

EXAMINATIONS

28 September 2004 (am)

Subject 107 — Economics

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *Enter all the candidate and examination details as requested on the front of your answer booklet.*
2. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
3. *Mark allocations are shown in brackets.*
4. *Attempt all 37 questions. From question 27 onwards begin each answer on a separate sheet.*

Graph paper is not required for this paper.

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet, with any additional sheets firmly attached, and this question paper.

In addition to this paper you should have available Actuarial Tables and your own electronic calculator.

For questions 1–26 indicate in your answer booklet which one of the answers A, B, C or D is correct.

- 1** The problem of scarcity in economics:
- A exists only in economies which rely on the market mechanism
 - B could be eliminated if we force prices to fall
 - C means that there are shortages of some goods
 - D exists because there are insufficient resources to satisfy human wants
- [1½]
- 2** Which of the following would NOT cause an increase in demand for a normal good?
- A An increase in income.
 - B An increase in the price of a substitute.
 - C A decrease in the price of a substitute.
 - D A decrease in the price of a complement.
- [1½]
- 3** Revenues from the sale of a good will decrease if:
- A income increases and the good is normal
 - B its price rises and demand is elastic
 - C its price rises and demand is inelastic
 - D income falls and the good is inferior
- [1½]
- 4** The price elasticity of demand for a product is -3 . A reduction in price from 30 pence to 29 pence will result in an increase in demand of:
- A 3.0%
 - B 3.3%
 - C 6.0%
 - D 10.0%
- [1½]
- 5** If the cross elasticity of demand between goods X and Y is positive then:
- A X and Y are complements
 - B X and Y are substitutes
 - C the demand for X and Y are both price elastic
 - D the demand for X and Y are both price inelastic
- [1½]

- 6** The problem of moral hazard:
- A describes the situation in which those who know they are particularly bad risks are more inclined to take out insurance than those who know they are good risks
 - B reduces the cost of insurance for low risk people
 - C describes the situation in which those with insurance act in a way which makes the insured event more likely
 - D reduces the cost of insurance for high risk people
- [1½]
- 7** A firm's marginal product of labour is positive but diminishing. In the short run, the employment of additional units of labour will cause:
- A total product to fall at an increasing rate
 - B total product to fall at a decreasing rate
 - C total product to rise at an increasing rate
 - D total product to rise at a decreasing rate
- [1½]
- 8** If the price of a fixed factor of production increases by 50%, what effect would this have on the marginal costs facing a firm?
- A Marginal costs would increase by 50%.
 - B Marginal costs would increase by less than 50%.
 - C Marginal costs would increase by more than 50%.
 - D No effect.
- [1½]
- 9** Which of the following DOES NOT describe both perfect competition and monopolistic competition?
- A Each firm produces an identical product.
 - B Normal profits are made in the long run.
 - C The demand curve for the industry as a whole slopes down.
 - D Free entry and exit of firms.
- [1½]

10 Which of the following is NOT a barrier to entry in oligopoly?

- A Product proliferation.
- B Investment in spare capacity.
- C Constant returns to scale.
- D High advertising expenditure.

[1½]

11 Which of the following taxes is indirect?

- A A tax on expenditure.
- B A tax on earned income.
- C A tax on investment income.
- D A tax on rent received.

[1½]

12 If a profit maximising firm's marginal revenue is less than its marginal cost, the firm:

- A must be experiencing economic losses
- B must be making supernormal profits
- C should decrease its output
- D should increase its output

[1½]

13 A firm with fixed costs of £100 per week and a constant average variable cost of £3 per unit of output, has the following information about its weekly sales.

<i>Quantity</i>	<i>Total Revenue</i>
30	240
40	280
50	300
60	310

Which of the following quantities of sales per week produces the highest level of profits?

- A 30 units.
- B 40 units.
- C 50 units.
- D 60 units.

[1½]

- 14** Net National Product is defined as Gross National Product minus:
- A taxes
 - B transfer payments
 - C depreciation
 - D retained corporate earnings
- [1½]
- 15** Which of the following is an example of an injection into the circular flow of income?
- A Investment
 - B Saving
 - C Taxation
 - D Imports
- [1½]
- 16** Which of the following factors helps explain why the aggregate demand curve has a negative slope? As the price level falls:
- A domestic consumers have an incentive to purchase more of the cheaper goods and services
 - B the central bank will have to increase the supply of money which will lead to an increase in the amount purchased
 - C the government will have to reduce taxes which will lead to an increase in the amount purchased
 - D the real balances of people holding a fixed quantity of money increases causing them to expand their purchases
- [1½]
- 17** If a household's disposable income increases from £15,000 to £20,000 and as a result its consumption increases from £12,000 to £15,000, what is the household's marginal propensity to consume?
- A 0.8
 - B 0.75
 - C 0.7
 - D 0.6
- [1½]

- 18** The economy cannot stay at a level of real national income above long-run aggregate supply because wages will:
- A fall, thus shifting the long-run aggregate supply curve rightward
 - B fall, thus shifting the short-run aggregate supply curve rightward
 - C rise, thus shifting the long-run aggregate supply curve leftward
 - D rise, thus shifting the short-run aggregate supply curve leftward

[1½]

- 19** “Crowding out” describes the:

- A extent to which government expansionary policy is counteracted by lower private spending resulting from higher interest rates
- B extent to which government contractionary policy is counteracted by lower private spending resulting from higher interest rates
- C increase in interest rates caused by contractionary monetary policy
- D increase in consumption expenditure caused by lower taxes

[1½]

- 20** The higher the reserve requirements for commercial banks:

- A the higher the money multiplier
- B the lower the money multiplier
- C the larger the amount of total deposits that can be created from a new deposit
- D the larger the amount of total money that can be created from a withdrawal

[1½]

- 21** Money that is held because of possible unforeseen events is held because of the:

- A speculative motive for holding money
- B transactions motive for holding money
- C precautionary motive for holding money
- D asset motive for holding money

[1½]

22 Purchasing Power Parity is the principle that:

- A the exchange rate adjusts to equate the standard of living in the trading countries
- B the exchange rate adjusts to offset differences in inflation rates between countries
- C the exchange rate adjusts to equate currency values relative to gold
- D the exchange rates between currencies are fixed

[1½]

23 If the hourly production of good X and good Y by individuals A and B is as follows:

	<i>Good X</i>	<i>Good Y</i>
Individual A	10	50
Individual B	40	800

- A B has a comparative advantage in producing X and Y
- B B has a comparative advantage in producing X
- C A has a comparative advantage in producing X
- D A has a comparative advantage in producing X and Y

[1½]

24 Under a fixed exchange rate system the following approaches might be considered by governments to correct a balance of payments deficit.

- I Discouragement of imports.
- II Support for exporters.
- III Increase the level of aggregate demand.

Which of the following is most likely to achieve this objective?

- A I only.
- B II only.
- C I and II only.
- D I, II and III.

[1½]

- 25** If unemployment is above the natural level, the long run Phillips curve would suggest that, other things remaining the same, real wages would:
- A fall and unemployment would rise
 - B fall and unemployment would fall
 - C rise and unemployment would fall
 - D rise and unemployment would rise

[1½]

- 26** Which of the following is best suited to reducing the level of structural unemployment?

- A Provision of government funds for retraining the unemployed.
- B Providing higher voluntary redundancy payments for those in declining industries.
- C Increasing general government fiscal expenditure.
- D Raising unemployment benefit.

[1½]

- 27** (i) A firm, operating in a perfectly competitive market, sells goods for £10 per unit (the market price). The wage rate for workers is £70 each per day. As more workers are employed, the output of the firm increases as shown in the table below:

<i>Number of Workers</i>	<i>Output per Day</i>
0	0
1	24
2	44
3	59
4	67
5	73
6	77

Construct a table to show at each level of employment (i.e. for each number of workers) the firm's

- (a) average product of labour per day
- (b) marginal product of labour per day
- (c) marginal revenue product of labour per day

[3]

- (ii) State the profit maximising level of employment.

[1]

[Total 4]

- 28** (i) Draw a diagram to show the profit maximising price and output of a firm with a kinked demand curve in an oligopoly market. The curves in the diagram should be labelled: MR for marginal revenue, AR for average revenue, MC for marginal cost. Price and quantity should be labelled P1 and Q1 respectively. [3]
- (ii) Explain why the demand curve is kinked. [2]
[Total 5]
- 29** (i) Define the following:
- (a) the IS curve
(b) the LM curve [2]
- (ii) Using an IS/LM diagram, describe the effect of an increase in government expenditure (fiscal expansion) on the equilibrium values of the rate of interest and national income. [2]
[Total 4]
- 30** (i) Explain two potential problems caused by unanticipated inflation. [2]
- (ii) Explain four potential problems caused by anticipated inflation. [2]
[Total 4]
- 31** (i) In each of the following cases calculate the value of the multiplier assuming that the components of aggregate demand are exogenous and that there are no direct taxes.
- (a) The marginal propensity to save is 0.4.
(b) The marginal propensity to consume is 0.75. [2]
- (ii) Explain how direct taxes which are proportional to income will affect the value of the multiplier. [2]
[Total 4]
- 32** (i) Explain the meaning of the term “economic growth”. [1]
- (ii) Outline the factors which may lead to economic growth. [3]
[Total 4]

- 33** Using a Phillips curve diagram, illustrate how a reduction in the rate of growth of money supply may lead to a reduction in the rate of inflation. Use the labels LRPC and SRPC for long run and short run Phillips curves respectively. [4]
- 34** Use the following data for a hypothetical Keynesian economy to answer the questions below.
- Consumption expenditure is £425 million plus 80% of disposable national income.
 The tax rate is 15% of national income.
 Investment expenditure is £265 million.
 Government expenditure is £210 million.
 Export expenditure is £230 million.
 Imports are 10% of national income.
- (i) Calculate the level of consumption expenditure when GDP is £2400 million. [1]
- (ii) Calculate the surplus or deficit on the balance of trade when GDP is £2400 million. [1]
- (iii) Calculate the equilibrium level of GDP. [2]
 [Total 4]
- 35** (i) Outline the economic benefits which arise from international trade. [2]
- (ii) Explain the expression “the terms of trade”. [2]
 [Total 4]
- 36** (i) Describe the relationship between the marginal productivity of labour and short run marginal costs. [2]
- (ii) Describe the relationship between average long run costs of production and
- (a) economies of scale
 (b) diseconomies of scale [2]
 [Total 4]
- 37** (i) Describe an indifference curve and discuss briefly the assumptions which underpin indifference curve analysis. [5]
- (ii) Use indifference curve analysis to explain the effect of a price change on the demand for a normal good and a Giffen good. [15]
 [Total 20]

END OF PAPER