



**ECONOMICS
STANDARD LEVEL
PAPER 2**

Tuesday 9 May 2006 (morning)

2 hours

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer three questions.
- Use fully labelled diagrams and real-world examples where appropriate.

Answer **three** questions. Each question is worth [20 marks].

1. Study the extract and table below and answer the questions that follow.

Poland joins the EU

- ❶ The Poland that has joined the EU is almost unrecognizable as the Eastern-bloc state of post-World War II Europe. A consumer boom has replaced the queues and shortages and, despite still very low wages, Poland is now a fully functioning **market economy** – although the latest analysis by the EU notes a disappointing slowdown in the use of **supply-side policies** such as privatization.
- ❷ Joining the EU has meant some economic hardship in the period of transition. The country has been forced to reform its heavy industries, traditionally the backbone of its economy in its Soviet-bloc days. The EU insisted on reductions in subsidies to its coal and steel industries which had been heavily subsidized. This has eliminated many thousands of jobs, particularly in coal.
- ❸ The Government is selling its main steel holding. Steel has had to absorb even heavier restructuring with the loss of 75 % of its workforce from 275 000 employees in 1990 to just over 75 000 now.
- ❹ Polish farmers, who make up 25 % of voters, are angry and fearful at the thought of being flooded by imports. Their outdated, inefficient farming practices leave them extremely vulnerable. For example, the Polish vodka industry is already 90 % owned by foreign companies.
- ❺ The private sector is looking at the opportunities presented by Poland's large, educated workforce and a growing economy. Computer firms, IBM and Hewlett Packard, have both recently indicated their intention to establish data processing plants in the cities of Warsaw and Krakow, while the German airline, Lufthansa announced last month its intention to open up three more routes.
- ❻ The rapid development of the country's own low-priced airline industry of Air Polonia and GetJet, will be welcome news for Poland's fast-growing tourism industry and the 18 million tourists who visit each year.

[Source: *The Australian* 3 May 2004]

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(Question 1 continued)

Poland: Recent economic indicators

| | 2000 | 2001 | 2002 | 2003 | 2004 (estimate) |
|--|-------------|-------------|-------------|-------------|----------------------------|
| Real GDP Growth (%) | 4.0 | 1.0 | 1.4 | 3.7 | 4.3 |
| GDP per capita (US\$) | 4287 | 4786 | 4948 | 5416 | 6154 |
| Current Account Deficit (US\$ million) | -9998 | -5357 | -5007 | -3595 | -3868 |
| Current Account Deficit (% GDP) | 6.1 | 2.9 | 2.6 | 1.7 | 1.6 |
| Inflation (% change) | 10.1 | 5.5 | 1.9 | 0.7 | 2.0 |
| Unemployment (%) | 14.0 | 18.0 | 19.7 | 20.0 | 19.5 |

[Source: Australian Department of Foreign Affairs and Trade]

- (a) Define the following terms indicated in bold in the text:
 - (i) market economy (*paragraph 1*) *[2 marks]*
 - (ii) supply-side policies (*paragraph 1*). *[2 marks]*

- (b) Using an appropriate diagram, explain the impact on the coal industry of reductions in subsidies (*paragraph 2*). *[4 marks]*

- (c) “Computer firms, IBM and Hewlett Packard, have both recently indicated their intention to establish data processing plants in the cities of Warsaw and Krakow.”

Use an AD/AS diagram to explain the likely effect of the above on the Polish economy. *[4 marks]*

- (d) Using the information in the text and table, and your knowledge of economics, evaluate the performance of the Polish economy. *[8 marks]*

2. Study the extract below and answer the questions that follow.

Norway prepares for dry North Sea

- ❶ Norway’s once vast oil reserves in the North Sea are dwindling, and the government is facing tough choices involving **opportunity costs**. Since oil was discovered in Norway’s seas in 1971, this small nation has been propelled into becoming the world’s third largest oil and gas exporter. Petroleum activities contribute 20 % of the nation’s **Gross Domestic Product**.
- ❷ The government believes there are another 50 years of oil remaining. Norway may increase its reserves by exploration in the far North Arctic Sea. This has provoked fierce criticism from environmental organizations which have argued that the fragile nature of the Arctic would not withstand any potential oil leaks. “These are also the very important fishing areas in Norway, and the population in this area is heavily dependent on fishing.”
- ❸ Forecasts suggest that oil, the country’s economic mainstay has started its inevitable decline. The oil and energy minister, Einar Stensnaes, said it was time to start looking at the alternatives. “Not only is it essential to look for other energy sources, it is also important to look for other industrial activities to develop alongside the petroleum activity,” he said. It’s essential that the government provides incentives to look for alternative sources.
- ❹ One company looking into future energy alternatives is Hydro, Norway’s second largest oil and gas producer. “We’re presently making a small scale research project on a small Norwegian island where we take the wind, transform it into electricity and then transform that electricity into hydrogen,” said executive vice president Tore Torvund. “When there is no wind, we can produce electricity based on hydrogen.” Tore Torvund does not foresee making any profits from alternative energy sources for the next 20-30 years.

[Source: *BBC News* 14 April 2004]

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(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) opportunity costs (*paragraph 1*) *[2 marks]*
 - (ii) Gross Domestic Product (*paragraph 1*). *[2 marks]*
- (b) Using a demand and supply diagram, explain how the dwindling reserves of oil in Norway will impact on its domestic market for oil. *[4 marks]*
- (c) Using an appropriate diagram, explain the consequences of failing to consider the negative externalities associated with drilling for oil in the Arctic Sea. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the economic consequences of the Norwegian government providing incentives for producers of alternative energy. *[8 marks]*

3. Study the extracts below and answer the questions that follow.

London Congestion Charging

Text 1:

Automobiles using roads in busy cities like London cause many problems that have to be paid for by the community. These **negative externalities** include pollution, extended travel times for goods and commuters across the city, as well as the frustration and related health problems that harm those caught up in the traffic congestion.

Text 2:

Since 17 February 2003, motor vehicles driving in central London on weekdays between 0700 hrs and 1830 hrs are required to pay £5. Congestion charging (a special toll for driving on busy roadways) is a form of **indirect taxation** that aims to reduce traffic congestion and raise revenue to fund public transport improvements.

The reason for the charge is neither new nor very hard to understand. If a finite resource is free, human beings tend to use it all up, regardless of the consequences. If it has a cost, they tend to use it more rationally. The higher the cost the less they use it.

The congestion tax has had a significant impact on travel in London. The number of motor vehicles in central London declined by 20 % in the first few months. Taxi trips are quicker and expenditure on fares has fallen by 20-40 % and bus delays have fallen by 50 % due to the faster traffic flow.

Text 3:

The net revenues from the tax will be used to improve public transport services, including more buses and major renovations to the subway (Underground) system which is widely agreed to be in need of significant redevelopment.

“We will just keep on increasing the congestion charge until we get enough revenue to fix the trains and buses” said one Underground traveller. “This is the best thing to happen to London.”

It remains to be seen how many motorists are willing to pay more than £5 to travel through central London.

Congestion charging

| Winners | Losers |
|---|---|
| <ul style="list-style-type: none"> • bus passengers • taxi riders and drivers • motorists with high-value trips • overall city productivity • pedestrians and cyclists | <ul style="list-style-type: none"> • motorists with marginal value trips • companies selling city centre parking • city centre businesses that depend on low cost weekday car access for their customers • residents and motorists in areas just outside the congestion charging area |

[Source: adapted from Litman, T (2004) *London Congestion Pricing: Implications for other cities* www.vtpi.org]

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(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) **negative externalities** (*Text 1*) *[2 marks]*
 - (ii) **indirect taxation** (*Text 2*). *[2 marks]*
- (b) Using an appropriate diagram, explain why the number of motor vehicles in London declined by 20 % in the first few months of congestion charging. *[4 marks]*
- (c) Using an appropriate diagram, explain the conditions necessary for another rise in the congestion charge to create further revenue for government to spend on improving public transport services. *[4 marks]*
- (d) Using the information provided and your knowledge of economics, evaluate the effectiveness of taxation as one of the government measures, to solve environmental problems. *[8 marks]*

4. Study the tables and extracts below and answer the questions that follow.

Oil harvest for Algeria

Table 1: The Economy at a glance (all figures are for 2003 unless indicated otherwise)

| | |
|------------------------|--------------|
| Economic growth | 7.0 % pa |
| Inflation | 2.0 % pa |
| Unemployment | 27.0 % |
| GDP <i>per capita</i> | 1 785 (US\$) |

Table 2: Current account (all figures are in US\$ million)

| | |
|--------------------------------|--------|
| Exports of Goods and Services | 20 010 |
| Imports of Goods and Services | 14 520 |
| Balance on Goods and Services | 5 490 |
| Net income | -2 220 |
| Net current transfers | 1 060 |
| Current account balance | 4 330 |

Table 3: Structure of the economy (as a % of GDP)

| | |
|----------------------------------|------|
| Agriculture | 10.0 |
| Industry (including oil and gas) | 52.7 |
| <i>of which Manufacturing is</i> | 7.9 |
| Services | 37.3 |

Text 1:

Algeria's foreign reserves reached around US\$30 billion by the end of 2003. In comparison, Algeria's total external debt was estimated at around US\$20 billion and falling at the end of 2002.

Oil and gas export revenues account for more than 95 % of Algeria's total export revenues, and 75 % of total fiscal revenues.

Budget estimates are based on oil prices of US\$19 per barrel in 2003.

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(Question 4 continued)

Text 2:

While 14 % of the population (or around 4 million people) were poor in 1995, by 2000 the rate may have dropped as a result of increased public expenditure, increased social transfers, and some recovery of the private non-oil industrial sector which led to an increase of income. Poverty incidence in rural areas is more pronounced than in urban areas.

Life expectancy increased from 56 to 71 years from the early 1970s to 2002, while the number of children dying before age one decreased from 120 to 39 (per 1000 live births).

Educational improvements resulted in a decrease in illiteracy from 36 % to 22 % for men from 1990 to 2002, and from 59 % to 40 % for women.

Text 3:

Oil due for delivery in June 2004 sold at US\$40.77 per barrel on the world market.

[Source: adapted from data published by The World Bank and Energy Information Administration]

- (a) Define the following terms indicated in bold in the text:
- (i) economic growth (*Table 1*) [2 marks]
 - (ii) current account balance (*Table 2*). [2 marks]
- (b) Using an aggregate demand and aggregate supply diagram, explain the possible effects of higher than expected oil prices on the Algerian economy. [4 marks]
- (c) Select **two** economic indicators from the information provided, other than GDP *per capita*, and explain why they are an indication that the Algerian economy has experienced economic development. [4 marks]
- (d) Using the information provided and your knowledge of economics, evaluate the problems the Algerian economy needs to overcome if it is to sustain economic development in the longer term. [8 marks]

5. Study the extract below and answer the questions that follow.

Talks collapse in Cancun

- ❶ In September 2003, 148 of the world’s trade ministers met in Cancun, Mexico, for the fifth Ministerial meeting of the **World Trade Organization** (WTO). The negotiations collapsed because several developing countries believed that the draft Ministerial Declaration was unacceptable.
- ❷ Developing countries wanted a reduction in agricultural subsidies and mechanisms in developed countries to protect their economies from “**dumping**”. Currently, developed countries subsidize their own agricultural production by a massive US dollars (\$) 1 billion per day. This encourages inefficient farmers to produce more, with the resulting oversupply driving down world prices for cotton, coffee, sugar and many other goods.
- ❸ Developing countries are often very efficient at producing such products, but they cannot afford to compete with these subsidized Western producers. The west African nations of Benin, Mali, Chad and Burkino Faso proposed to end worldwide cotton subsidies in an attempt to protect the west and central African economies that rely on cotton for up to 80 % of their export earnings. The 60-80 % of people in developing countries who are dependent on agriculture for their livelihood are significantly disadvantaged. Low prices for their crops may mean they cannot afford to feed their families or have any hope of escaping poverty.
- ❹ The reductions in subsidies being offered were very limited – about 20 % in the case of the EU and virtually nothing by the US. The proposed deal didn’t offer a workable system for protection from the “dumping” of heavily subsidized crops onto their markets.
- ❺ After the failure of the talks, several developing countries have set up bilateral trade relationships. But a multilateral trading system gives developing countries the best chance of supporting their economic interests.

[Source: World Vision Action News Spring 2003]

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(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) World Trade Organization (*paragraph 1*) *[2 marks]*
 - (ii) dumping (*paragraph 2*). *[2 marks]*
- (b) Using a demand and supply diagram, explain how subsidies impact on the world market for agricultural products such as cotton. *[4 marks]*
- (c) Explain the difference between a multilateral trading system and a bilateral trading system. Use examples to support your answer. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the economic consequences for developing countries if agricultural subsidies were removed in developed countries. *[8 marks]*
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