

2010 Examinations

SPECIMEN EXAMINATION

Subject CT7 — Business Economics Core Technical

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 36 questions. From question 27 onwards begin each answer on a separate sheet.*
5. *Candidates should show calculations where this is appropriate.*

Graph paper is 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 the 2002 edition of the Formulae and Tables and your own electronic calculator from the approved list.

- 1** Which one of the following is NOT a function of money?
- A A medium of exchange.
 - B A store of value.
 - C A unit of account.
 - D A measure of liquidity.
- [1½]
- 2** The Phillips curve shows that the:
- A higher the level of prices, the lower will be the rate of unemployment.
 - B higher the rate of inflation, the lower will be the rate of unemployment.
 - C lower the level of prices, the lower will be the rate of unemployment.
 - D higher rate of inflation, the higher will be the rate of unemployment.
- [1½]
- 3** Which one of the following is most likely to be the best method of reducing long term structural unemployment?
- A Expansionary fiscal policy.
 - B Expansionary monetary policy.
 - C A reduction in trade union powers.
 - D Better education and training.
- [1½]
- 4** A depreciation of sterling in the foreign exchange market would cause the sterling value of United Kingdom exports to:
- A rise while import values must fall.
 - B fall while import values must rise.
 - C rise while import value may rise or fall.
 - D fall while import value may rise or fall.
- [1½]
- 5** Which of the following would NOT be included in the current account of a country's balance of payments?
- A Property income from abroad.
 - B The purchase of shares in a UK company by foreign investors.
 - C Interest and dividends paid to the rest of the world.
 - D Exports of services.
- [1½]

- 6** “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]
- 7** According to the accelerator principle investment expenditure will:
- A fluctuate more than consumer expenditure.
 - B rise when the long term rate of interest falls.
 - C accelerate if business confidence picks up.
 - D accelerate if the government increases its capital expenditure.
- [1½]
- 8** 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 income of people earning a fixed quantity of money increases causing them to expand their purchases.
- [1½]
- 9** As a result of an economic policy change interest rates and consumption rise but investment falls. The new policy was:
- A an expansionary fiscal policy.
 - B an expansionary monetary policy.
 - C a contractionary fiscal policy.
 - D a contractionary monetary policy.
- [1½]

- 10** The short run aggregate supply schedule tells us that an increase in the average price level will encourage firms to:
- A reduce output and increase employment.
 - B reduce output and employment.
 - C increase output and reduce employment.
 - D increase output and employment.
- [1½]
- 11** Which one of the following is NOT a cause of cost push inflation:
- A an increase in the price of raw materials.
 - B an increase in wages above increases in labour productivity.
 - C an increase in profit margins applied by firms.
 - D an appreciation of the exchange rate.
- [1½]
- 12** Which one of the following accurately describes the opportunity cost of producing Good X?
- A The cost of producing Good X in money terms.
 - B The foregone output from the next best alternative use to which factors of production used to produce Good X could be put.
 - C The stream of services provided by Good X over its entire lifetime.
 - D The production of Good X foregone in the previous year to enable Good X to be produced this year.
- [1½]
- 13** 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]

- 14** Following an increase in the price of fuel there is a 20% increase in the price of air travel tickets which results in a 10% decrease in total revenue. How would you describe the demand for air travel?
- A The demand for air travel is price inelastic.
 - B The demand for air travel is price elastic.
 - C The demand for air travel is perfectly price elastic.
 - D The demand for air travel perfectly price inelastic.
- [1½]
- 15** Which of the following events would shift the demand curve for good X to the left?
- A An increase in the price of Good X.
 - B An increase in the price of a substitute good.
 - C An increase in the price of a complementary good.
 - D An increase in consumer income.
- [1½]
- 16** According to the principle of diminishing marginal utility the total satisfaction that a consumer receives from consuming Good X will:
- A rise at an increasing rate as the consumption of Good X increases.
 - B rise at a decreasing rate as the consumption of Good X increases.
 - C fall at an increasing rate as the consumption of Good X increases.
 - D fall at a decreasing rate as the consumption of Good X increases.
- [1½]
- 17** A consumer declines a gamble which offers him a 50-50 chance of winning or losing £100. His behaviour corresponds to:
- A increasing marginal utility and a risk lover.
 - B increasing marginal utility and a risk averter.
 - C diminishing marginal utility and a risk lover.
 - D diminishing marginal utility and a risk averter.
- [1½]
- 18** If the cross-price 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]

19 Which one of the following will shift the supply curve for good X to the right?

- A A decrease in labour productivity in industry X.
- B A fall in the price of raw materials used to produce good X.
- C An increase in real wages in industry X.
- D A government sales tax on the product in of good X.

[1½]

20 Which one of the following statements about market structure is TRUE?

- A Perfect competition is distinguished from all other market structures because of the assumption of no barriers to entry/exit from the industry.
- B Firms under monopolistic competition face horizontal demand curves for their products.
- C A monopoly will find that its average revenue is always greater than its average costs.
- D Under perfect competition, in the long run, each firm will find that its marginal cost is equal to its average cost of production.

[1½]

21 A perfectly competitive firm is producing at a level of output where short run marginal cost is rising and exceeds marginal revenue. What should the firm do to maximise its short run profits?

- A Reduce its output.
- B Raise its output.
- C Raise its price.
- D Reduce its price.

[1½]

22 Which of the following statements is FALSE?

- A In monopolistic competition, supernormal profits cannot be made in the long run.
- B First degree price discrimination would allow the monopolist to produce the socially efficient level of output.
- C Collusion may occur between firms in oligopolistic competition.
- D A firm in perfect competition faces a perfectly inelastic demand curve.

[1½]

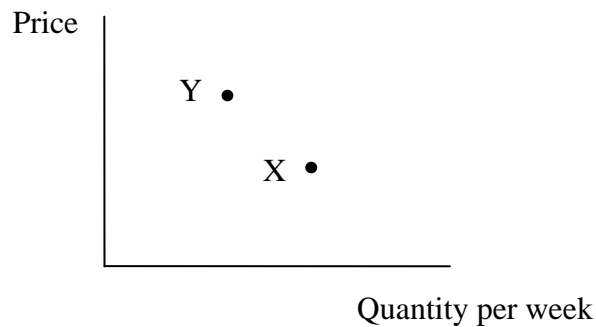
23 The prisoner's dilemma, applied to a situation involving two oligopolists, illustrates that:

- A each firm will not take account of its rival's reactions when making its decision.
- B the price set by one firm will not influence the price of the other firm.
- C in avoiding the worst possible outcome the firms will fail to reach the best possible outcome.
- D in avoiding the worst possible outcome the firms will succeed in reaching the best possible outcome.

[1½]

- 24** In the diagram below points X and Y represent the equilibrium price and quantity traded of a good in two successive time periods.

Which of the following is NOT a possible explanation?



- A An input in the production process became more expensive.
- B The price of a close substitute for the good increased.
- C An input in the production process became more expensive and the price of a close substitute increased.
- D An input in the production process became more expensive and the price of a close substitute decreased.

- 25** Which one of the following is NOT a barrier to entry into a monopoly market?

- A Significant economies of scale.
- B Heavy potential advertising costs.
- C Large capital requirements.
- D Constant returns to scale.

[1½]

- 26** Which one of the following conditions indicates that a firm is operating in a perfectly competitive industry rather than a monopolistic industry?

- A Output of the firm is where marginal revenue equals marginal cost.
- B The cost curves of the firm are U-shaped.
- C Marginal revenue equals average revenue.
- D The marginal cost curve cuts the average cost curve at its minimum point.

[1½]

- 27** (i) List THREE factors that determine the demand for shares in general. [2]
- (ii) Provide an example of a specific government policy to make the demand for petrol more elastic. [2]
- [Total 4]
- 28** (i) Describe the concept of moral hazard in the context of insurance. [2]
- (ii) List TWO ways in which insurance companies attempt to mitigate the additional risk arising from moral hazard. [2]
- [Total 4]
- 29** A country is experiencing low aggregate demand due, in part, to reduced availability of credit.
- Explain the methods which the central bank could use to change the money supply in order to stimulate aggregate demand. [5]
- 30** (i) State whether each of the following is an example of a horizontal, vertical, or conglomerate type of merger.
- (A) A company providing roadside recovery service merging with a company providing energy.
- (B) A building society merging with a bank.
- (C) A supermarket chain merging with a distribution company. [2]
- (ii) Explain the extent to which consumers' interests are affected by mergers. [2]
- [Total 4]

- 31** A profit maximising firm has its marginal cost and marginal revenue both equal to 5 when output is 8 units. It sells an identical product in two separate markets X and Y , with average revenue given by the following functions:

$$P_x = -Q_x + 11$$

$$P_y = -2Q_y + 25$$

Where P_x , P_y denote prices and Q_x , Q_y are units of output in markets X and Y respectively.

- (i) Determine the total revenue function for each market. [2]
 - (ii) Calculate the marginal revenue for suitable levels of output in each market; the amount of output that the firm will sell; and the price it will charge in each market, assuming the firm is able to exercise third-degree price discrimination. [4]
- [Total 6]

- 32** Describe TWO examples of negative externalities and TWO examples of positive externalities which affect the social efficiency of markets. [4]

- 33** In a two-country world, where only two countries A and B trade, the demand and supply for the currency of A are given by the following functions:

Demand for A 's currency: $Q_d = 13 - 10E$

Supply of A 's currency: $Q_s = 2.5 + 5E$

Where E = the equilibrium exchange rate for A 's currency, Q_d and Q_s are the demand and supply for A 's currency.

- (i) Draw a diagram and use this to find the equilibrium exchange rate under a floating exchange rate system. [2]
 - (ii) Explain how the equilibrium exchange rate will be restored if the current exchange rate is above or below this rate. [2]
 - (iii) Describe TWO factors that would cause shifts in the demand and supply for Country A 's currency. [2]
- [Total 6]

- 34**
- (i) A bank's liquidity ratio is 10 per cent, and the bank's deposits increase by £50 billion. Calculate the increase in total deposits. [2]
 - (ii) Explain in what circumstances the overall multiplier effect could be smaller than that shown by your result in (i) above. [2]
- [Total 4]

- 35** (i) In a closed economy the marginal propensity to consume domestically produced goods is 0.75. Calculate the increase in the equilibrium GDP if government expenditure increases by 20. [2]
- (ii) Explain why the value of the multiplier might be lower in some countries, compared to that in other countries. [2]
- [Total 4]
- 36** (i) List the main features of a product which a supplier might focus on in its strategy of product differentiation. [2]
- (ii) Explain the factors which have influenced the sale of supermarkets' own brands in the past two decades. [5]
- (iii) State the arguments for and against advertising. [5]
- (iv) Analyse, with reference to appropriate diagrams, the short-run and the long-run effects of advertising on a product's sales and profitability. [8]
- [Total 20]

END OF PAPER