



**ECONOMICS  
HIGHER LEVEL  
PAPER 3**

Tuesday 14 November 2000 (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.

#### Windows 98: Caught in a U.S. anti-monopoly battle

- (1) On May 18 1998 lawyers for the U.S. Justice Department filed a long-anticipated anti-monopoly (Trust) lawsuit against Microsoft, the world's largest software company – and the computer industry may never be the same.
- (2) Should the U.S. government succeed, the lawsuit could significantly alter the way Microsoft develops and markets its Windows operating system, software that controls essential functions of 90% of all desktop computers sold. But the impact on ordinary computer users is likely to be slight – at least for now.
- (3) Predictably, Bill Gates, Microsoft's forceful chairman, doesn't want regulators dictating what features are integrated into his software. He called the lawsuit "a step backward for America, consumers and for the PC industry".
- (4) Among other charges, government lawyers argue the company uses its monopoly on operating systems to squeeze out competition – breaking a key U.S. antitrust law. While monopolies are not necessarily illegal, they argue that it is anti-competitive for firms to use **monopoly power** to force their way into other businesses. Netscape, which spied a commercial opportunity in Internet browsers long before Microsoft, provides a perfect test case. U.S. officials allege Microsoft has slashed Netscape's market share from 90% to 60% through illegal acts such as threatening computer makers with the loss of crucial Windows 95 licenses if they install Netscape's browser in new machines.
- (5) In Windows 95 the browser was more or less an optional extra. In Windows 98 Internet Explorer, the Microsoft browser, is in **joint supply** with the operating system. Regulators fear that by making Internet Explorer integral to Windows 98, Microsoft will make other browsers superfluous – effectively finishing off Netscape. In fact, the regulators argue that Microsoft can use the same technique to beat competitors in other arenas. If a newcomer devises successful voice-recognition software, for example, Microsoft can capture that market, too, simply by building voice recognition into an operating system for which there is no practical alternative. "Consumers and computer manufacturers should have the right to choose the software they want installed on their personal computers," said U.S. Attorney General Janet Reno.

[Source: *Asiaweek*, May 29, 1998]

- (a) Explain the following words in bold in the text:
- (i) joint supply *[2 marks]*
  - (ii) monopoly power *[2 marks]*
- (b) According to the article, the U.S. Justice Department filed a long anticipated anti-monopoly (Trust) lawsuit against Microsoft, the world's largest software company (paragraph 1).
- (i) State **two** examples of ways in which a government might regulate a monopoly. *[2 marks]*
  - (ii) Identify and explain **two** examples of actions by Microsoft which might justify anti-monopoly (Trust) legislation. *[4 marks]*
- (c) Using the text and your own knowledge
- (i) evaluate the arguments for government regulation of monopolies (Trusts). *[7 marks]*
  - (ii) consider whether monopolies can ever be considered desirable. *[8 marks]*

### Question 2

Study the extract below and answer the questions which follow.

# Defence and Policing

**F**ORGET “swords into ploughshares”, the catchphrase which came into use at the end of the Cold War as armed forces throughout Europe were scaled down. The latest survey of government spending habits in Europe by the European Union’s statistical office, Eurostat, suggests that states are swapping old-fashioned bullets and bombs for less conventional weapons.

The data shows that EU countries are clearly spending less on defence-related activities than they were in the 1980s. For the eight countries surveyed, expenditure on “defence affairs and services” dropped from an average of 3.19 per cent of gross domestic product in 1985 to 1.88 per cent of GDP in 1995, the last year for which figures are available.

However, the survey also shows that some of the savings have been ploughed back into policing countries’ domestic populations rather than the perceived threat from abroad. Total expenditure on “public order and safety affairs”, a euphemism for policing and domestic internal security, climbed from 1.47 per cent of GDP in 1985 to 1.86 per cent in 1995.

While all of the surveyed countries – which represent 80 per cent of EU GDP – registered falls in

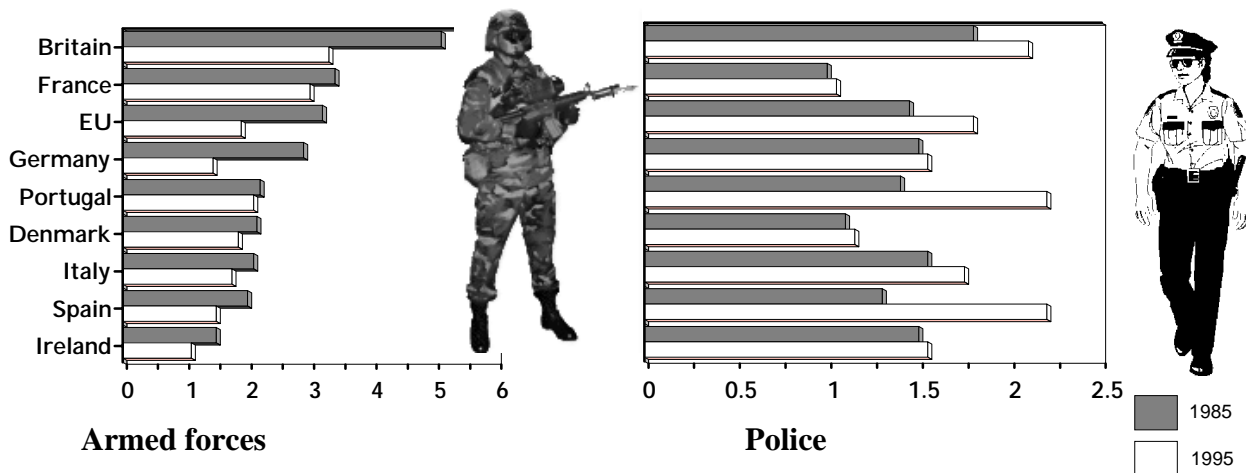
defence spending, there are still clear differences in the share of state spending devoted to external security.

The most significant falls in defence spending came in Britain and Germany. Defence expenditure in Britain dropped from 5.11 per cent in 1985 – easily the highest in the EU – to 3.3 per cent in 1995, just above the level in France. In Germany the level halved from 2.84 per cent to 1.41 per cent over the same period. Ireland spends the least on defence at just 1.05 per cent of GDP.

The largest rises in public order budgets came in Spain and Portugal. Spanish spending rose from 1.28 per cent to 2.23 per cent and in Portugal from 1.42 per cent to 2.24 per cent. These two countries also spend the highest proportion of GDP on this sector. France spends the least on public order, just 1.03 per cent of GDP.

Amid the flying bullets, spending on social security and welfare still dominates government budgets. The average climbed from 48.6 per cent to 50.2 per cent among the surveyed countries. Denmark’s 61.9 per cent share is the EU’s highest.

**FROM BULLETS TO BATONS**  
Defence and policing expenditure, % of GDP



[Source: *The European*, 15 June 1998]

- (a) Between 1985 and 1995 what was the dominant trend in defence and police expenditure in EU countries? *[2 marks]*
- (b) Why has the author chosen to express these expenditures as percentages of **GDP** rather than as a percentage of any other national income aggregate? *[2 marks]*
- (c) Using the table, explain how the experience of Spain and Portugal has differed from that of Britain and Germany? *[4 marks]*
- (d) What other economic indicators might be examined to explain the proportionate increases in police expenditure? *[5 marks]*
- (e) What theoretical macroeconomic effects would be expected to follow a decline in defence expenditure by
- (i) a Keynesian economist? *[6 marks]*
- (ii) a supply side or monetarist economist? *[6 marks]*

**SECTION B**

Answer **one** question from this section.

**Question 3**

- (a) Why are environmental problems considered to be an example of market failure? *[10 marks]*
- (b) To what extent can government intervention correct this failure? *[15 marks]*

**Question 4**

- (a) Under what conditions is price discrimination possible and profitable? *[12 marks]*
- (b) Who gains and who loses from price discrimination? Illustrate your answer with examples. *[13 marks]*

**Question 5**

- (a) What problems might a country face if it experiences a persistent deficit in the current account of its balance of payments? *[10 marks]*
- (b) Evaluate the alternative ways in which such a deficit might be reduced or eliminated. *[15 marks]*

**Question 6**

- (a) Under what circumstances might a country achieve economic growth without economic development? *[12 marks]*
  - (b) Evaluate the effectiveness of outward-orientated strategies in achieving growth and development. *[13 marks]*
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