General Certificate of Education
Advanced Subsidiary/Advanced

372/01

ECONOMICS – EC2

A.M. THURSDAY, 17 January 2008

(1 hour)

ADDITIONAL MATERIALS

In addition to this examination paper, you will need a 8 page answer book.

INSTRUCTIONS TO CANDIDATES

This paper contains **one** compulsory question.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question.

You are reminded of the necessity for good written communication and orderly presentation in your answers.

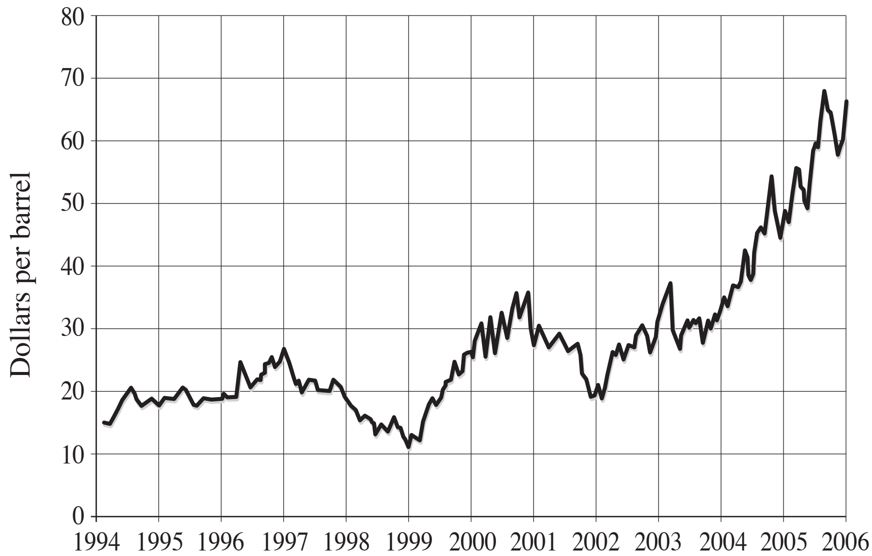
Study the information below and then answer the questions that follow.

NONSENSE, NONSENSE, NONSENSE: THE MYTHS ABOUT HIGH OIL PRICES

THE British call it petrol, the Americans prefer gasoline. But whatever you call it prices at the pump are soaring. Last week petrol hit \$3 a gallon in some parts of the United States. It's no great mystery why the British pay more than double what the Americans pay to fill up their cars. For years the UK has imposed much higher taxes on petrol than the United States making petrol prices so high that it has been a huge cost burden on UK businesses. We have the highest petrol and diesel prices in Europe. So if British motorists want to blame someone for the high cost of motoring they know where to start.

Of course, it's not Gordon Brown's fault that the underlying price of petrol has risen steeply since he came to office. Crude oil prices hit a record price of \$75 a barrel last week. That's six times the price that producers were asking back in 1998. However, the price of petrol at petrol stations has not risen by as much as the price of crude oil. The blame for the rise in the price of crude oil is down to supply and demand economics. Global demand for oil has risen by around 40% in the last twenty years, much of it from China as a result of its rapid industrialisation. Rising demand for petrol and diesel leads to rising demand for crude oil. Soaring demand is coinciding with stagnant supply not helped by limitations on refining capacity.

Oil Prices, 1994 - 2006



The consumption of oil poses environmental problems as the burning of fossil fuels leads to rises in CO_2 emissions. Unfortunately high crude oil prices act as a signal for oil companies to exploit previously unprofitable deposits of oil. At the same time, high oil prices do not seem to deter people in the United States from buying gas guzzling 4 x 4 vehicles. Even at \$3 a gallon, demand for petrol appears to be price inelastic.

Could we be about to relive the 1970s which was the last time oil prices rose steeply? (They fell steeply in the 1980s.) The good news is that, thanks to increased efficiency, and less energy intensive industry, the major economies are much less oil dependent than 30 years ago. The UK has itself been a significant oil producer for the last 30 years although the decline of North Sea oil and gas production is now making the UK very dependent on imported energy. However, most economists believe that high world oil prices are not likely to bring back the 'stagflation' - low economic growth plus high inflation - we saw in those dreary days.

Adapted from Niall Ferguson, Sunday Telegraph, 30 April 2006

(a) With the aid of the data and a diagram, explain why oil prices have risen in recent years. [5]

(b) Using the data, explain what is meant by 'demand for petrol appears to be price inelastic'. (Lines 20-21) [4]

(c) Explain why 'the price of petrol at petrol stations has not risen by as much as the price of crude oil'. (Lines 11-12) [3]

(d) With the aid of a diagram and the data, explain how high taxes on petrol aim to correct market failure. [8]

(e) With the aid of the data, discuss the view that the UK Government should introduce a maximum retail price for petrol. [8]

(f) Using the data, discuss the view that high oil prices could bring a return to 'low economic growth plus high inflation.' (Line 27). [12]