

**ECONOMICS  
STANDARD LEVEL  
PAPER 1**

Thursday 20 May 2004 (afternoon)

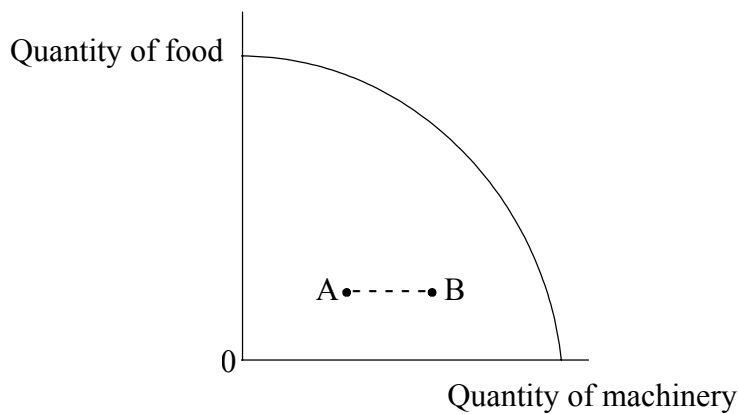
1 hour

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**INSTRUCTIONS TO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- Answer all the questions.
- For each question, choose the answer you consider to be the best and indicate your choice on the answer sheet provided.

1. Which of the following represents a positive economic statement?
  - A. The recent increase in interest rates will help to reduce inflation.
  - B. Unemployment is a more serious economic problem than inflation.
  - C. Government expenditure on health and education should be raised.
  - D. The proportion of tax revenues raised from indirect as opposed to direct taxes is too high.
  
2. An economic good is one that
  - A. has an unlimited supply.
  - B. involves an opportunity cost when consumed.
  - C. is taxed at a higher rate because of negative externalities.
  - D. is not found in a planned economy.
  
3. The following graph shows the production possibility curve of a given country.

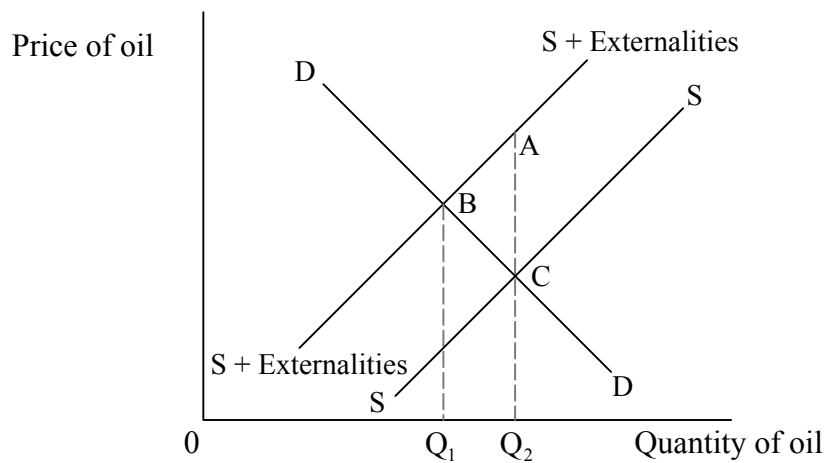


The move from point A to point B would represent

- A. increasing opportunity costs in terms of food.
- B. decreasing opportunity costs in terms of machinery.
- C. constant opportunity costs in terms of food.
- D. no opportunity cost.

4. Which of the following is considered to be an essential characteristic of the price mechanism?
- A. Resources are allocated in response to price changes.
  - B. Buyers and sellers set prices according to their preferences.
  - C. A socially optimum pattern of resource allocation is achieved.
  - D. Goods and services produced always reflect consumer sovereignty.

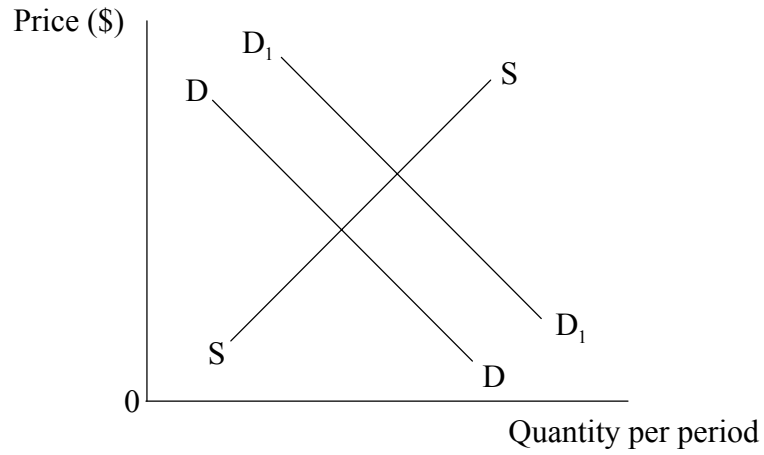
5. The diagram below represents the market for oil.



A way to internalize the externalities associated with the production of oil would be to

- A. impose an environmental tax on the price of oil equivalent to AC.
- B. extend property rights to those affected by pollution from oil consumption equal to BC.
- C. increase quotas on the production of oil from  $0Q_1$  to  $0Q_2$ .
- D. issue pollution permits up to, but not beyond, a level equal to  $0Q_2$ .

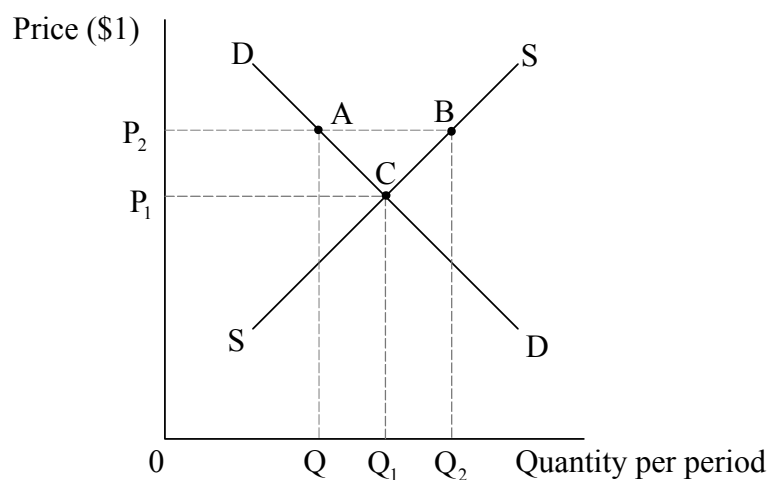
6. The diagram below represents the market for rail travel in country X.



The shift of the demand curve from D to D<sub>1</sub> could be explained by the government's decision to

- A. expand its road building programme.
- B. abolish motorway/freeway tolls.
- C. reduce rail subsidies.
- D. impose a tax on car parking at work-places.

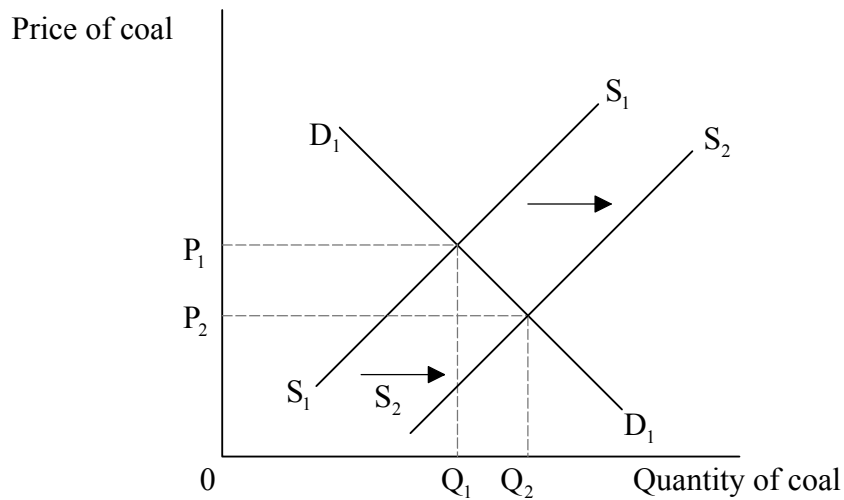
7. The diagram below represents the market for an agricultural product in which a floor price of  $OP_2$  is set.



If the government buys up all the surplus stocks at the floor price, what would the farmers' total income be?

- A.  $OP_1CQ_1$
- B.  $OP_2BQ_2$
- C.  $QABQ_2$
- D.  $OP_2AQ$

8. The diagram below represents the market for coal.



Which of the following will cause the supply of coal to increase from  $S_1$  to  $S_2$ ?

- A. A decrease in the price of coal.
  - B. More efficient methods of mining coal.
  - C. An expansion in the demand for coal.
  - D. A rise in the price of substitutes for coal.
9. Market failure occurs when
- A. firms in a particular market are forced out of business.
  - B. market demand exceeds market supply.
  - C. a good with a negative externality is overproduced.
  - D. firms are unable to make adequate profits.

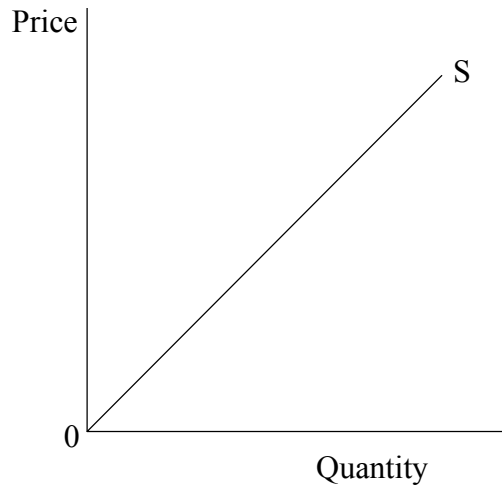
10. The table below shows the costs and benefits from producing different quantities of a chemical.

<b>Output of chemicals (tons per week)</b>	<b>Marginal private cost (\$000)</b>	<b>Marginal social cost (\$000)</b>	<b>Marginal social benefits (\$000)</b>
500	100	130	165
600	130	160	160
700	160	170	150
800	180	190	130

In order to achieve the best outcome from society's point of view,

- A. output of the chemical should be completely banned.
  - B. there should be a maximum output of 600 tons per week.
  - C. the firm should produce at its profit maximizing output.
  - D. marginal social benefit should be maximized by producing 500 tons per week.
11. Income elasticity of demand shows the responsiveness of
- A. income to a change in demand.
  - B. quantity demanded to a change in price.
  - C. quantity demanded to a change in income.
  - D. price to a change in income.
12. A supermarket reduces the price of melons from \$3 to \$2 each. Subsequently, the daily sales increase from 200 to 250. The price elasticity of demand is
- A. -0.25.
  - B. -0.75.
  - C. -1.00.
  - D. -1.33.

13. The diagram below shows a supply curve.



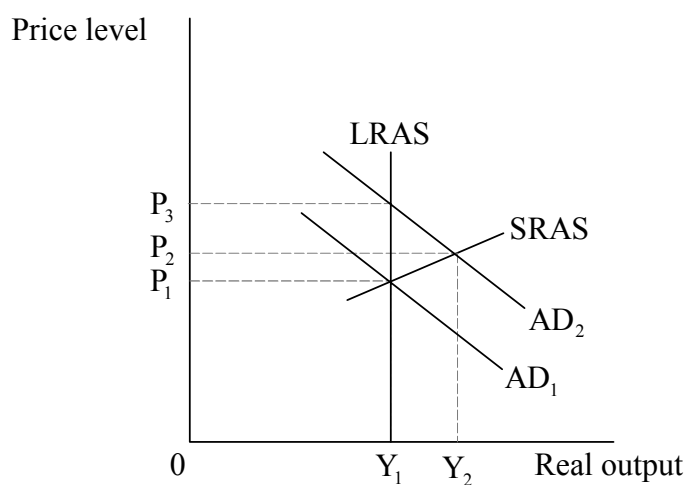
According to the diagram as the price and the quantity increase, the price elasticity of supply

- A. becomes elastic.
  - B. becomes inelastic.
  - C. remains unitary.
  - D. increases and then falls.
14. Cross elasticity of demand measures the extent to which the
- A. price of good X is affected by a change in the supply of good Y.
  - B. price of good X is affected by a change in the price of good Y.
  - C. demand for good X is affected by a change in the price of good Y.
  - D. demand for good X is affected by a change in the price of good X.



15. If the supply of a product is dominated by a small number of large firms, the structure of the market can be said to be
- A. oligopolistic.
  - B. monopolistic competition.
  - C. perfectly competitive.
  - D. monopoly.
16. An economy has achieved allocative efficiency if
- A. goods are produced at their lowest cost.
  - B. it stops responding to technical change.
  - C. it is unable to produce more output by transferring any resources between industries.
  - D. all negative externalities have been eliminated.
17. What are the three leakages from the circular flow of income?
- A. Investment, taxes and spending on imports.
  - B. Saving, taxes and spending on imports.
  - C. Saving, government spending, spending on imports.
  - D. Saving, taxes, spending on exports.
18. Which of the following changes are necessary to convert National Income at Market Prices into National Income at Factor Cost?
- A. Subtract indirect taxes and add subsidies.
  - B. Subtract both indirect taxes and subsidies.
  - C. Add both indirect taxes and subsidies.
  - D. Add indirect taxes and subtract subsidies.

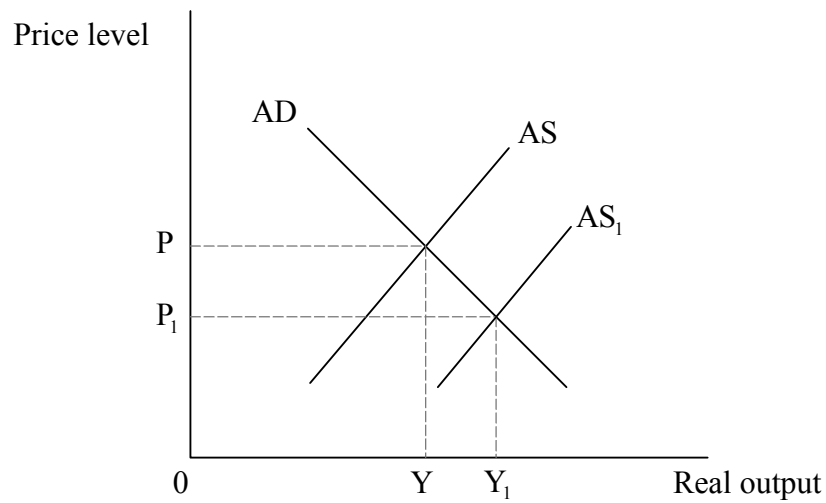
19. The diagram below illustrates the aggregate demand curves (AD), long-run aggregate supply curve (LRAS) and short-run aggregate supply curve (SRAS) for an economy.



The shift of the AD curve from  $AD_1$  to  $AD_2$  will

- A. increase both output and inflation in the short-run.
- B. leave inflation and output unchanged in the short-run.
- C. increase output but not inflation in the long-run.
- D. leave inflation and output unchanged in the long-run.

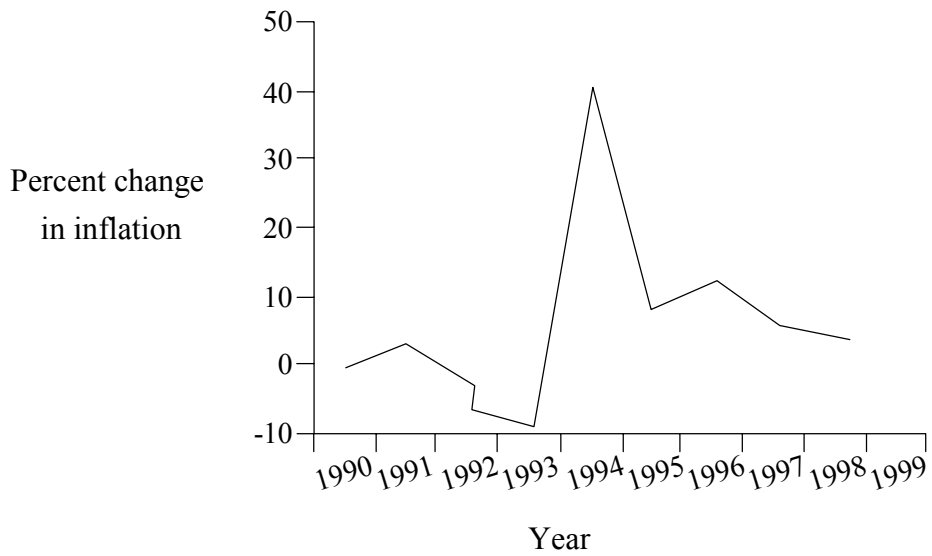
20. The diagram below shows the aggregate demand (AD) and aggregate supply curves (AS) for an economy.



Which of the following is most likely to explain the shift of the aggregate supply curve from AS to AS<sub>1</sub>? An increase in

- A. private consumption.
  - B. the capital stock.
  - C. wage costs.
  - D. the money supply.
21. An increase in interest rates is most likely to have which **one** of the following economic effects?
- A. A decrease in bank profits.
  - B. A reduction in new housing loans.
  - C. A decrease in the level of unemployment.
  - D. A rise in investment spending.

22. The graph below shows inflation levels in Chad (Central Africa) from 1990 to 1998.



[Source: African Development Report 1999]

The graph shows that prices fell over the period(s) of

- A. 1992 – 1993.
  - B. 1994 – 1995.
  - C. 1996 – 1998.
  - D. 1992 – 1993 and 1994 – 1998.
23. An expansionary fiscal policy may include which **one** of the following?
- A. Lower rates of taxation and increased government spending.
  - B. Lower interest rates.
  - C. An increase in money supply.
  - D. Lower government spending and higher rates of taxation.

24. The table below shows the changes in inflation and the money supply in Africa from 1995 to 1998.

<b>Africa: Macroeconomic indicators</b>				
<b>Indicators</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>
Inflation (%)	33.0	25.1	13.7	12.0
Growth of the money supply (%)	22.6	18.4	15.8	12.4

[Source: *ADB Statistics Division and IMF*, cited in African Development Report 1999]

Based on the data above, which of the following statements is most likely to be correct for African economies?

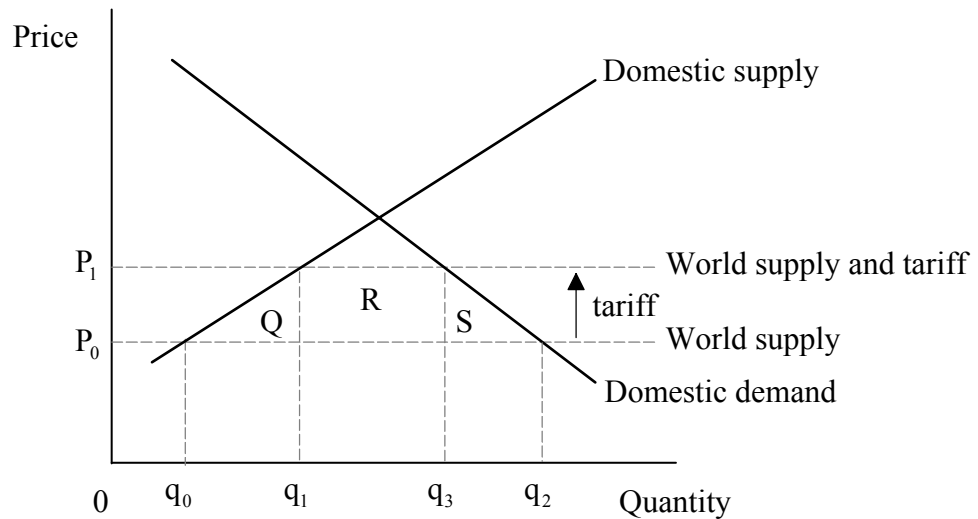
- A. There is a recession.
  - B. Government budgets are approaching balance.
  - C. Standards of living must be falling.
  - D. Monetary policy is being tightened.
25. This question refers to the table below.

<b>Country</b>	<b>Output per unit of input</b>	
	<b>Clothing</b>	<b>Food</b>
Fenna	300	600
Kensari	100	400

From the table above, it can be concluded that

- A. Kensari has a comparative advantage in clothing.
- B. Fenna has a comparative advantage in food.
- C. Kensari has an absolute advantage in both goods.
- D. Fenna has an absolute advantage in both goods and a comparative advantage in clothing.

26. Which **one** of the following would **not** increase barriers to world trade?
- A. The imposition by the Indian government of controls on medicines produced overseas.
  - B. The abolition of agricultural support systems provided to farmers in the European Union.
  - C. A requirement by the Chinese government that customs documents be presented and completed in Chinese.
  - D. A voluntary agreement between the government of the USA and foreign producers limiting the volume of textile imports to the USA.
27. This question is based on the demand and supply diagram below.

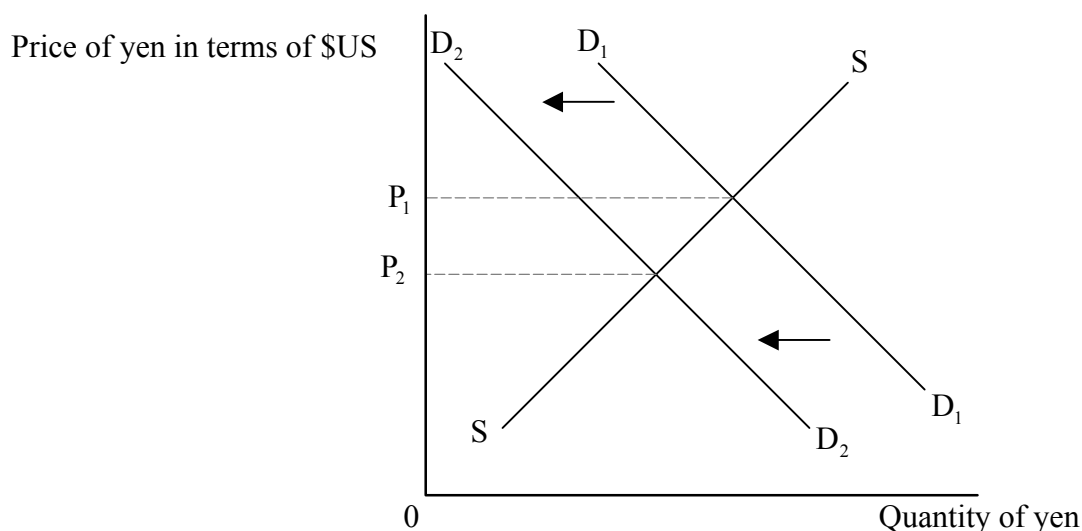


Which of the following areas correctly show the tax revenue which the government would receive when a tariff is imposed?

- A. Area Q
- B. Area R
- C. Area S
- D. Areas Q, R and S

28. A group of countries who have agreed to the free movement of goods, services and factors of production between members countries, and who have a common external tariff, is known as a
- A. free trade area.
  - B. customs union.
  - C. common market.
  - D. World Trade Organization.
29. Which of the following will result in an increase in the credit transactions for a country's balance of payments on capital account?
- A. An increase in the rate of interest paid on external borrowings.
  - B. Larger loans made to countries under IMF agreements.
  - C. Increased payments received for services provided to overseas users.
  - D. Increased borrowing from overseas creditors.

30. The diagram below illustrates a depreciation of the Japanese yen in terms of United States dollars (\$US) in a freely floating foreign exchange market.



Which of the following is the most likely cause of the depreciation of the Japanese yen illustrated?

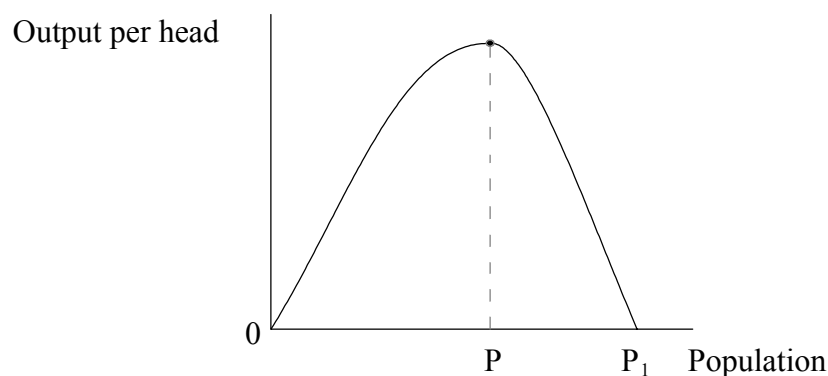
- A. More Japanese tourists are travelling overseas.
  - B. A decrease has occurred in Japanese investment abroad.
  - C. The Japanese rate of inflation is persistently lower than that experienced by its trading partners.
  - D. The level of exports from Japan has fallen.
31. The theory of purchasing power parity suggests that, over time, exchange rates will move in line with which **one** of the following?
- A. Trade balances
  - B. Interest rates
  - C. Inflation rates
  - D. Unemployment rates



32. When a country has an improving terms of trade, it will be experiencing
- A. an increase in export earnings compared to import expenditure.
  - B. a rate of inflation that is lower than its trading partners.
  - C. increased purchasing power of its exports.
  - D. a depreciation of its exchange rate.
33. Economic growth is most likely to lead to economic development if it is accompanied by greater
- A. levels of consumption on luxury goods and services.
  - B. government expenditure on merit goods.
  - C. reliance on the price system and the “trickle down” of income.
  - D. tax incentives to multinational corporations.
34. How do capital stocks, energy consumption *per capita* and the degree of urbanization in less developed countries (LDCs) compare with more developed countries?

In LDCs...			
	Capital stocks are	Energy consumption <i>per capita</i> is	The degree of urbanization is
A.	higher	lower	higher
B.	lower	lower	lower
C.	lower	higher	higher
D.	higher	lower	lower

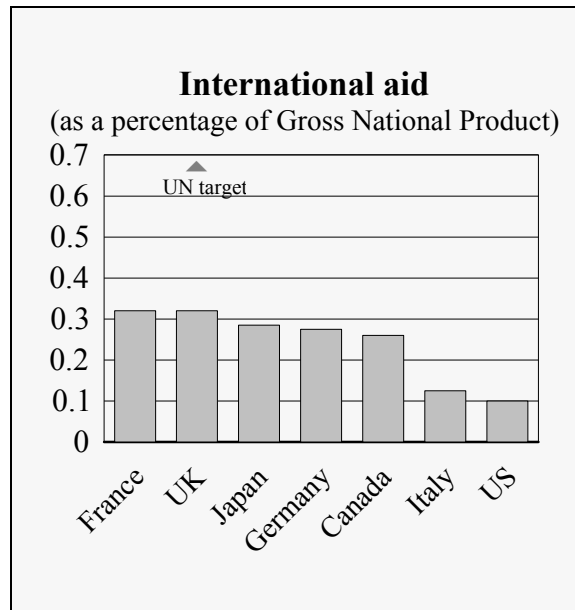
35. The diagram below relates output per head to population size, with given resource availability.



On the basis of this diagram, underpopulation occurs

- A. only at 0.
  - B. between points 0 and P.
  - C. at 0P.
  - D. between points P and  $P_1$ .
36. Historically, the less developed countries (LDCs) have specialized in the production of primary commodities. This pattern of specialization has been disadvantageous because primary commodities tend to have a
- A. positive price elasticity of demand.
  - B. high price elasticity of supply in the short-run.
  - C. negative cross elasticity of demand.
  - D. low income elasticity of demand.
37. The government of a less developed country (LDC) gives cash grants to its trainee teachers. This is an example of investment in
- A. social capital.
  - B. appropriate technology.
  - C. productivity payments.
  - D. human capital.

38. The chart below shows international aid given by donor countries in 2001.

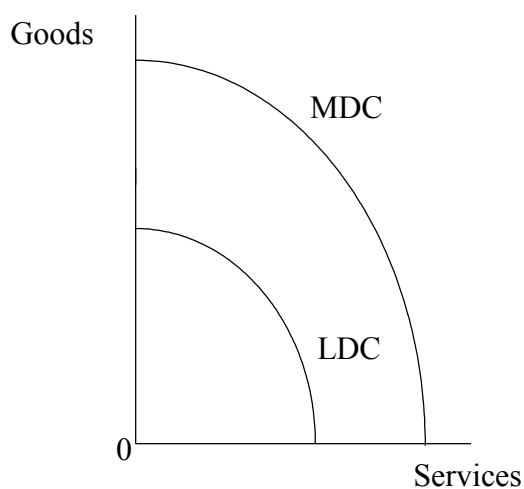


[Source: OECD]

From the chart, it may be deduced that France and the UK

- A. donated approximately 0.3 % of their total government spending in aid.
  - B. gave the most money in international aid.
  - C. were the only countries likely to meet the UN target.
  - D. gave just over 0.3 % of the value of their total output in aid.
39. The International Monetary Fund's (IMF) involvement with less developed countries (LDCs) has mainly taken the form of the
- A. financing of infrastructural projects.
  - B. implementation of structural adjustment programmes.
  - C. promotion of regional trade blocs.
  - D. coordination of international aid for LDCs.

40. The diagram below represents the production possibility frontiers for a less developed country (LDC) and a more developed country (MDC).



The production possibility boundary of the LDC is to the left of the production possibility boundary of the MDC because the LDC is likely to have

- A. a higher Human Development Index.
  - B. more resources, particularly capital.
  - C. a greater productivity of existing resources.
  - D. less productive potential.
-