

**ECONOMICS  
HIGHER LEVEL  
PAPER 2**

Thursday 20 May 2004 (afternoon)

1 hour

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**INSTRUCTIONS TO CANDIDATES**

- Do not turn over this examination paper until instructed to do so.
- Answer four questions.
- Use diagrams and real-world examples where appropriate.

*Each question is worth [10 marks].*

1. “As price falls the quantity supplied falls. As supply increases price falls.” Use supply and demand analysis to explain why these two statements do **not** contradict each other.
  2. Why is the concept of income elasticity of demand likely to be important for a producer of an agricultural product? Use supply and demand analysis in your answer.
  3. A firm in perfect competition is producing at the profit maximizing output, but making a loss. Using diagrammatic analysis, explain how this is possible.
  4. Use an aggregate demand/aggregate supply diagram to explain how cost push inflation may occur, and outline **two** ways in which it might be controlled.
  5. Explain how, in theory, balance of payments deficits and surpluses on current account are automatically adjusted under a system of flexible exchange rates. Illustrate your answer using supply and demand analysis.
  6. Use a production possibility curve to explain the distinction between economic growth and economic development.
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