Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/11**

Paper 1 Multiple Choice **May/June 2017**

1 hour

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

0496074314

READ THESE INSTRUCTIONS FIRST

Write in soft pencil.
Do not use staples, paper clips, 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.
DO **NOT** WRITE IN ANY BARCODES.

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.

CAMBRIDGE International Examinations

1 What must follow when scarcity exists?

A Consumers have to make choices.

B Governments are unable to supply public goods.

C Producers must be misallocating resources.

D Workers must be earning low wages.

Answer
Scarcity is a fundamental concept in economics that arises because resources are limited while human wants are unlimited. When scarcity exists, it implies that there are not enough resources to fulfill all desires, leading to the necessity of making choices about how to allocate those resources efficiently.
Let's evaluate each option:

Option A (Consumers have to make choices):

This is true. Scarcity requires consumers to make choices about what to purchase and how to allocate their limited resources (such as time and money) among various options. This is because they cannot have everything they want due to limited resources.

Option B (Governments are unable to supply public goods):

This is not necessarily true. While scarcity affects all sectors, governments can still supply public goods through taxation and redistribution of resources. The challenge lies in prioritizing and managing resources efficiently.

Option C (Producers must be misallocating resources):

This is not necessarily a consequence of scarcity. Scarcity itself does not imply misallocation; it simply means that resources are limited. Misallocation would occur if resources are not used in the most efficient manner to meet the needs and wants of society.

Option D (Workers must be earning low wages):

This is not a direct result of scarcity. While scarcity can influence wages through supply and demand for labor, low wages are not a necessary outcome of scarcity. Wages depend on various factors, including productivity, skills, and market conditions.

The correct answer is Option A: Consumers have to make choices. Scarcity necessitates that consumers make decisions on how to best use their limited resources, as they cannot satisfy all their wants simultaneously.

2 What is likely to be introduced in the market for bus travel if an economy moved from a mixed economy to a market economy?

A allowing companies to bid for bus routes

B free bus travel for school children

C maximum prices for bus travel

D subsidies to bus operators

Answer
When an economy transitions from a mixed economy to a market economy, the focus shifts towards reducing government intervention and increasing the role of market forces in determining the allocation of resources. In a market economy, decisions about production, investment, and distribution are typically driven by supply and demand. Let's evaluate each option:

Option A (Allowing companies to bid for bus routes):

This is likely to be introduced in a market economy. Allowing companies to bid for bus routes encourages competition, which is a key characteristic of a market economy. It enables private companies to operate routes based on efficiency and profitability, rather than government allocation.

Option B (Free bus travel for school children):

This is more characteristic of a mixed economy or a welfare state, where the government provides certain services for free or at subsidized rates to ensure access for all. In a market economy, such services would typically be provided by private companies for a fee.

Option C (Maximum prices for bus travel):

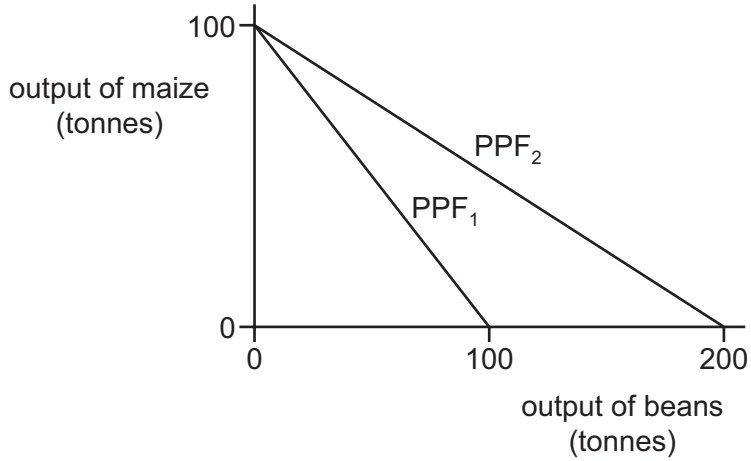
Maximum prices are a form of government intervention to control the cost of services. This is more typical of a mixed economy, where the government regulates prices to ensure affordability. In a market economy, prices are usually determined by market forces.

Option D (Subsidies to bus operators):

Subsidies involve government financial support to reduce the cost of services. This is more common in a mixed economy, where the government aims to make certain services more affordable. In a market economy, subsidies are less common as the focus is on minimizing government intervention.

The correct answer is Option A: Allowing companies to bid for bus routes. This option aligns with the characteristics of a market economy by promoting competition and reducing government control over the allocation of bus routes.

3 The diagram shows that the production possibility frontier of maize and beans has changed from PPF_1 to PPF_2.



What has happened to the opportunity cost of maize and the returns to factors producing beans?

	opportunity cost of maize	returns to factors producing beans
A	fallen	fallen
B	fallen	risen
C	risen	fallen
D	risen	risen

Answer
To determine the changes in the opportunity cost of maize and the returns to factors producing beans, let's re-evaluate the PPF shift from PPF1 to PPF2.

Analyzing PPF Shift:
The outward shift of the entire PPF indicates that the economy can produce more of both maize and beans than before, which typically results from improvements in factors such as technology or resource availability.

Opportunity Cost of Maize:
Opportunity cost is the amount of beans that must be given up to produce an additional unit of maize.
The shift from PPF1 to PPF2, particularly if it is more pronounced along the maize axis, can indicate increased efficiency or productivity in maize production.
As such, the opportunity cost of producing maize relative to beans might have risen if the ability to produce maize has increased notably more than beans.

Returns to Factors Producing Beans:
Returns to factors are a measure of how effectively inputs are used to produce beans.
If both maize and beans production capabilities have increased, this implies that the efficiency of using resources for beans also improved, leading to an increase in returns.
Thus, the returns to factors producing beans would have risen.

Based on this interpretation, the most consistent explanation of the PPF shift is that both the opportunity cost of maize has risen and the returns to factors producing beans have risen. Therefore, the correct answer is D) risen, risen.

4 An individual buys a ticket to visit a government-owned art gallery.

How would this visit be classified by an economist?

A private and demerit good

B private and merit good

C public and demerit good

D public and merit good

Answer
To classify the visit to a government-owned art gallery, we need to understand the terms involved:

Private vs. Public Goods:

Private Goods: These are excludable and rivalrous goods. Excludable means people can be prevented from using them, and rivalrous means one person's use of the good reduces its availability to others.
Public Goods: These are non-excludable and non-rivalrous. People cannot be prevented from using them, and one person's use does not diminish availability to others.

Merit vs. Demerit Goods:

Merit Goods: These have positive externalities and are considered beneficial for individuals and society. Governments often promote them.
Demerit Goods: These have negative externalities and are considered harmful, leading governments to discourage their use.

Now, let's classify the visit:

Private vs. Public:

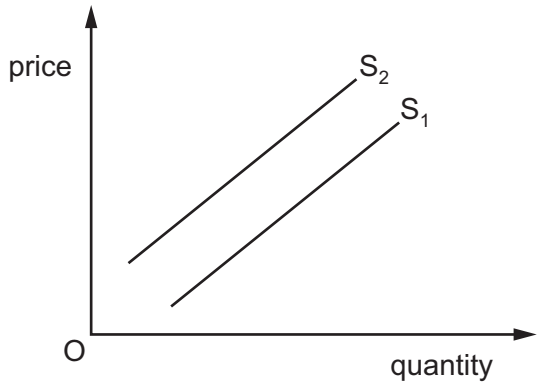
Visiting a government-owned art gallery typically involves purchasing a ticket, making it excludable. It can also be considered rivalrous if the gallery has limited space or capacity. Therefore, it is a private good.

Merit vs. Demerit:

Visiting an art gallery is generally considered a positive and educational experience, enriching individuals and society. Hence, it is a merit good.

Therefore, the correct classification is Option B: private and merit good.

5 The diagram shows a shift in a firm's supply curve from S_1 to S_2.



What may have caused the shift from S_1 to S_2?

A a decrease in the costs of production of the firm

B a decrease in the popularity of the firm's product

C a decrease in the subsidy on the good

D a decrease in the tax on the good

Answer
The shift in the supply curve from S1 to S2 represents a leftward shift, indicating a decrease in supply.
Let's analyze each option to understand which factor could cause such a shift:
A) A decrease in the costs of production of the firm:

A decrease in production costs would typically lead to an increase in supply, shifting the supply curve to the right. Not applicable here.

B) A decrease in the popularity of the firm's product:

Popularity affects demand, not supply. This choice is unrelated to the supply curve shift.

C) A decrease in the subsidy on the good:

Subsidies decrease production costs. If there is a decrease in the subsidy, production costs increase, causing a decrease in supply, which shifts the supply curve to the left. This is consistent with the supply curve shift shown.

D) A decrease in the tax on the good:

A decrease in taxes usually lowers production costs, thus increasing supply and shifting the curve to the right. This doesn't apply to a leftward shift.

Therefore, the correct answer is C) a decrease in the subsidy on the good.

6 A change in the price of a good causes an increase in the quantity of the good demanded.

What would be the nature of the good and the direction of price change for this to be certain to happen?

	nature of good	price change
A	inferior	fall
B	inferior	rise
C	normal	fall
D	normal	rise

Answer
A change in the price of a good causing an increase in the quantity demanded is a typical response described by the law of demand. According to this law, when the price of a good falls, the quantity demanded generally increases, assuming all other factors remain constant.
Let's analyze each option:

Option A (Inferior, Fall):

Inferior goods are those for which demand increases as consumer income decreases. However, the key here is the price change. A fall in price would increase the quantity demanded for both normal and inferior goods, so this is a possible scenario.

Option B (Inferior, Rise):

If the price of an inferior good rises, the quantity demanded would typically decrease, not increase. This does not align with the given scenario.

Option C (Normal, Fall):

Normal goods are those for which demand increases as consumer income increases. A fall in price of a normal good would lead to an increase in the quantity demanded, which aligns perfectly with the law of demand.

Option D (Normal, Rise):

An increase in price would usually decrease the quantity demanded for a normal good, which does not fit the scenario.

Based on the analysis, the correct answer is Option C: Normal, Fall, because a decrease in the price of a normal good will certainly lead to an increase in quantity demanded, according to the law of demand.

7 Which combination is most likely to result in the demand for a product being highly price elastic?

	number of close substitutes	% of income spent on product
A	large	large
B	large	small
C	small	large
D	small	small

Answer
Price elasticity of demand measures how sensitive the quantity demanded of a product is to a change in its price. A product is considered to be highly price elastic when a small change in price leads to a significant change in the quantity demanded. Two main factors that influence price elasticity are:

Number of Close Substitutes: The more substitutes available, the more elastic the demand, as consumers can easily switch to another product if the price rises.

Percentage of Income Spent on the Product: The larger the percentage of income spent on a product, the more elastic the demand tends to be, because price changes have a more significant impact on the consumer's budget.

Let's evaluate the options:
Option A (Large, Large):
A large number of close substitutes and a large percentage of income spent on the product would make demand highly elastic. Consumers can easily switch to other products and are sensitive to price changes because it significantly impacts their budget.

Option B (Large, Small):
A large number of substitutes tends to increase elasticity, but a small percentage of income spent means consumers are less sensitive to price changes.

Option C (Small, Large):
A small number of substitutes would make the demand less elastic, even if a larger percentage of income is spent.

Option D (Small, Small):
Both a small number of substitutes and a small percentage of income spent would result in inelastic demand, as there are fewer alternatives and less impact on the budget.

The correct answer is Option A: Large, Large, as having many substitutes and a significant portion of income spent on the product makes demand highly price elastic.

8 A manufacturer increases the price of his product from $4 in an attempt to increase total revenue.

The table shows the outcome of the policy.

price ($)	total revenue 000's ($)
4	400
5	500
6	600

What is the price elasticity of demand for the product?

A perfectly elastic

B perfectly inelastic

C relatively elastic

D relatively inelastic

Sure, let's go through the complete explanation for determining the price elasticity of demand using the given table:
Understanding Elasticity of Demand:
Elastic Demand: When the price increases, the quantity demanded decreases significantly, leading to a decrease in total revenue. Demand is sensitive to price changes.
Inelastic Demand: When the price increases, the quantity demanded doesn't decrease much, leading to an increase in total revenue. Demand is not sensitive to price changes.
Perfectly Inelastic Demand: When the price changes, the quantity demanded remains unchanged. Total revenue increases or decreases directly with price changes.
Analyzing the Table:
Initial Price: $4, Total Revenue: $400,000
New Price: $5, Total Revenue: $500,000
New Price: $6, Total Revenue: $600,000
Observations:
As the price increases from $4 to $5, total revenue increases from $400,000 to $500,000.
As the price increases further from $5 to $6, total revenue increases from $500,000 to $600,000.
Conclusion:
Since total revenue increases with each price increase, this indicates that the quantity demanded does not decrease significantly enough to offset the price increase.
This behavior is characteristic of perfectly inelastic demand, where changes in price do not affect the quantity demanded at all, resulting in proportional changes in total revenue with price changes.
Thus, the correct answer is:
B. perfectly inelastic

9 A firm establishes that the price elasticity of supply of its product has a value of 0.3.

What is likely to be true about the firm?

A It has unused productive capacity.

B It has unsold stock of its product.

C It uses a high proportion of perishable raw materials.

D It uses factors of production that are easily substituted.

Answer
The price elasticity of supply measures how responsive the quantity supplied of a product is to a change in price. A price elasticity of supply value of 0.3 indicates that the supply is relatively inelastic, meaning the quantity supplied changes by a smaller percentage than the price change.
Let's analyze each option to determine which is most consistent with a relatively inelastic supply:
A) It has unused productive capacity:

If a firm has unused productive capacity, it typically means it can increase production without a significant increase in costs, making the supply more elastic, not inelastic. This doesn't align with the given elasticity value.

B) It has unsold stock of its product:

Having unsold stock suggests that the firm can quickly increase supply in response to price changes, which would imply more elastic supply. This also doesn't match the inelastic supply value.

C) It uses a high proportion of perishable raw materials:

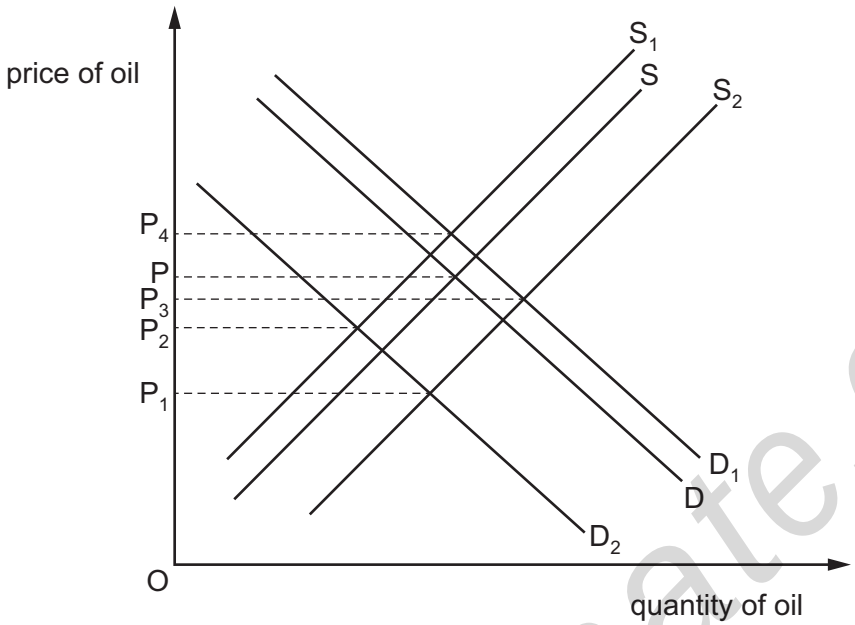
Perishable raw materials can limit the firm's ability to adjust supply quickly in response to price changes. If raw materials perish quickly, the firm may not be able to store or adjust production easily, contributing to a relatively inelastic supply.

D) It uses factors of production that are easily substituted:

If factors of production are easily substituted, the firm can adjust its production processes more readily, leading to a more elastic supply.

The correct answer is Option C: It uses a high proportion of perishable raw materials. This condition likely contributes to the firm's relatively inelastic supply, as it limits flexibility in adjusting supply quickly in response to price changes.

10 There is a reduction in world oil supplies due to war in some supplying countries at a time when the winter in some importing countries was much colder than usual. The diagram shows the original equilibrium price, P.



What will be the equilibrium price of oil in these circumstances?

A P_1 **B** P_2 **C** P_3 **D** P_4

Answer
Given the reduction in oil supplies and the increase in demand due to a colder winter, we can analyze the shifts:

Supply Side:

The reduction in oil supplies shifts the supply curve leftward from S to S2.

Demand Side:

The colder winter increases the demand for oil, shifting the demand curve rightward from D to D2.

The new equilibrium occurs at the intersection of S2 and D2, which is at the price level P4.
Thus, the equilibrium price of oil in these circumstances will be P4.

11 Good X is a substitute for good Y and a complement to good Z.

What would happen after a fall in the price of good X?

A Only the demand for X will rise.

B Demand for X, Y and Z will rise.

C Demand for Y will fall and for Z will rise.

D Demand for Y will rise and for Z will fall.

Answer
To determine the effects of a fall in the price of good X, we must consider its relationship with goods Y and Z:

Good X and Good Y: X is a substitute for Y. This means that if the price of X falls, consumers are more likely to purchase X instead of Y. As a result, the demand for Y will decrease.

Good X and Good Z: X is a complement to Z. This means that if the price of X falls, consumers are more likely to purchase more of X, which will also increase the demand for Z, as they are often used together.

Based on these relationships, let's analyze the options:
A) Only the demand for X will rise.

This is not correct because the changes in demand for Y and Z also need to be considered.

B) Demand for X, Y, and Z will rise.

This is not correct because the demand for Y, being a substitute, will fall, not rise.

C) Demand for Y will fall and for Z will rise.

This is correct because the decrease in the price of X will lead to a decrease in demand for Y (substitute) and an increase in demand for Z (complement).

D) Demand for Y will rise and for Z will fall.

This is not correct because the demand for Y will fall, not rise, and the demand for Z will rise, not fall.

Therefore, the correct answer is Option C: Demand for Y will fall and for Z will rise

12 A government imposes a specific indirect tax on a product.

When will the tax cause the greatest reduction in consumer surplus for the buyers of the product?

A The product has price elastic demand and price elastic supply.

B The product has price elastic demand and price inelastic supply.

C The product has price inelastic demand and price elastic supply.

D The product has price inelastic demand and price inelastic supply.

Answer
Let's analyze the impact of imposing a specific indirect tax on a product and how it affects consumer surplus, considering the elasticity of demand and supply.
Consumer surplus is the difference between what consumers are willing to pay and what they actually pay. When a specific indirect tax is imposed, it tends to increase the price consumers pay, thereby reducing consumer surplus. The extent of this reduction depends on the elasticity of demand and supply:

Price Elastic Demand: If demand is elastic, consumers are sensitive to price changes, and a tax increase leads to a large decrease in quantity demanded. However, this can minimize the reduction in consumer surplus because consumers quickly reduce consumption.

Price Inelastic Demand: If demand is inelastic, consumers are less sensitive to price changes, so they continue purchasing even when prices rise due to the tax. This results in a larger reduction in consumer surplus because consumers absorb more of the tax burden.

Price Elastic Supply: If supply is elastic, producers can adjust their production levels easily in response to price changes.

Price Inelastic Supply: If supply is inelastic, producers cannot easily adjust their production levels, meaning they don't absorb much of the tax burden, which falls more on consumers.

Let's evaluate each option:
A) The product has price elastic demand and price elastic supply.
Both consumers and producers are responsive to price changes, leading to significant adjustments in quantity demanded and supplied, minimizing the consumer surplus reduction.

B) The product has price elastic demand and price inelastic supply.
Consumers reduce quantity demanded significantly due to the tax, while producers cannot adjust supply as much, leading to some reduction in consumer surplus.

C) The product has price inelastic demand and price elastic supply.
Consumers continue to purchase the product despite the higher price, while producers can adjust supply. This scenario results in a large reduction in consumer surplus because consumers bear most of the tax burden.

D) The product has price inelastic demand and price inelastic supply.
Both consumers and producers are not very responsive to price changes, leading to a significant reduction in consumer surplus, but not as much as when supply is elastic.

Therefore, the correct answer is Option C: The product has price inelastic demand and price elastic supply. This combination causes the greatest reduction in consumer surplus because consumers continue to buy the product despite higher prices, and producers can adjust supply to pass on the tax burden to consumers.

13 The table shows the maximum amount three students would each be willing to pay for a taxi to take them home from a nightclub.

	$
Jane	10.00
Sara	8.00
Yasmin	6.00

Assume they share the taxi fare as shown in the table below.

Which shows how much they each should pay so that they each obtain the same consumer surplus?

	Jane $	Sara $	Yasmin $
A	2.00	4.00	6.00
B	4.00	4.00	4.00
C	5.00	4.00	3.00
D	6.00	4.00	2.00

Answer is on next page

Answer
To determine how much each student should pay so that they each obtain the same consumer surplus, we first need to understand the concept of consumer surplus. Consumer surplus is the difference between what a consumer is willing to pay and what they actually pay.
Let's calculate the consumer surplus for each scenario and find the one where all three students have the same consumer surplus.
The maximum amount each student is willing to pay is:

Jane: $10.00
Sara: $8.00
Yasmin: $6.00

Now, let's evaluate each option:
A) Jane: $2.00, Sara: $4.00, Yasmin: $6.00
Consumer Surplus:
Jane: $10.00 - $2.00 = $8.00
Sara: $8.00 - $4.00 = $4.00
Yasmin: $6.00 - $6.00 = $0.00

B) Jane: $4.00, Sara: $4.00, Yasmin: $4.00
Consumer Surplus:
Jane: $10.00 - $4.00 = $6.00
Sara: $8.00 - $4.00 = $4.00
Yasmin: $6.00 - $4.00 = $2.00

C) Jane: $5.00, Sara: $4.00, Yasmin: $3.00
Consumer Surplus:
Jane: $10.00 - $5.00 = $5.00
Sara: $8.00 - $4.00 = $4.00
Yasmin: $6.00 - $3.00 = $3.00

D) Jane: $6.00, Sara: $4.00, Yasmin: $2.00
Consumer Surplus:
Jane: $10.00 - $6.00 = $4.00
Sara: $8.00 - $4.00 = $4.00
Yasmin: $6.00 - $2.00 = $4.00

In Option D, each student has the same consumer surplus of $4.00. Therefore, the correct answer is Option D: Jane pays $6.00, Sara pays $4.00, and Yasmin pays $2.00.

14 A government fixes a minimum price for a service.

What will be the outcome of such a policy?

A Demand will fall if the minimum price is below the equilibrium price.

B Demand will rise if the minimum price is above the equilibrium price.

C Production will fall if the minimum price is above the equilibrium price.

D Production will stay the same if the minimum price is below the equilibrium price.

Answer
When a government sets a minimum price for a service, it establishes a price floor. This price floor is the lowest price that can legally be charged for the service. The effects of this policy depend on whether the minimum price is set above or below the market equilibrium price:

Minimum Price Below Equilibrium Price:

If the minimum price is set below the equilibrium price, it is not binding. The market naturally operates at the equilibrium price, and the minimum price does not affect supply or demand. Therefore, production and demand will stay the same.

Minimum Price Above Equilibrium Price:

If the minimum price is set above the equilibrium price, it is binding. This means the price floor prevents the market from reaching equilibrium. At this higher price, the quantity supplied will typically exceed the quantity demanded, leading to a surplus. Consumers will demand less due to the higher price, and producers will want to supply more.

Let's evaluate each option:
A) Demand will fall if the minimum price is below the equilibrium price.

This is incorrect. If the minimum price is below the equilibrium price, it is not binding, and demand remains unchanged.

B) Demand will rise if the minimum price is above the equilibrium price.

This is incorrect. If the minimum price is above the equilibrium price, demand will not rise; it will fall because the higher price discourages consumers from purchasing the service.

C) Production will fall if the minimum price is above the equilibrium price.

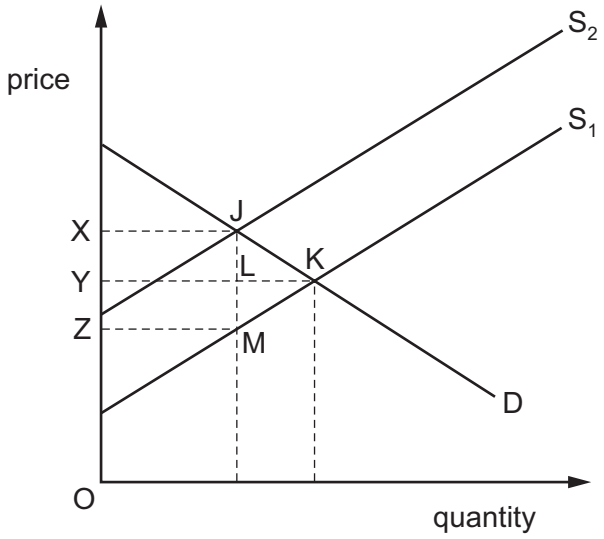
This is incorrect. If the minimum price is above the equilibrium price, production will not fall; it will likely increase because producers are encouraged to supply more due to the higher price.

D) Production will stay the same if the minimum price is below the equilibrium price.

This is correct. If the minimum price is below the equilibrium price, it is not binding, and production remains at the equilibrium quantity.

Therefore, the correct answer is Option D: Production will stay the same if the minimum price is below the equilibrium price.

15 The diagram illustrates the effects of placing a specific tax equal to JM on a good.



Which area represents total tax receipts?

A JKM **B** XJKY **C** XJLY **D** XJMZ

Answer
In the given scenario, a specific tax causes a shift in the supply curve from its original position, denoted as S1, to a new position, denoted as S2.
Key points in the diagram:

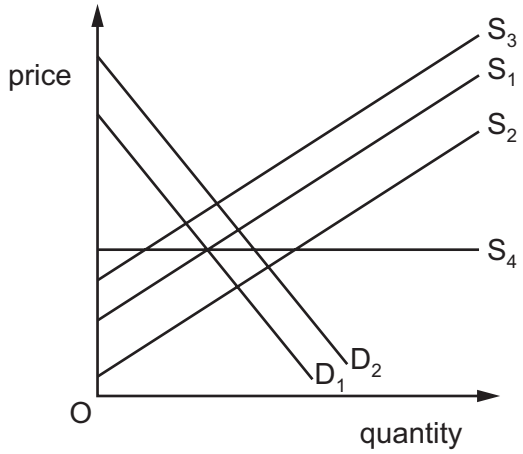
The price that producers receive is marked at point M.
The price that consumers pay is marked at point J.
The difference between these two prices, represented as JM, indicates the tax amount per unit of the good.

After the tax is imposed, the quantity of goods traded is at point K.
To calculate the total tax receipts, you need to multiply the tax per unit (JM) by the number of units sold (the quantity from L to K). This is visually represented by a rectangle in the diagram, specifically the area of the rectangle bounded by:

The vertical distance JM, which is the tax per unit.
The horizontal distance from L to K, which indicates the quantity sold after the tax is implemented.

Thus, the total tax receipts are represented by the area of the rectangle JKMZ.
Therefore, the area representing the total tax receipts is the rectangle XJMZ.

16 The diagram shows the demand curve, D_1, and the supply curve, S_1, for a good.



The government decides to pay producers a specific subsidy for each unit supplied to the market.

Which curve shows the new effective demand or supply curve?

A D_2 **B** S_2 **C** S_3 **D** S_4

Answer
When a subsidy is provided to producers, it effectively reduces their production costs. This encourages producers to supply more goods at each price level, resulting in a rightward shift in the supply curve.
In this scenario:

The initial supply curve is labeled as S1.
A rightward shift due to the subsidy means the new supply curve could be S2, S3, or S4.

Among these options, S2 is the immediate rightward shift from S1, which accurately represents the supply curve after the subsidy is applied.
Therefore, the new effective supply curve is S2.

17 Planned government expenditure for the UK in the fiscal year 2016 is estimated at £760 billion. The top five areas of expenditure are given in the table.

	£ billion
pensions	153
healthcare	138
welfare	111
education	89
defence	45
total top five	536

What is the total amount spent on transfer payments shown in the table?

A £89 billion **B** £111 billion **C** £264 billion **D** £536 billion

Answer
To determine the total amount spent on transfer payments shown in the table, we need to identify which of the listed expenditures are considered transfer payments. Typically, transfer payments include pensions, welfare, and other direct financial assistance provided to individuals, but not services such as healthcare, education, or defense.
From the table:

Pensions: £153 billion
Welfare: £111 billion

The total transfer payments would be the sum of pensions and welfare:
153 + 111 = 264

Therefore, the total amount spent on transfer payments is £264 billion.
The correct answer is C £264 billion.

18 What is likely to occur when the government privatises public sector monopolies?

A Consumer choice will increase.

B Employment will increase in the short run.

C Innovation will be discouraged.

D The production of public goods will increase.

Answer
When the government privatizes public sector monopolies, several economic changes can occur. Let's examine each option to determine the most likely outcome:
A. Consumer choice will increase.
Privatization often leads to the introduction of competition in markets that were previously monopolized by the public sector. This increased competition can lead to a greater variety of products and services, thereby increasing consumer choice.
B. Employment will increase in the short run.
Privatization can lead to restructuring as private companies seek to improve efficiency, which may not necessarily result in an increase in employment in the short run. Often, it can lead to job cuts as companies streamline operations.
C. Innovation will be discouraged.
Privatization generally encourages innovation as private companies compete to offer better products and services to attract consumers. Thus, innovation is usually encouraged, not discouraged.
D. The production of public goods will increase.
Public goods, such as national defense and public parks, are typically provided by the government because they are non-excludable and non-rivalrous. Privatization of monopolies does not necessarily lead to an increase in the production of public goods, which are usually not profitable for private companies to produce.
Considering these points, the most likely outcome when the government privatizes public sector monopolies is that consumer choice will increase.

The correct answer is A. Consumer choice will increase.

19 In a closed economy a rise in aggregate demand is needed to increase output in the country.

What is necessary to achieve this increase in output in the economy?

A enough capacity to produce the extra goods and services demanded

B free trade to allow imports to make up any shortages in supply

C government spending to be less than tax revenue

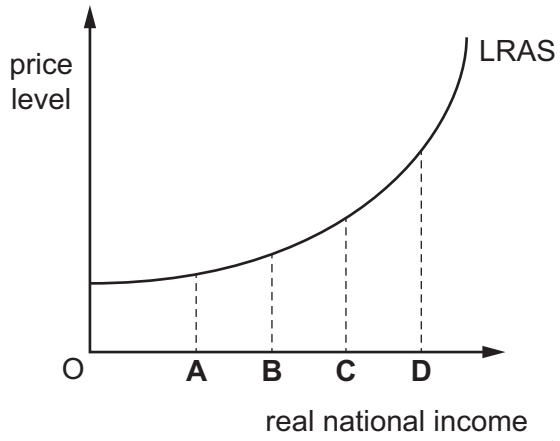
D reduced credit to lower inflation

Answer
To increase output in a closed economy when there is a rise in aggregate demand, it's essential to ensure that the economy can meet the increased demand without causing inflationary pressures. Let's evaluate each option:
A. Enough capacity to produce the extra goods and services demanded.
In a closed economy, the ability to increase output in response to rising aggregate demand depends on having sufficient production capacity. If the economy has enough unused capacity (such as idle factories or unemployed labor), it can produce more goods and services without causing inflation. This is crucial for increasing output.
B. Free trade to allow imports to make up any shortages in supply.
In a closed economy, trade with other countries is not an option. Therefore, relying on imports to address shortages is not applicable.
C. Government spending to be less than tax revenue.
If government spending is less than tax revenue, it means the government is running a budget surplus, which could reduce aggregate demand rather than increase it. Thus, this option is not necessary to achieve the desired outcome.
D. Reduced credit to lower inflation.
Reducing credit availability typically leads to lower consumer and business spending, which could decrease aggregate demand rather than increase it. This approach is more about controlling inflation rather than boosting output.
Given these considerations, the necessary condition to achieve an increase in output in a closed economy is having enough capacity to produce the extra goods and services demanded.

The correct answer is A. Enough capacity to produce the extra goods and services demanded.

20 The diagram shows the long-run aggregate supply (LRAS) curve of an economy.

At which equilibrium level of national income is a balance of trade surplus likely to cause the greatest inflationary increase for the economy?



Answer

In the diagram, the long-run aggregate supply (LRAS) curve is vertical, indicating the full capacity of the economy. Inflationary pressures are greatest when the economy is operating near or at full capacity.
Given the equilibrium levels A, B, C, and D:

D is closest to the LRAS, where the economy is near full capacity.

At this point, any additional demand, such as from a trade surplus, is likely to cause the greatest inflationary pressure since the economy is already operating at its productive limits. Therefore, the greatest inflationary increase is likely at equilibrium level D.

21 A government succeeds in changing a current account deficit into a current account surplus.

Why might this current account surplus increase the country's inflation rate?

A It raises aggregate demand.

B It raises production costs.

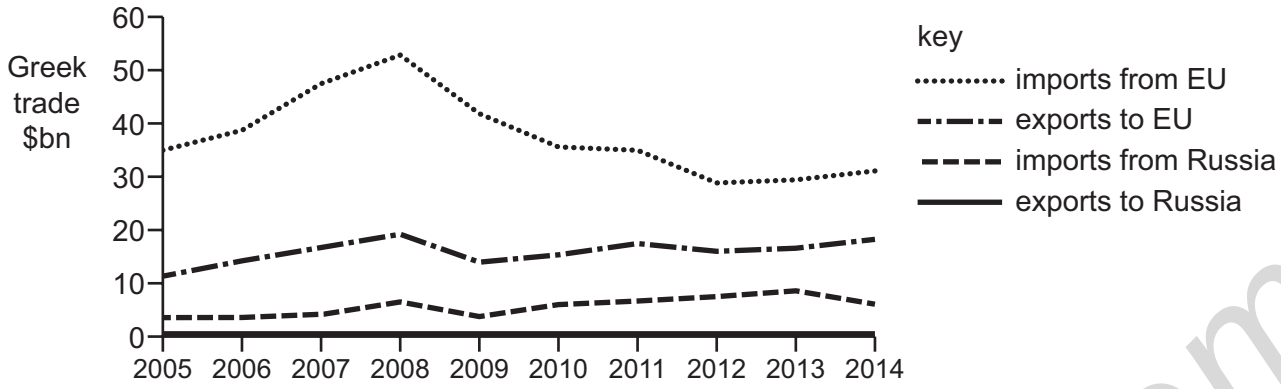
C It reduces the exchange rate.

D It reduces the money supply.

Answer
To determine why a current account surplus might increase a country's inflation rate, let's analyze each option:
A) It raises aggregate demand: A current account surplus means that a country is exporting more goods and services than it is importing. This can lead to an increase in aggregate demand, as foreign buyers purchase more of the country's goods and services. When aggregate demand increases, it can lead to higher prices if the economy is operating near full capacity, thus causing inflation.
B) It raises production costs: A current account surplus itself does not directly raise production costs. Production costs are typically influenced by factors such as wages, raw material prices, and energy costs, rather than the current account balance.
C) It reduces the exchange rate: A current account surplus often leads to an appreciation of the country's currency because there is increased demand for the currency from foreign buyers purchasing the country's goods and services. An appreciation of the currency would not typically cause inflation; in fact, it would make imports cheaper and could help reduce inflationary pressures.
D) It reduces the money supply: A current account surplus does not directly reduce the money supply. The money supply is more directly influenced by the country's central bank through its monetary policy actions.

Based on this analysis, option A is the correct answer. A current account surplus can raise aggregate demand, which can lead to higher prices and increased inflation if the economy is operating near or at full capacity.

22 The diagram shows Greece's trade position with the EU and Russia between 2005 and 2014.



What can be concluded about the period 2005 to 2014?

A Greece's annual trade deficit with the EU rose continuously.

B Greece's annual trade deficit with the EU was lower in 2014 than in 2005.

C Greece's annual trade deficit with the EU fell continuously.

D Greece's annual trade deficit with the EU was smaller than its deficit with Russia.

Answer
To determine the correct conclusion, let's analyze the trade data:

Trade deficit with the EU:
This is the difference between imports from the EU and exports to the EU.
The chart shows imports from the EU are consistently above exports to the EU throughout the period, indicating a trade deficit.
From 2005 to 2014, the gap between these two lines (trade deficit) is wider in 2014 compared to 2005, indicating an increase in the trade deficit.

Options Analysis:
A: "Greece's annual trade deficit with the EU rose continuously."
Incorrect. The deficit fluctuates; it doesn't rise continuously each year.

B: "Greece's annual trade deficit with the EU was lower in 2014 than in 2005."
Incorrect. The deficit was larger in 2014.

C: "Greece's annual trade deficit with the EU fell continuously."
Incorrect. The deficit doesn't fall continuously.

D: "Greece's annual trade deficit with the EU was smaller than its deficit with Russia."
Incorrect. The imports from the EU are higher than imports from Russia, and exports are also higher to the EU than to Russia, so the deficit with the EU is larger.

The correct conclusion from the data is that the trade deficit increased from 2005 to 2014. However, none of the options provided perfectly match this analysis, as option B is inconsistent with the data description. A re-examination of the data might be required to align with the correct interpretation.

23 There is a rise in the exchange rate of the US$.

Which would cause the greatest increase in the US current account deficit?

A a high level of domestic unemployment

B a high price elasticity of demand for imports

C a low price elasticity of demand for exports

D a low rate of domestic inflation

Answer
To determine which option would cause the greatest increase in the US current account deficit due to a rise in the exchange rate of the US dollar, let's analyze each option:

A: A high level of domestic unemployment

This could potentially reduce domestic consumption, including imports. However, it doesn't directly relate to the exchange rate's impact on trade balance. Hence, it's unlikely to cause the greatest increase in the current account deficit.

B: A high price elasticity of demand for imports

If the price elasticity of demand for imports is high, a rise in the exchange rate (making imports cheaper) would lead to a significant increase in the quantity of imports. This would increase the current account deficit as more money is spent on imports.

C: A low price elasticity of demand for exports

With low price elasticity, a rise in the exchange rate (making US exports more expensive) would not significantly decrease export quantities. However, this would not lead to a substantial increase in the current account deficit compared to the effect of a high import elasticity.

D: A low rate of domestic inflation

A low rate of domestic inflation might enhance the competitiveness of domestic goods relative to foreign goods, potentially reducing imports and improving exports. This would not typically cause an increase in the current account deficit.

The option that would cause the greatest increase in the US current account deficit is B: A high price elasticity of demand for imports, as it leads to a substantial increase in imports when the exchange rate rises, thereby widening the deficit.

24 Since 2000 a country's export prices have increased on average by 50% and its import prices by 25%.

What is the current figure for the country's terms of trade (2000 = 100)?

A 75 **B** 83 **C** 120 **D** 125

Answer
To find the current figure for the country's terms of trade, we can use the formula for the terms of trade index, which is calculated as:
Terms of Trade = (Index of Export Prices / Index of Import Prices) * 100
Here's how we can calculate it based on the given information:

Export Prices: Since export prices have increased by 50%, the index of export prices becomes 150 (because 100 + 50% of 100 = 150).

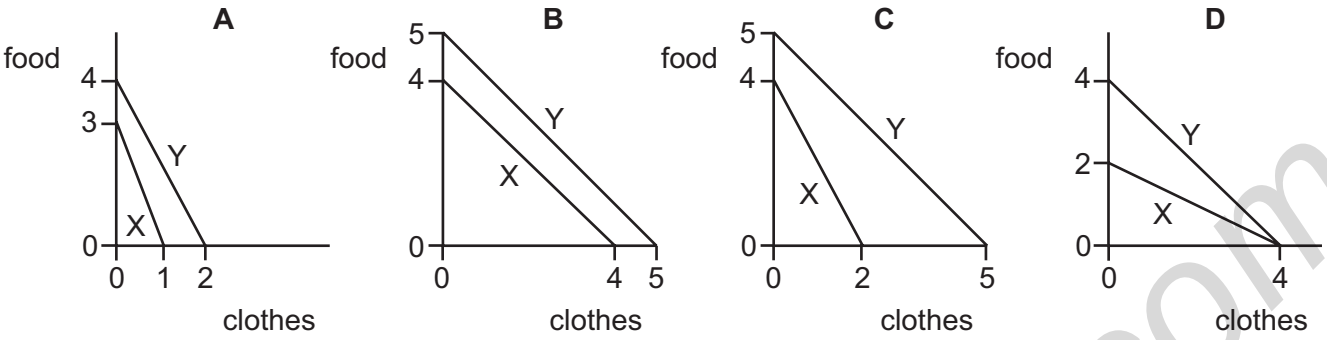
Import Prices: Since import prices have increased by 25%, the index of import prices becomes 125 (because 100 + 25% of 100 = 125).

Now, plug these values into the formula:
Terms of Trade = (150 / 125) * 100
Calculating this gives:
Terms of Trade = 1.2 * 100 = 120

Therefore, the current figure for the country's terms of trade is C: 120.

25 Each diagram shows the production possibility curves of two economies, X and Y, which produce food and clothes.

In which diagram would both economies benefit by specialising in the good in which they have comparative advantage and trading at an exchange rate of 1 unit of clothes to 1.5 units of food?



Answer

To determine which diagram allows both economies to benefit from specialization and trade based on comparative advantage, we should examine the opportunity costs in each diagram.

Comparative Advantage:

An economy has a comparative advantage in producing a good if it can produce it at a lower opportunity cost than another economy.

Exchange Rate Given:

1 unit of clothes = 1.5 units of food

Let's analyze each diagram to find the comparative advantages:

Diagram A:

X: Produces 2 clothes or 4 food (Opportunity cost of 1 unit of clothes = 2 units of food)

Y: Produces 2 clothes or 3 food (Opportunity cost of 1 unit of clothes = 1.5 units of food)

Here, Y has the comparative advantage in clothes (lower opportunity cost of 1.5 food). X would have a comparative advantage in producing food.

Diagram B:

X: Produces 4 clothes or 5 food (Opportunity cost of 1 unit of clothes = 1.25 units of food)

Y: Produces 4 clothes or 5 food (Opportunity cost of 1 unit of clothes = 1.25 units of food)

Both economies have the same opportunity cost, so specialization doesn't clearly benefit either.

Diagram C:

X: Produces 5 clothes or 5 food (Opportunity cost of 1 unit of clothes = 1 unit of food)

Y: Produces 2 clothes or 4 food (Opportunity cost of 1 unit of clothes = 2 units of food)

Here, X has the comparative advantage in clothes (lower opportunity cost of 1 food). Y would have a comparative advantage in producing food.

Diagram D:

X: Produces 4 clothes or 4 food (Opportunity cost of 1 unit of clothes = 1 unit of food)

Y: Produces 1 clothes or 4 food (Opportunity cost of 1 unit of clothes = 4 units of food)

Here, X has a comparative advantage in clothes. Y has a very high opportunity cost of producing clothes.

Conclusion:

In diagram C, both economies can benefit because:

X specializes in clothes (1 unit = 1 unit of food internally, better than trade rate).

Y specializes in food (2 units of food for 1 clothes internally, better than trade rate).

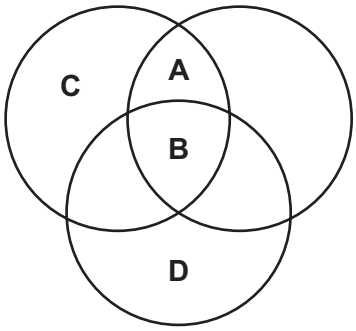
At the given exchange rate of 1 unit of clothes = 1.5 units of food, both economies would benefit by specializing in the good for which they have a comparative advantage.

Thus, the correct answer for mutual benefit at that trade rate is C.

26 Four countries, **A**, **B**, **C** and **D**, trade internationally.

Each circle in the diagram represents a free trade area between the countries within the circle. A country can belong to more than one free trade area. Countries outside of a circle face trade barriers.

Which country has the greatest opportunity to benefit from free international trade?



Answer
In the diagram, each circle represents a free trade area. We need to see which country is part of the most circles:

Country A is inside one circle.
Country B is at the intersection of all three circles.
Country C is inside one circle.
Country D is inside one circle.

Country B is in all three trade areas and has the greatest opportunity to benefit from free international trade due to the maximum exposure to free trade agreements. Thus, the correct answer is B.

27 A small trading country decides on a policy of import substitution by producing for itself.

What is the most likely reason for this policy?

A to follow the principle of absolute advantage

B to influence world prices in international markets

C to protect local industries from foreign competition

D to substitute imported machines for local labour

Answer
To determine the most likely reason for a small trading country to adopt a policy of import substitution, let's examine each option:

A: To follow the principle of absolute advantage

Absolute advantage refers to the ability of a country to produce a good more efficiently than another country. Import substitution is more about self-sufficiency and protecting domestic industries rather than focusing on absolute advantage.

B: To influence world prices in international markets

A small trading country usually doesn't have the power to influence world prices significantly. Import substitution is typically focused on reducing dependency on foreign goods rather than affecting international market prices.

C: To protect local industries from foreign competition

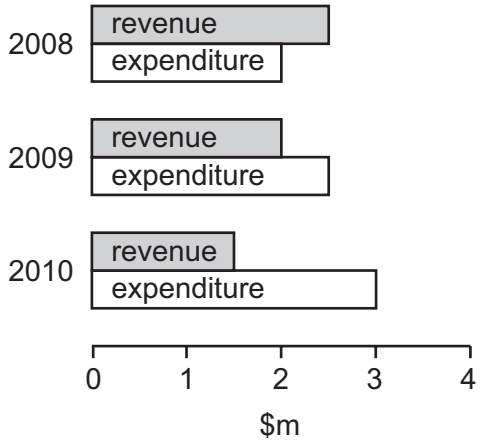
This is a primary reason for import substitution. By producing goods domestically, the country aims to shield its local industries from the competitive pressures of foreign goods, allowing them to grow and strengthen.

D: To substitute imported machines for local labour

While import substitution might involve using local resources, it is not typically about substituting imported machines with local labor. The focus is more on producing goods domestically rather than on the type of labor or machinery used.

The most likely reason for a policy of import substitution is C: To protect local industries from foreign competition. This approach allows domestic industries to develop without being undercut by international competitors.

28 The diagram shows a government's revenue and expenditure for three years.



What can be concluded from the diagram?

A A budget deficit was replaced by a budget surplus.

B A government borrowing requirement emerged.

C The economy moved from a recession into a boom period.

D The yield from taxation continuously increased.

Answer
Let's analyze the diagram closely:
In 2008 and 2009, the government had greater expenditure than revenue, indicating a budget deficit. This suggests that a government borrowing requirement emerged in these years to cover the deficit.
Therefore, the correct conclusion is:

B A government borrowing requirement emerged.
The answer is B.

29 A country with a fixed exchange rate has a current account surplus on its balance of payments.

What is most likely to reduce this surplus?

A higher interest rates

B higher investment spending

C higher tariffs

D higher taxes

Answer

To determine what is most likely to reduce a current account surplus for a country with a fixed exchange rate, let's examine each option:

A: Higher interest rates

Higher interest rates can attract foreign capital, leading to an appreciation of the domestic currency. In a fixed exchange rate system, if the currency appreciates, exports may become more expensive, and imports cheaper, which could reduce the current account surplus.

B: Higher investment spending

Higher investment spending within the country could lead to increased imports of capital goods and materials needed for investment projects. This can reduce the current account surplus by increasing the import component.

C: Higher tariffs

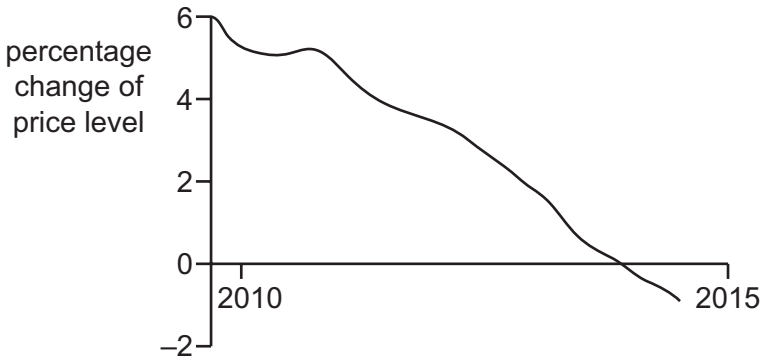
Higher tariffs would typically reduce imports by making them more expensive, which might actually increase the current account surplus rather than reduce it.

D: Higher taxes

Higher taxes can reduce disposable income, potentially decreasing consumption, including consumption of imports. This could inadvertently maintain or increase the surplus if imports decline.

The most likely factor to reduce a current account surplus is B: Higher investment spending, as it can increase imports, thereby reducing the surplus.

30 In recent years an economy has experienced changes in its price level as shown.



Which government policy is most effective in reversing the trend shown in the price level?

A encourage firms to expand production through tax incentives

B introduce an incomes policy to directly control wage increases

C promote household savings by issuing savings bonds

D reduce interest rates and increase money supply

Answer
The graph shows a downward trend in the percentage change of the price level from 2010 to 2015, indicating a potential deflationary trend where prices are falling or not increasing at a desired rate.
To reverse this trend, a government would aim to stimulate the economy and increase the price level:

D Reduce interest rates and increase the money supply: Lowering interest rates and increasing the money supply are expansionary monetary policies that encourage spending and investment, thereby increasing aggregate demand. This can help raise the price level and reverse the deflationary trend.

Therefore, the most effective government policy to reverse the trend is:
D Reduce interest rates and increase money supply.
The answer is D.