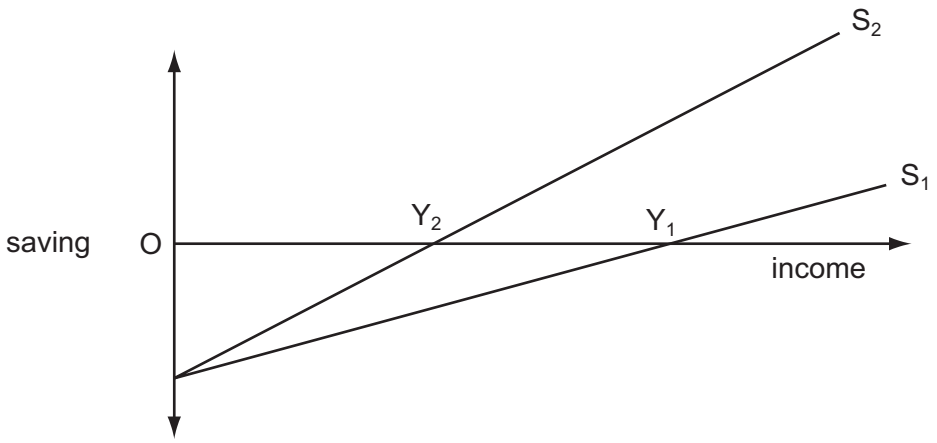
The full employment level of income is $240 million.

By how much would investment have to increase to reach full employment?

A $5 million **B** $15 million **C** $20 million **D** $30 million

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19 The diagram shows a shift in the economy's saving function from S_1 to S_2.



What can be deduced from the diagram?

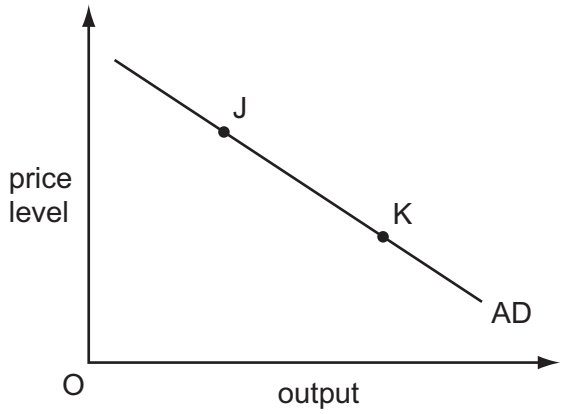
A The multiplier has increased.

B The marginal propensity to save has increased.

C Autonomous consumption has increased.

D Equilibrium national income has fallen from OY_1 to OY_2.

20 The diagram shows an economy's aggregate demand curve.



Which change will occur as the economy moves from point J to point K?

A an increase in the money supply

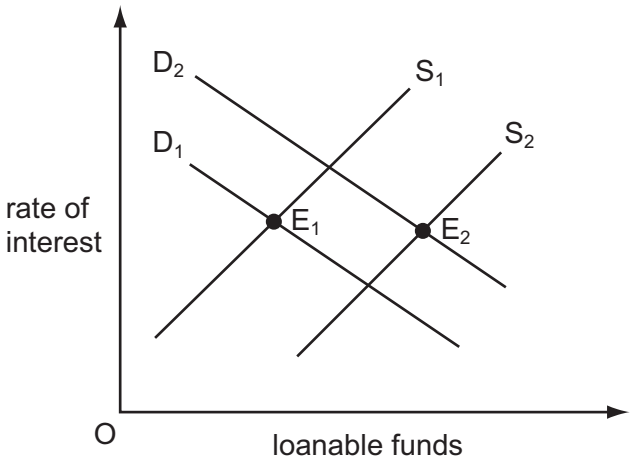
B a decrease in the money supply

C an increase in interest rates

D a decrease in interest rates

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21 The diagram shows the market for loanable funds.



Which changes could cause the equilibrium to move from E_1 to E_2?

A an increase in the propensity to save and an increase in bank lending

B the discovery of oil reserves and an increase in the propensity to save

C advances in technology and a decrease in bank lending

D a decrease in the propensity to save and the introduction of new products

22 In a closed economy, if the income velocity of circulation of money remains constant, what will be the result of an increase in the money supply?

A a proportionate increase in the level of money income

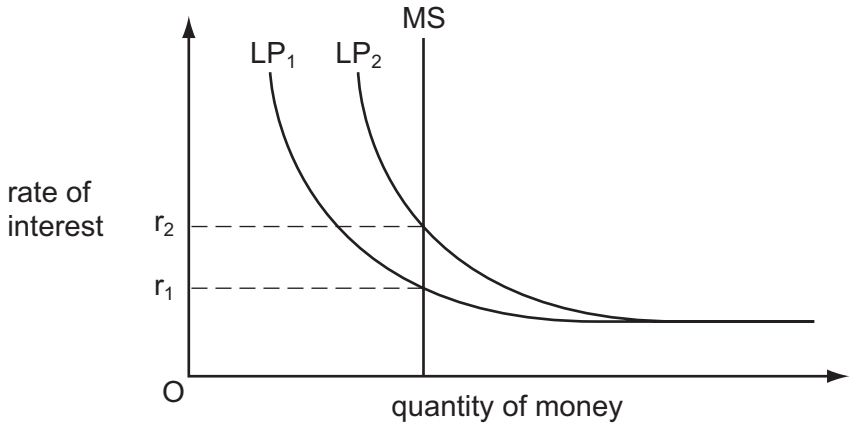
B a proportionate increase in the level of output

C a proportionate increase in the rate of growth of money income

D a proportionate increase in the rate of growth of output

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23 The diagram shows the determination of the rate of interest in an economy where MS represents the money supply and LP represents liquidity preference.



The rate of interest rises as a result of a shift in the liquidity preference curve from LP_1 to LP_2.

Which policy might be used to try to maintain the rate at r_1?

A the purchase of bonds in the open market

B reductions in income tax rates

C increases in indirect taxes

D increased government expenditure

24 A developing economy experiences a rapid growth in labour productivity.

What is likely to result from this?

A an increase in the country's balance of trade deficit

B an increase in the country's relative labour costs

C a depreciation of the country's currency

D an increase in real income per head

25 What will assist a country's potential growth in national output?

A a reduction in cyclical unemployment

B an increase in the rate of inflation

C an increase in the government's budget deficit

D increased participation in the labour force

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26 In an economy with flexible exchange rates an increase in government spending is financed by borrowing from the public.

What is likely to be the effect on interest rates and on the level of net exports?

	effect on interest rates	effect on net exports
A	increase	increase
B	increase	decrease
C	decrease	decrease
D	decrease	increase

27 Which of the following is an appropriate government policy for closing a deflationary gap?

A an increase in the rate of interest

B an open market sale of bonds

C an increase in government spending

D an increase in income tax

28 In an economy with unemployed resources the government increases its expenditure.

This would be **least** likely to increase national income by the full multiplier effect if the

A level of autonomous private investment is increased.

B marginal propensity to save is reduced.

C government allows money supply to expand.

D level of interest rates rises.

29 What is most likely to increase as a result of a rise in interest rates in a country?

A the inflow of short-term foreign capital

B the level of company profits

C the level of private investment

D the level of share prices

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30 A country introduces import quotas.

The suppliers of imported goods charge market-clearing prices.

Assuming the demand for imports is price-elastic, what will be the impact on the country's balance of trade and on its terms of trade?

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

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