

**ECONOMICS  
STANDARD LEVEL  
PAPER 2**

Friday 17 May 2002 (morning)

2 hours

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**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

Study the extract below and answer the questions which follow.

#### Time to put the oil lobby in its place

- ① Swedish farmers are throwing away corn in the square in Skövde. Angry truck and taxi drivers are blocking the roads in Brussels. A third of all petrol (gasoline) stations in Britain have run out of petrol because of the blockade of refineries and panic buying. Few things arouse such passion as high petrol prices. The lobbyists for the motor and fuel industries have taken advantage of this passion to put governments under pressure to reduce the taxes on petrol and diesel. So far the European Union's finance ministers have tried to argue that it is not fuel taxes which should be cut but rather that OPEC\* should now be encouraged to increase production. They claim that lower fuel taxes do not lead to lower fuel prices but to greater profit for oil companies.
- ② Meanwhile OPEC's behaviour can lead to reduced fuel consumption and a better environment in Europe. The transport sector is the greatest threat to the environment. Fuels such as petrol must be heavily taxed if there is going to be a change to a sustainable and environmentally friendly transport system in the long term. Ethanol, natural gas and electricity are examples of goods in **competitive demand** which have a future. The problem is not technology but price. Just now they are too expensive to use but through environmental taxes or a **subsidy**, a market for these alternative fuels can be opened.
- ③ Those who are worried about the environment should also be out protesting against the fuel protests. For people living in the countryside, commuters and low income earners high petrol prices are a big attack on their personal finances. The government should be cutting taxes on public transport, increasing tax allowances for travel and increasing income support for the low paid. This is clearly a better policy in terms of income distribution and the environment than the oil lobby's demand for lower petrol prices.

[Source: Adapted from *Aftonbladet*, 13 September 2000]

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\* Organisation of Petroleum Exporting Countries

- (a) Define the following terms which are in bold in the text:
- (i) competitive demand (paragraph 2); *[2 marks]*
  - (ii) a subsidy (paragraph 2). *[2 marks]*
- (b) Use separate demand and supply diagrams to explain the likely effect on the market for petrol of
- (i) panic buying of petrol (paragraph 1); *[3 marks]*
  - (ii) OPEC increasing production (paragraph 1). *[3 marks]*
- (c) With reference to the passage, explain how rising petrol prices might affect
- (i) the distribution of income; *[4 marks]*
  - (ii) the environment. *[4 marks]*
- (d) Evaluate the view that the government should take the measures outlined in paragraph 3, rather than lowering petrol prices. *[7 marks]*

### Question 2

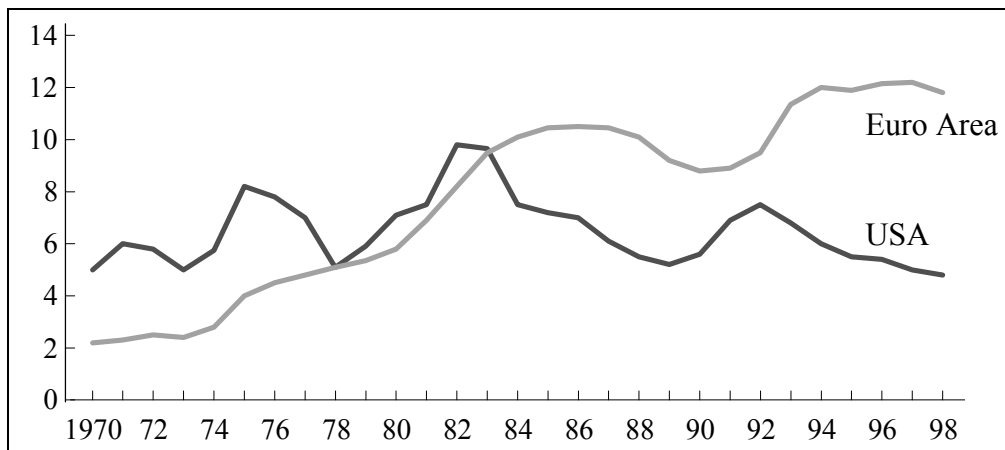
Study the extract below and answer the questions which follow.

#### Item 1 — Cyclical and structural unemployment

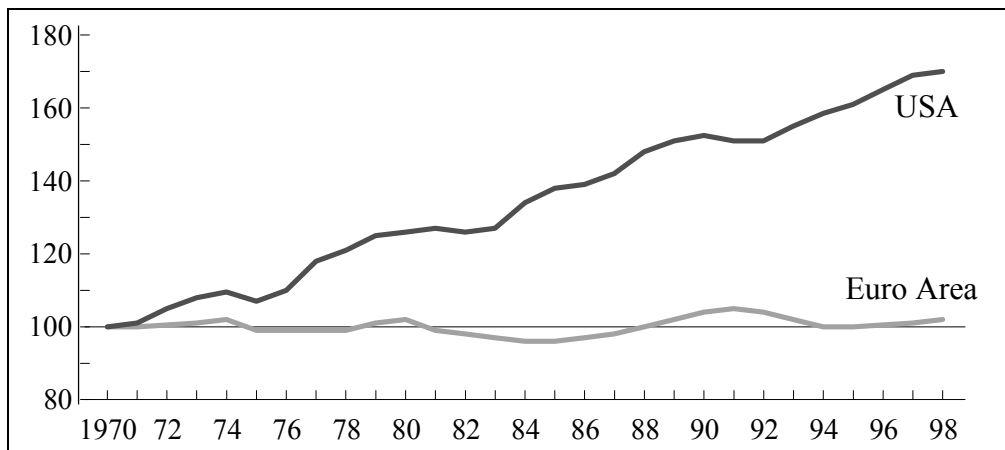
The large social costs of high European unemployment provide strong reasons for immediate remedial policy action. Because **current unemployment comprises both a cyclical and a structural component**, both supply and demand management policies have a role to play in restoring better **labour market equilibrium**.

Experts believe most European unemployment is of a structural nature and cannot be eliminated by cyclical recovery alone. Structural reforms will be required to improve the performance of the labour market in Europe. Using demand management policies to try and reduce unemployment faster than the cyclical rate would be dangerous. There is a risk it would cause the inflation and fiscal deficits that damaged many advanced economies in the 1970s and 1980s.

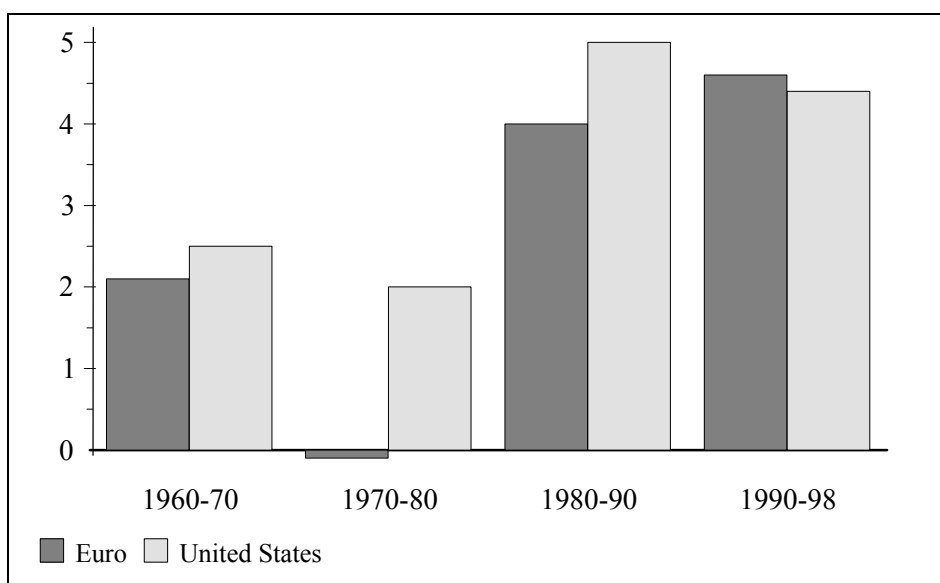
#### Item 2 — Unemployment rate (% of labour force)



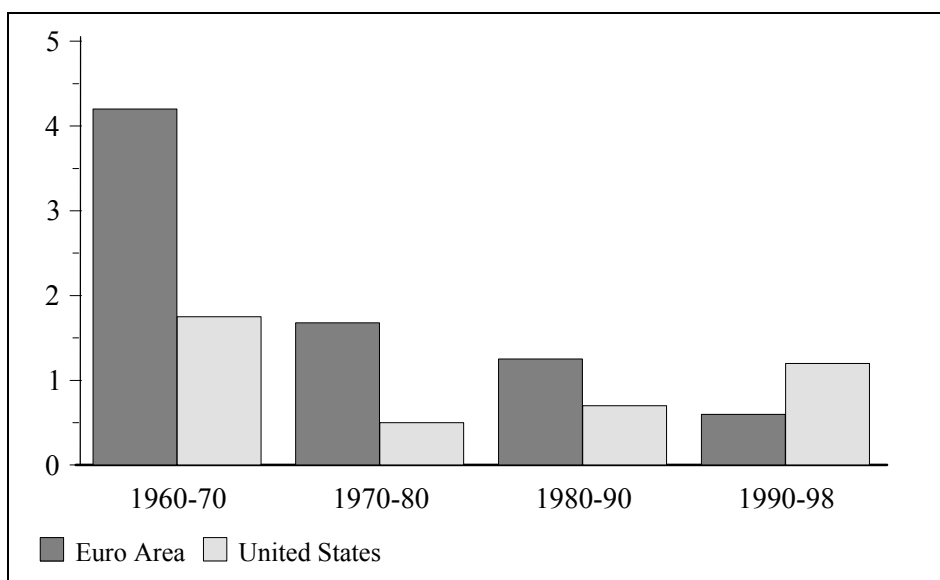
#### Item 3 — Business Sector Employment (1970 = 100)



**Item 4 — Real Long-Term Interest Rates  
(percent; annual average)**



**Item 5 — Growth of Total Factor Productivity  
(percent; annual average)**



[Source: World Economic Outlook, May 1999.]

- (a) With reference to Item 1, explain what is meant by
- (i) “current unemployment comprises both a cyclical and structural component”; *[3 marks]*
  - (ii) labour market equilibrium. *[3 marks]*
- (b) (i) With reference to Item 2, briefly describe the changes in unemployment in the United States and the Euro Area from 1990 onwards. *[2 marks]*
- (ii) Using the data in Items 3, 4 and 5, explain the changes you identified in b(i) above. *[7 marks]*
- (iii) What other data might be useful in explaining the changes in unemployment in the United States and the Euro Area from 1990 onwards. *[3 marks]*
- (c) Use the data and your knowledge of economics to evaluate the ways in which unemployment might be most effectively tackled. *[7 marks]*

## SECTION B

Answer **one** question from this section.

### Question 3

- (a) Explain how the existence of “positive externalities” may cause free markets to misallocate resources. *[10 marks]*
- (b) Evaluate the options available to governments to overcome the failure of markets to take account of positive externalities. Refer to real world examples in your answer. *[15 marks]*

### Question 4

- (a) What problems can a prolonged period of high inflation bring to an economy? *[10 marks]*
- (b) Evaluate the strategies that can be used to reduce the level of inflation. Include some reference in your answer to countries with which you are familiar. *[15 marks]*

### Question 5

Discuss the possible causes and consequences of a persistent deficit balance in a country’s current account. *[25 marks]*

### Question 6

- (a) What evidence would indicate to an economist that a country is experiencing economic development as well as economic growth? *[10 marks]*
- (b) Evaluate the strategies that may be used to achieve economic development. Refer to real world examples in your answer. *[15 marks]*
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