

**ECONOMICS
HIGHER LEVEL
PAPER 1**

Thursday 20 May 2004 (afternoon)

1 hour

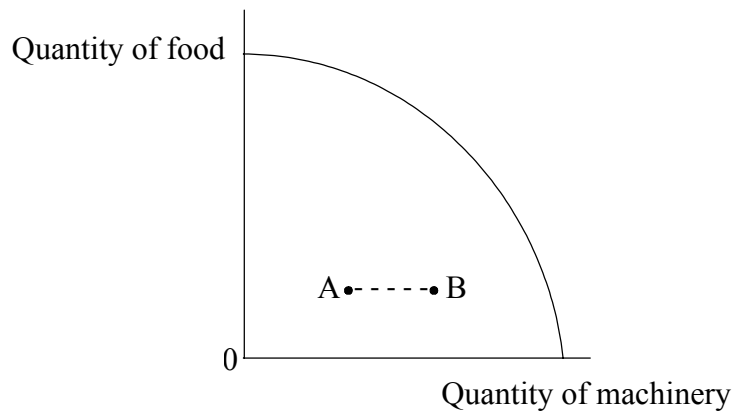
INSTRUCTIONS TO CANDIDATES

- 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. In the study of economics, the term *utility* refers to
- A. the alternate use of resources by entrepreneurs.
 - B. single use goods.
 - C. rational economic behaviour by consumers and producers.
 - D. the satisfaction derived from consuming a good.

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.

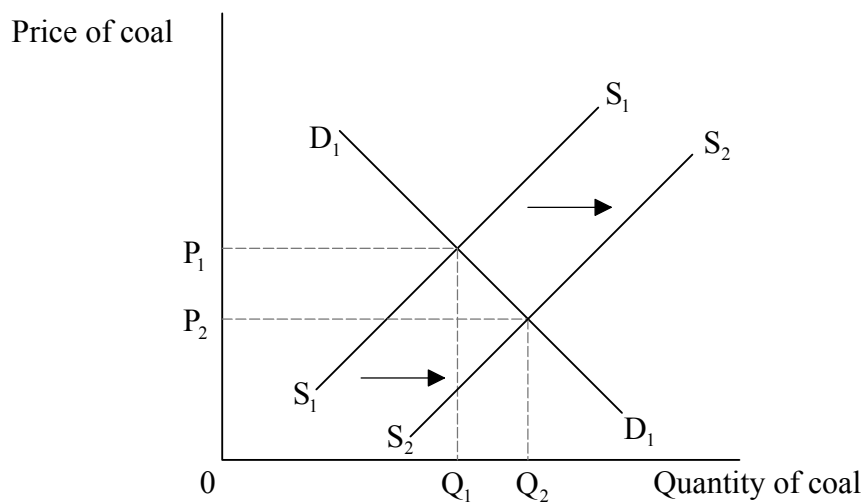


The move from point A to point B would represent

- 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 a characteristic only found in a planned economy?
- A. Limited private ownership of resources.
 - B. Government involved in the allocation of resources.
 - C. Taxation used to redistribute income from the wealthy to the needy.
 - D. Government intervention when market failure occurs.

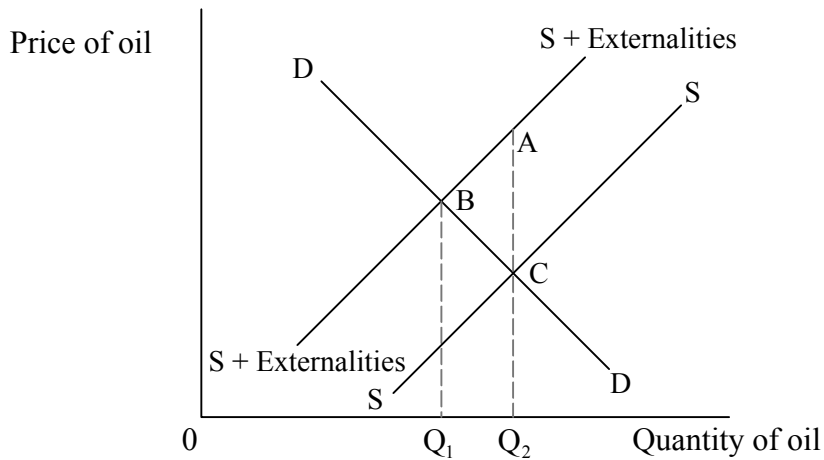
5. The diagram below represents the market for coal.



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.
6. Which of the following would best be described as a merit good?
- A. Street lighting
 - B. Motor cars
 - C. Welfare provision
 - D. Alcoholic drinks

7. 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 $0Q_2$.

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

| Output of chemicals (tons per week) | Marginal private cost (\$000) | Marginal social cost (\$000) | Marginal social benefits (\$000) |
|-------------------------------------|-------------------------------|------------------------------|----------------------------------|
| 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.

9. 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.
10. 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.
11. The following data represent demand and supply schedules for a particular good over a given period of time.

| Price (yen) | Quantity demanded (units) | Quantity supplied (units) |
|-------------|---------------------------|---------------------------|
| 8 | 10 | 18 |
| 7 | 12 | 16 |
| 6 | 14 | 14 |
| 5 | 16 | 12 |
| 4 | 18 | 10 |

If the government grants a subsidy of 2 yen per unit to producers of the good, the new equilibrium price will be

- A. 7 yen.
- B. 6 yen.
- C. 5 yen.
- D. 4 yen.

12. A firm has a fixed amount of capital and land, and increases output by employing additional labour according to the schedule below.

| Labour | Output |
|---------------|---------------|
| 1 | 30 |
| 2 | 64 |
| 3 | 100 |
| 4 | 125 |
| 5 | 140 |
| 6 | 130 |

The law of diminishing returns begins to operate when how many units of labour are employed?

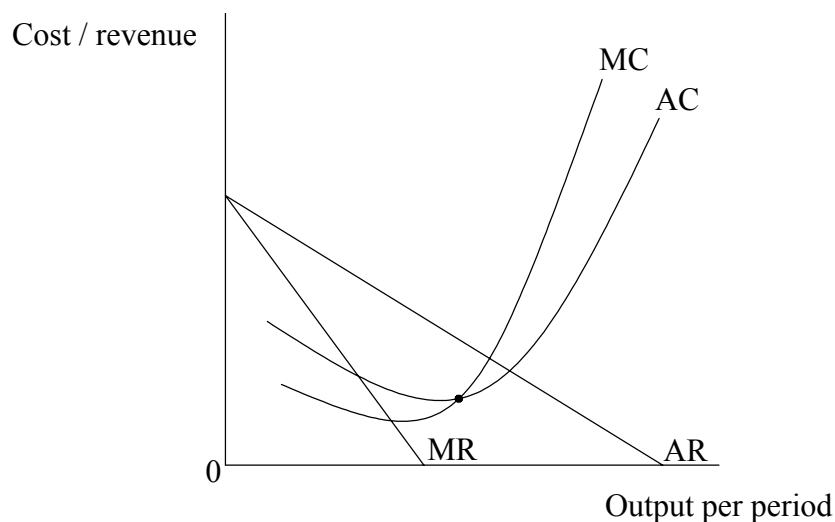
- A. 3
 - B. 4
 - C. 5
 - D. 6
13. The data below refer to the costs of a firm at various levels of output.

| Output (units) | Total costs (\$) |
|-----------------------|-------------------------|
| 0 | 20 |
| 1 | 22 |
| 2 | 26 |
| 3 | 32 |
| 4 | 40 |

The average fixed cost of producing 4 units of output is

- A. \$5.
- B. \$10.
- C. \$20.
- D. \$40.

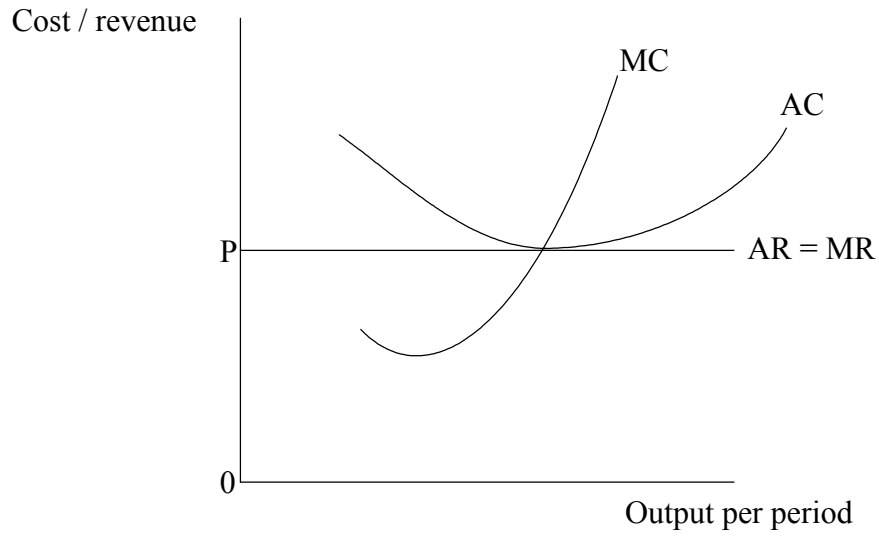
14. The diagram below shows the cost and revenue curves for a business operating in an imperfectly competitive market.



The firm's objectives change from sales maximization to profit maximization. As a result, there would be a

- A. higher output and a higher price.
- B. lower output and a lower price.
- C. higher output and a lower price.
- D. lower output and a higher price.

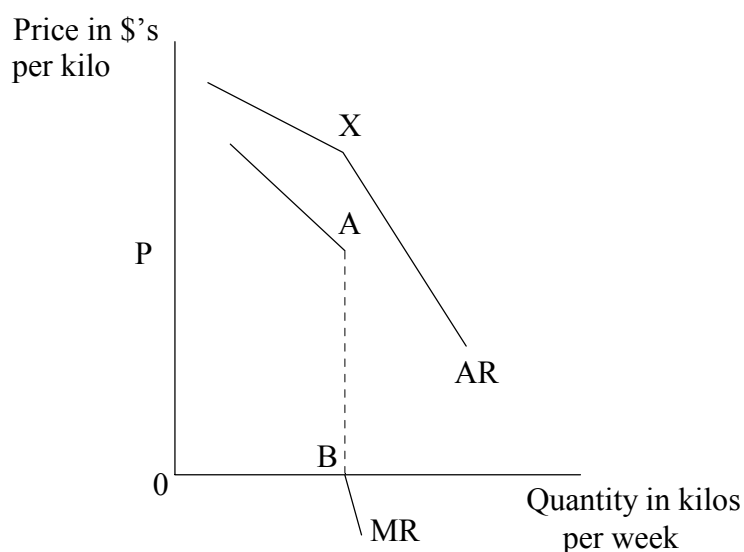
15. The diagram below shows the cost and revenue curves for a firm in perfect competition.



At the equilibrium level of output, the firm is

- A. operating without an opportunity cost.
- B. allocatively efficient.
- C. making abnormal profits.
- D. productively inefficient.

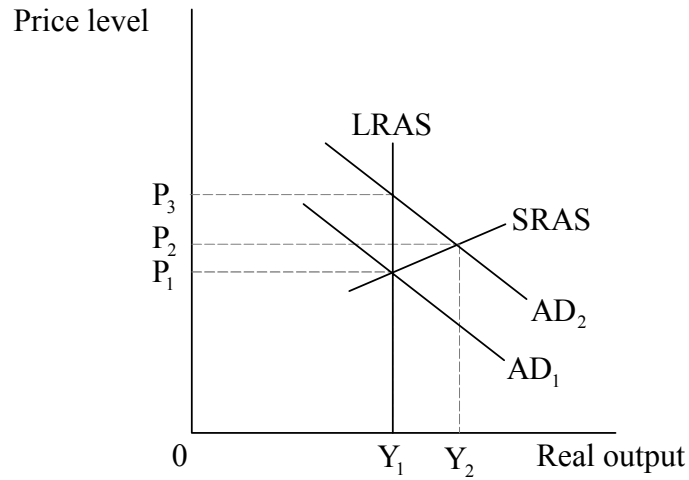
16. The diagram below shows a firm operating in an oligopolistic market with a kink in the demand curve at X.



The discontinuous section AB in the marginal revenue curve occurs because

- A. demand is price elastic to the left of X and price inelastic to the right of X.
 - B. demand is price inelastic to the left of X and price elastic to the right of X.
 - C. non-price competition is a feature of oligopoly.
 - D. demand is perfectly inelastic over a given price range.
17. Real national income may be defined as
- A. the sum of all the incomes earned over a given time period.
 - B. national income expressed in constant prices.
 - C. national income expressed in current prices.
 - D. national income net of all tax payments.

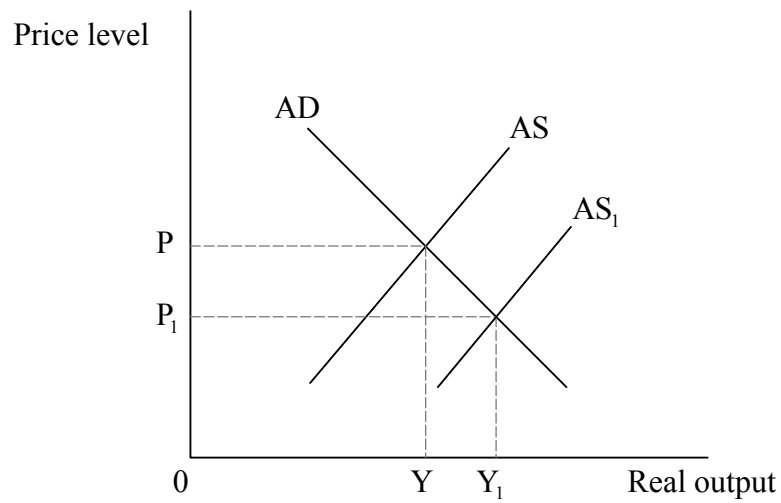
18. The diagram below illustrates the aggregate demand curves (AD), long-run aggregate supply curve (LRAS) and short-run aggregate supply curve (SRAS) for an economy.



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.
19. In a closed economy without a government sector, an initial increase in investment of £10 billion generates a total increase in national income of £40 billion. The value of the marginal propensity to consume is
- A. 4.
 - B. 1.25.
 - C. 0.75.
 - D. 0.25.

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

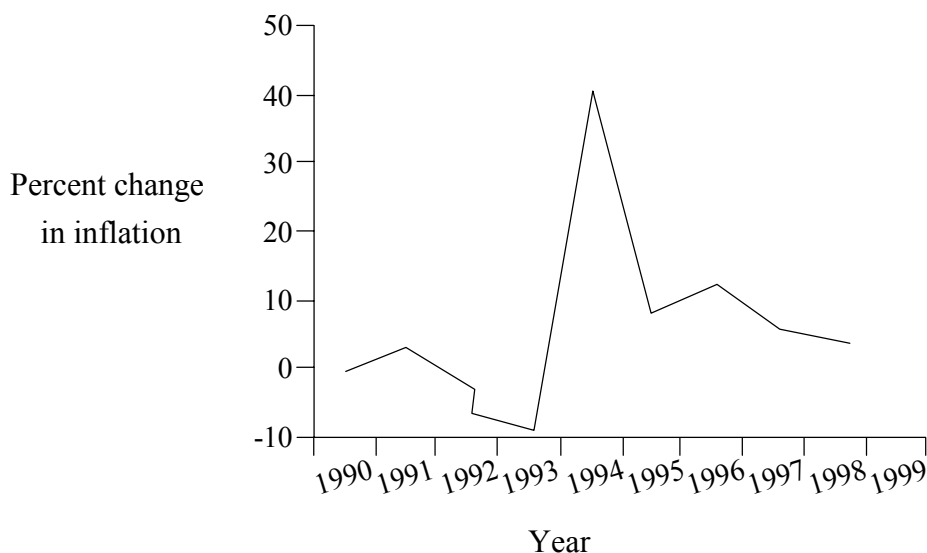


Which of the following is most likely to explain the shift of the aggregate supply curve from AS to AS₁? An increase in

- A. private consumption.
 - B. the capital stock.
 - C. wage costs.
 - D. the money supply.
21. Supply side policies are said to be more effective than demand side policies at reducing
- A. demand-pull inflation.
 - B. cost-push inflation.
 - C. cyclical unemployment.
 - D. seasonal unemployment.

22. Increased borrowing by the government results in the private sector being able to borrow less. This would be an example of
- A. crowding out.
 - B. the multiplier effect.
 - C. crowding in.
 - D. the accelerator effect.

23. 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.

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

| Africa: Macroeconomic indicators | | | | |
|---|-------------|-------------|-------------|-------------|
| Indicators | 1995 | 1996 | 1997 | 1998 |
| 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.

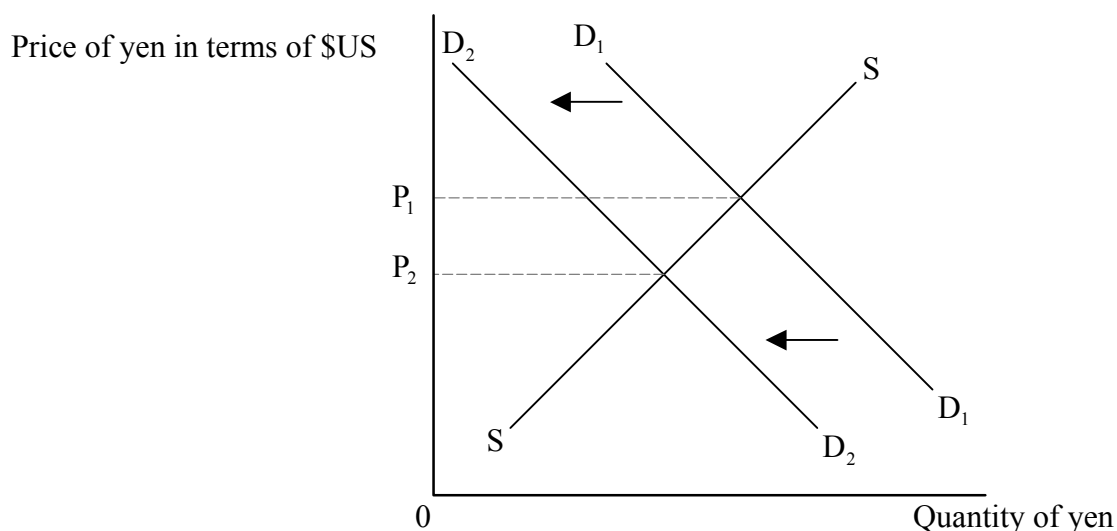
| Country | Output per unit of input | |
|----------------|---------------------------------|-------------|
| | Clothing | Food |
| Fenna | 300 | 600 |
| Kensari | 100 | 400 |

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. Which of the following is most likely to occur after a decrease in European Union interest rates? A decrease in
- A. European Union inflation rates.
 - B. aggregate demand within the European Union.
 - C. demand for European Union exports.
 - D. the value of the Euro (the European Union currency).

28. 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?

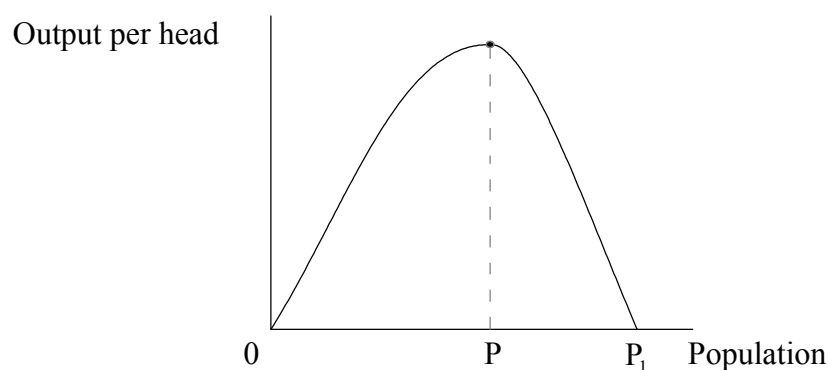
- A. More Japanese tourists are travelling overseas.
 - B. A decrease has occurred in Japanese investment abroad.
 - C. The Japanese rate of inflation is persistently lower than that experienced by its trading partners.
 - D. The level of exports from Japan has fallen.
29. The theory of purchasing power 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

- 30.** A “dirty” float of the Argentinean peso may involve buying pesos by which of the following?
- A. International Monetary Fund (IMF)
 - B. Central Bank of Argentina
 - C. Foreign speculators
 - D. USA government
- 31.** Which of the following is an example of an expenditure switching policy?
- A. An increase in interest rates.
 - B. A decrease in government spending on education.
 - C. An increase in the tariff imposed on imported cars.
 - D. An decrease in company tax 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.

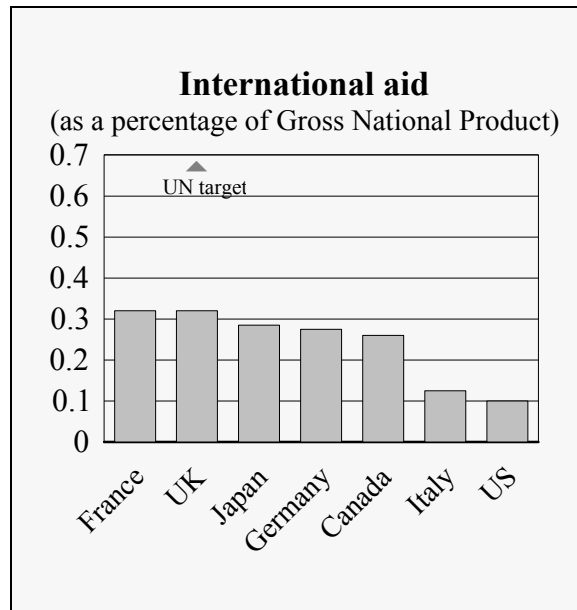


On the basis of this diagram, underpopulation occurs

- 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.

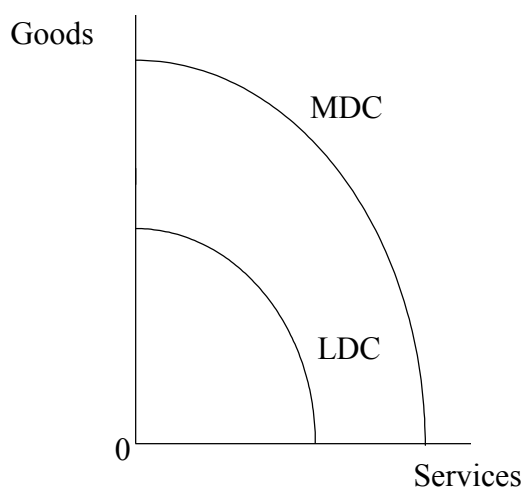


[Source: OECD]

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.
-