INTERNATIONAL BACCALAUREATE
BACCALAURÉAT INTERNATIONAL
BACHILLERATO INTERNACIONAL

ECONOMICS
STANDARD LEVEL
PAPER 2

Thursday 8 November 2001 (morning)

2 hours

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer one question from Section A and one question from Section B.
- Use diagrams where appropriate.

SECTION A

*Answer **one** question from this section.*

Question 1

Read the passage below and answer the questions which follow.

The Buses are Free – for Everyone

1) In the town of Kristinehamn in West Sweden bus travel has been made free and the number of passengers has increased by 160 %. "The reasoning behind the decision was to obtain **externalities.** To try to get cars out of the city centre, reduce accidents and give citizens a better service," said Tommy Tärnemar, the head of the local authority in Kristinehamn.

2) It was about a year ago that the decision was made to give a **subsidy** to cover the whole of the ticket price. At that time the buses were usually half full but now they are overflowing. Indeed, this does lead to problems at times since people do not respect the fact that the bus is full and still try to get on. In response to this Tommy Tärnemar commented, "When the bus is full, then it is full and we do not have the ability to put on extra buses." However despite the overcrowded buses the people in Kristinehamn seem to be pleased. The reaction of Rickard Karlzon, aged 18, is typical. "I travel a lot more by bus since it has become free and I save a lot of money," he said. The bus drivers are also pleased with the change since the buses are now full and they no longer have to account for all the money that was spent on bus fares.

3) The additional cost of subsidising the buses so that they are free comes to about two million Swedish crowns (approximately $250,000 US dollars) but the local authority calculates that it can partially cover this through reduced costs for its own workers' travel expenses.

4) The reaction in some other cities to the experiment in Kristinehamn has been negative. Carl Soneson, the head of the committee responsible for bus travel in thirty three local authorities in South Sweden said, "We have no plans to introduce free bus travel. People do not value a **free good**." In Stockholm, Johan Elfver, speaking for the local authority noted, "We already subsidise 57 % of the bus fare and have no plans to increase this amount. On the contrary, the trend is to reduce the amount that the tax payer has to pay."

[Source: Adapted from *'Aftonbladet'*, Monday January 11th 1999]

(a) Explain the meaning of the following terms used in the passage:

(i) externalities (paragraph 1); *[2 marks]*

(ii) subsidy (paragraph 2). *[2 marks]*

(b) What is the price elasticity of demand for bus travel in Kristinehamn? (Refer to paragraph 1) *[4 marks]*

(c) Compare Carl Soneson's use of the term 'free good' (paragraph 4) with that of an economist. *[4 marks]*

(d) Why might other local authorities be reducing their support to state supplied services? Refer to paragraph 4 in your answer. *[6 marks]*

(e) Using the information in the article and your own knowledge of economic theory, how would an economist judge whether the experiment of free bus travel in Kristinehamn was a success? *[7 marks]*

Question 2

Study the tables and the article below and answer the questions which follow.

Finland, OECD Report

Table 1

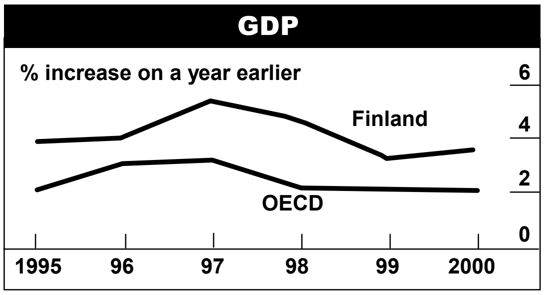


Table 2

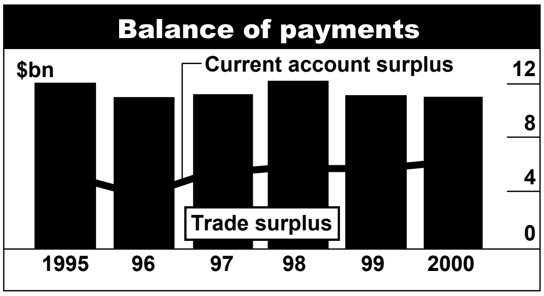


Table 3

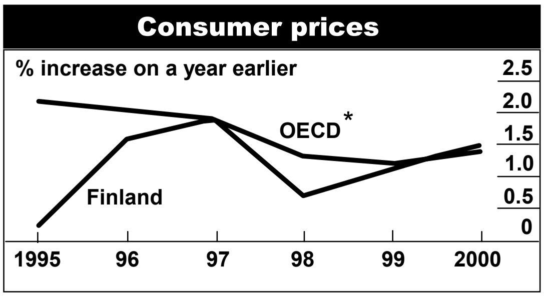
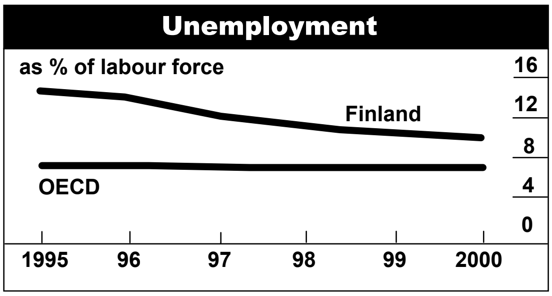


Table 4



Source:OECD

* Excluding high-inflation countries

■ **FINLAND** Since a severe recession in the early 1990s, caused in part by the collapse of the Soviet Union, the Finnish economy has been among the OECD's strongest. Between 1993 and 1998, GDP growth averaged over 4 %. The OECD expects growth to slow to just over 3 % this year, thanks to weaker demand from abroad, before picking up again in 2000. The OECD praises the Finns for turning a budget deficit of 7 % of GDP in 1993 into a surplus of 1.5 % in 1998. Unemployment has dropped sharply in the past five years but, at over 10 %, it is still higher than before the recession: labour-market and tax reforms are needed, says the OECD. There is a risk that the economy will overheat next year, because monetary policy in the euro area, which includes Finland, looks too loose for the Finnish economy.

[Source: *The Economist*, July 24, 1999]

(a) With reference to the Balance of payments table, explain the meaning of the following terms:

(i) trade surplus (Table 2); *[2 marks]*

(ii) current account surplus (Table 2). *[2 marks]*

(b) Explain the relationship between the current account surplus and the trade surplus over the period 1995 to 2000. *[3 marks]*

(c) With reference to the tables, suggest how the Finnish government was able to 'turn a budget deficit of 7 % of GDP in 1993 into a surplus of 1.5 % in 1998'. *[4 marks]*

(d) Explain how loose monetary policy in Europe might harm the Finnish economy? (See final sentence of the article.) *[4 marks]*

(e) (i) State why the OECD feels that labour-market and tax reforms are needed. *[3 marks]*

(ii) Discuss the types of wage and tax policies which might be proposed by a supply side economist to carry out such reforms. *[7 marks]*

SECTION B

*Answer **one** question from this section.*

Question 3

(a) Explain why and how a buffer stock scheme might be used to stabilise prices in a market economy. *[12 marks]*

(b) Evaluate the difficulties involved in the operation of such a scheme. *[13 marks]*

Question 4

(a) To what extent is GNP per capita an appropriate measurement to use to compare living standards in different countries? *[12 marks]*

(b) Discuss other measures which might be used to compare living standards. *[13 marks]*

Question 5

(a) What are the costs of a high level of unemployment in a developed economy? *[10 marks]*

(b) Suggest and evaluate measures to deal with high unemployment. *[15 marks]*

Question 6

Evaluate the consequences for developing countries of relying on market forces and outward orientated strategies to achieve economic growth. *[25 marks]*