Cambridge International AS & A Level

Cambridge International Examinations
General Certificate of Education
Advanced Subsidiary Level and Advanced Level

ECONOMICS **9708/03**

Paper 3 Multiple Choice **For Examination from 2016**

SPECIMEN PAPER

1 hour 15 minutes

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

READ THESE INSTRUCTIONS FIRST

Write your Centre number, candidate number and name on the Answer Sheet in the spaces provided unless this has been done for you.
Write in soft pencil.
Do not use staples, paper clips, glue or correction fluid.
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 **15** printed pages and **1** blank page.

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1 All firms in an economy produce at levels of output where price and marginal private cost are equal.

Why might this **not** be sufficient to ensure that allocative efficiency is achieved?

A a small number of buyers and sellers

B differences in consumers' preferences

C product differentiation

D the presence of externalities

2 Which problem might an extension of defined property rights help to resolve?

A a divergence between private and social costs

B imperfect information on the part of consumers

C inequalities of income and wealth

D the exploitation of consumers by a monopoly supplier

3 In a social cost-benefit study what would be included when calculating the net social benefit of raising the maximum speed limit on motorways from 70 mph to 80 mph?

	an increase in road deaths	an increase in fuel consumption	an increase in revenue from petrol tax	a reduction in journey times
A	no	no	no	yes
B	yes	no	yes	no
C	yes	yes	no	yes
D	no	yes	yes	no

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4 The table shows the total utility that an individual derives from consuming different quantities of a good.

quantity of good (units)	total utility (units)
1	20
2	36
3	50
4	62
5	72
6	80

The individual's marginal utility of money is $1 = 2 units of utility.

What is the maximum quantity of the good that the individual will buy when its price is $6?

A 2 units **B** 3 units **C** 4 units **D** 5 units

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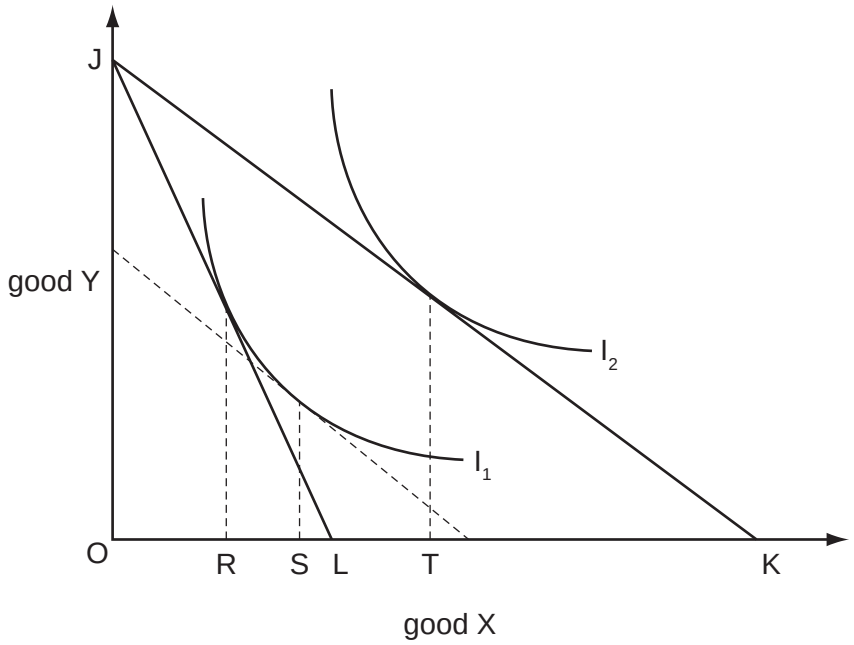
5 In the diagram I_1 and I_2 are an individual's indifference curves and JK is her initial budget line.



An increase in the price of good X causes her budget line to shift to JL.

Which distances measure the resulting income and substitution effects on the quantity demanded of good X by the individual?

	income effect	substitution effect
A	RT	RS
B	RT	RL
C	ST	RS
D	ST	RL

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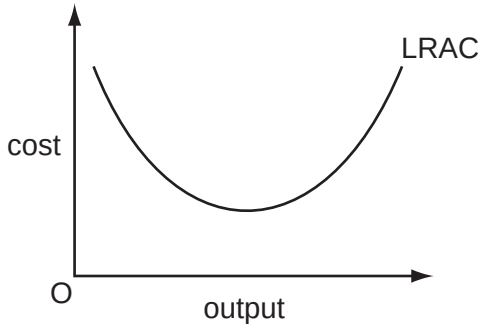
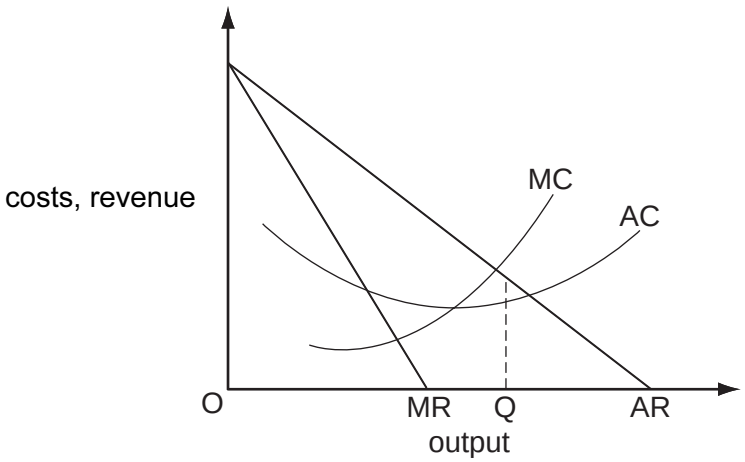
6 The diagram shows the long-run average cost curve of a firm which faces constant factor prices.



Which economic concepts in the table explain the shape of the LRAC curve?

	economies and diseconomies of scale	the law of diminishing returns	the law of variable proportions
A	✓	✓	×
B	✓	×	×
C	×	✓	✓
D	×	×	✓

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



What could explain why the firm produces output OQ?

A It is operating in a contestable market.

B It is operating in a perfectly competitive market.

C It is seeking to maximise profits.

D It is seeking to maximise sales revenue.

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8 Which feature of an economy would be most favourable for the survival of small firms?

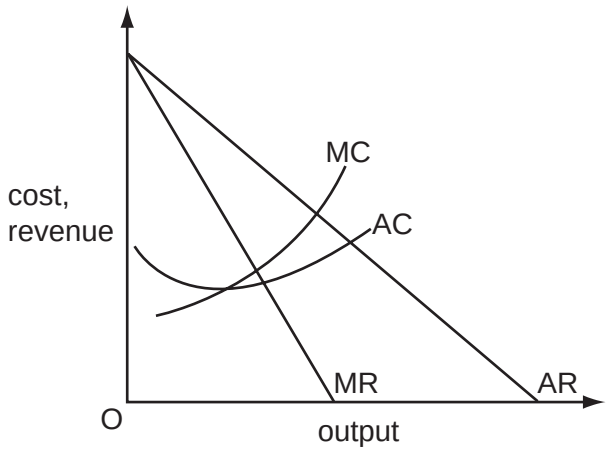
A capital intensive production

B economies of scale in production

C preference for standardised products

D the widespread availability of bank lending

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



The firm changes its objective from sales revenue maximisation to profit maximisation.

Which groups are most likely to be winners and losers as a result of this change?

	winners	losers
A	customers	managers
B	managers	workers
C	workers	shareholders
D	shareholders	customers

10 The demand for a firm's product is perfectly inelastic.

What will be the effect on the firm's revenue if it increases its price by 5%?

A Its revenue will be unchanged.

B Its revenue will increase by 5%.

C Its revenue will decrease by 5%.

D Its revenue will fall to zero.

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11 Which policy change might a firm's owners introduce to deal with a principal agent problem?

A an extension of the firm's opening hours from 9.00 am–5.00 pm to 8.00 am–8.00 pm

B a switch from monthly salaries to profit-related pay

C a switch from pursuing profit maximisation to the pursuit of sales revenue maximisation

D the introduction of preferential terms for its regular customers

12 What is limit pricing designed to achieve?

A to deter potential competitors from entering a firm's market

B to minimise a firm's potential losses

C to set an upper limit on a firm's profitability

D to set a lower limit on a firm's market share

13 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.

		price charged by X	
		P_X = \$20	P_X = \$10
price charged by Y	P_Y = \$20	\$5m$_X$ \$5m$_Y$	\$9m$_X$ –\$2m$_Y$
	P_Y = \$10	–\$2m$_X$ \$9m$_Y$	zero$_X$ zero$_Y$

In the absence of collusion, what will be X's profits?

A –\$2 million **B** zero **C** \$5 million **D** \$9 million

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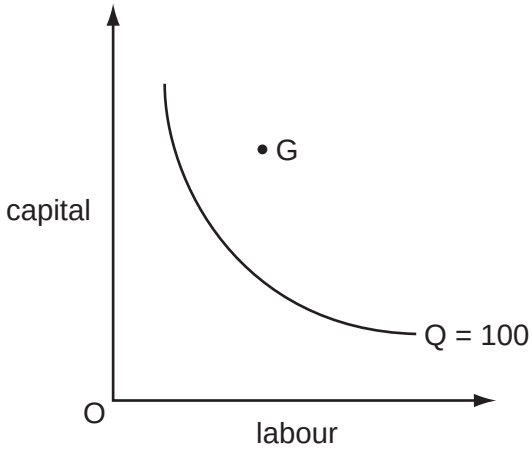
14 The curve in the diagram shows the minimum combinations of capital and labour that are needed to produce 100 units of output.



A firm's management hires the combination of capital and labour indicated by point G in the diagram to produce 100 units of output.

Which term best describes this situation?

A lack of specialisation

B managerial diseconomy

C market failure

D X-inefficiency

15 A recent study undertaken in an advanced economy found that simply increasing the income of a pensioner by $100 will increase their spending on fuel by $3.

However, if the increase is labelled the 'Cold Weather Fuel Allowance' then $41 will be spent on fuel.

What can be concluded from this finding?

A The payment of a cold weather fuel allowance should be related to income (means tested).

B The cold weather fuel allowance should be replaced by an equivalent increase in the state pension.

C People can be relied upon to act in their own best interests.

D People's behaviour does not always conform to economists' traditional expectation of rational behaviour.

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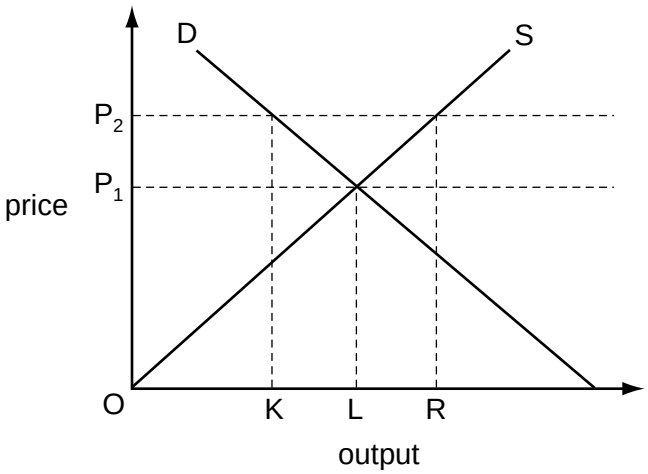
16 A country has a floating exchange rate and an independent central bank with the power to set interest rates.

The inflation rate is currently stable at the central bank's target rate of 5%.

What is likely to happen to interest rates and to the exchange rate if the bank's target rate was reduced to 2%?

	interest rates	exchange rate
A	decrease	depreciate
B	decrease	appreciate
C	increase	depreciate
D	increase	appreciate

17 The diagram shows the market supply and demand curves for corn.



What should a government do if it is to maintain a minimum price of OP_2?

A buy quantity KR

B buy quantity LR

C sell quantity KL

D sell quantity OL

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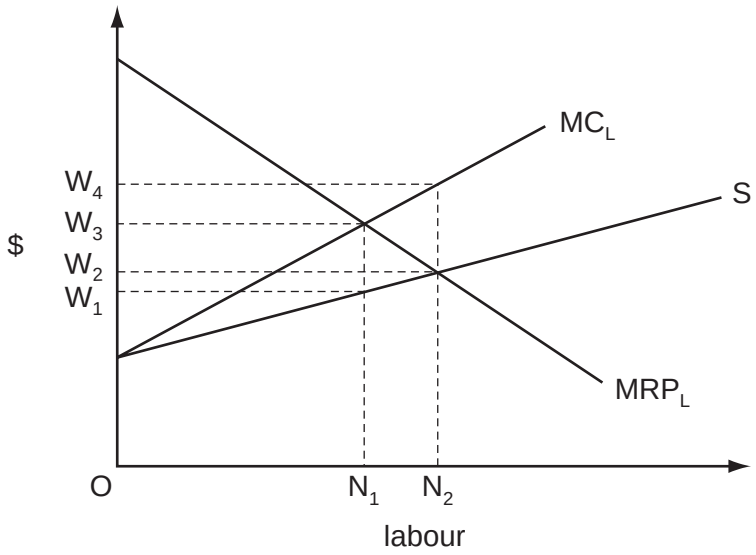
18 In the diagram, MRP_L is a firm's marginal revenue product of labour curve, S is its supply of labour curve, and MC_L its marginal cost of labour curve.



Assuming profit maximisation, how many workers will the firm employ and what wage will it pay?

	number employed	wage
A	N_1	W_1
B	N_1	W_3
C	N_2	W_2
D	N_2	W_4

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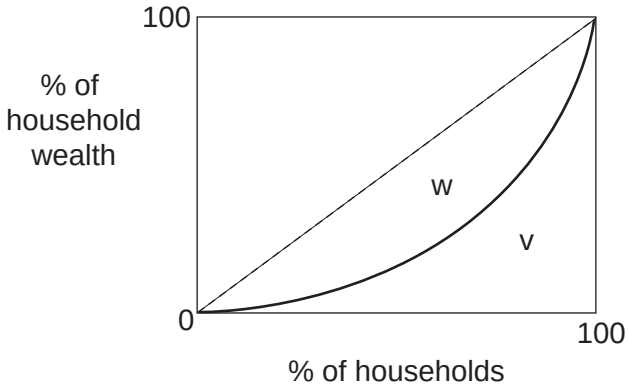
19 The Lorenz Curve in the diagram depicts the distribution of household wealth in an economy.



How is the economy's Gini Coefficient of Inequality measured?

A area w

B area w – area v

C $\frac{\text{area w}}{\text{area v}}$

D $\frac{\text{area w}}{\text{area w} + \text{area v}}$

20 The table gives the percentage of employment in the primary, secondary and tertiary sectors in four countries.

Which country is most likely to be a developing country?

	primary sector %	secondary sector %	tertiary sector %
A	15	40	45
B	30	40	30
C	35	45	20
D	45	35	20

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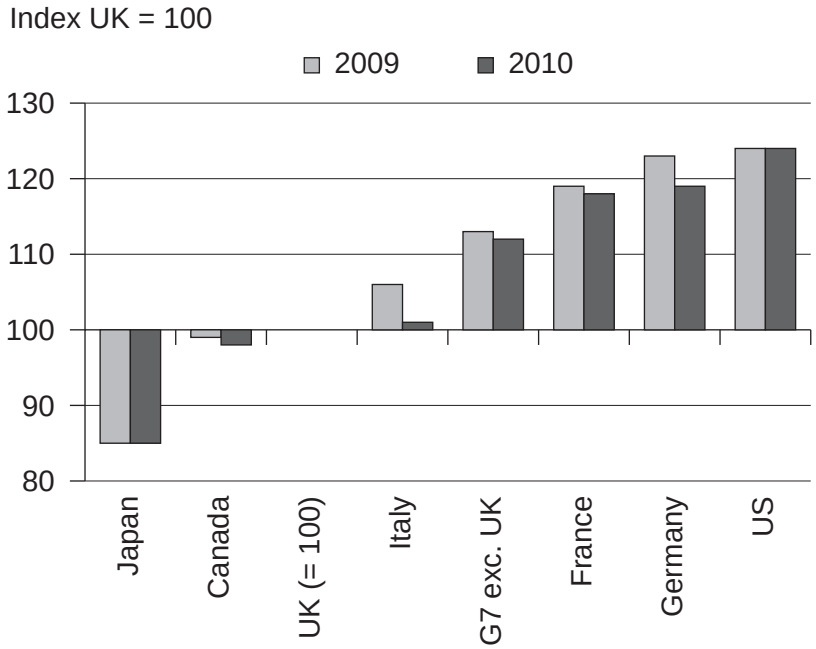
21 The graph shows GDP per hour worked in the G7 group of countries relative to the United Kingdom in 2009 and 2010.



Source: ONS

What can be concluded from the graph?

A GDP per hour worked was unchanged in the United Kingdom between 2009 and 2010.

B GDP per worker was lower in the United Kingdom than in Italy in 2009 and 2010.

C Productivity in Japan and the United States was unchanged between 2009 and 2010.

D The gap in GDP per hour worked between Germany and France was unchanged between 2009 and 2010.

22 Which correctly identifies injections into a country's circular flow of income?

	private sector I > S	government sector G > T	trade sector M > X
A	no	yes	yes
B	yes	no	no
C	yes	yes	no
D	no	no	yes

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23 Other things remaining unchanged, what is likely to be a consequence of an increase in net cash withdrawals from the commercial banks?

A an inflationary spiral

B an increase in the cash reserves of the commercial banks

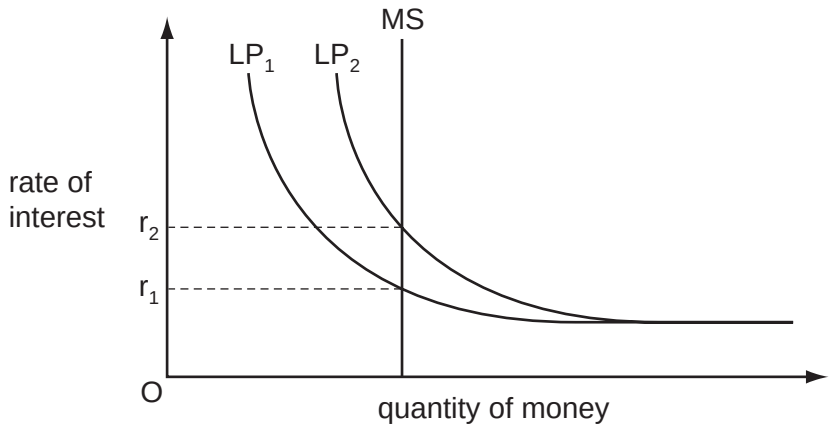
C an increase in the liquidity of the commercial banks

D a restriction in the ability of the commercial banks to lend

24 According to monetarist theory, what will be the short-run effect on the level of output and on the price level of an unanticipated increase in the money supply?

	effect on output	effect on the price level
A	increase	increase
B	increase	no change
C	no change	increase
D	no change	no change

25 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 increased government expenditure

B increases in indirect taxes

C reductions in income tax rates

D the purchase of bonds in the open market

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26 Which policy is likely to promote economic development in a developing economy but may lead to a decline in the rate of economic growth?

A a policy to increase female participation in the labour market

B a policy to increase immunisation rates

C a policy to reverse environmental degradation

D a policy to promote exports

27 Other things being equal, what is likely to result from an increase in interest rates in a country?

A a capital outflow from the country

B a depreciation of the country's currency

C a decrease in consumption

D an increase in investment

28 Without any change in government policy, what will be the effect of an economic recession on tax revenue and on government expenditure?

	tax revenue	government expenditure
A	decrease	decrease
B	decrease	increase
C	increase	increase
D	increase	decrease

29 In an economy, the marginal propensity to consume of the unemployed is higher than that of taxpayers.

The government increases expenditure on unemployment benefits by $10 million.

What will the government need to do if it wishes to keep aggregate demand unchanged?

A raise taxation by less than $10 million

B raise taxation by more than $10 million

C raise taxation by $10 million

D leave taxes unchanged

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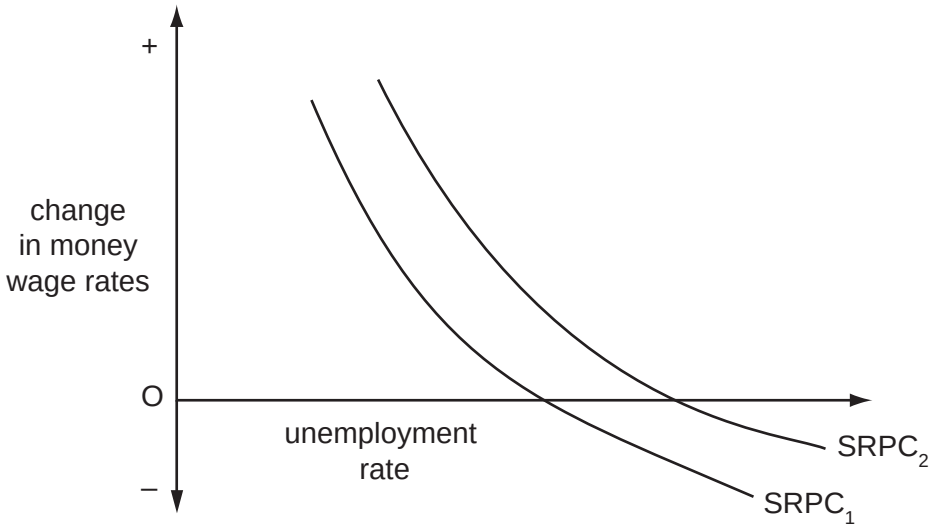
30 In the diagram, the curve $SRPC_1$ is an economy's initial short-run Phillips Curve.



What could cause the curve to shift to $SRPC_2$?

A a depreciation of the currency

B a decrease in the expected rate of inflation

C an increase in interest rates

D an increase in the natural rate of unemployment

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