



**ECONOMICS
HIGHER LEVEL
PAPER 3**

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.

Liberalisation backfires on Japan's Taxi Industry

- (1) As the Japanese economy enters its third year of recession, the taxi industry's troubles are obvious. During the day, drivers wait their turn for hours at a time outside the central Tokyo hotels, in lines that wind around the block. At night the rows of taxis are so dense that they cause traffic jams in the entertainment districts.
- (2) Recessions are bad for taxi drivers. The number of taxis increases as workers are squeezed out of other jobs, just as the number of customers on the street declines. But this time it has been made much worse by an untimely attempt at **market liberalisation**.
- (3) The government is trying to deregulate the market by cutting fares and loosening restrictions on new entrants, encouraging a flood of new drivers who are competing for a shrinking number of customers. As companies cut salaries and bonuses and restructure their workforce, fewer people need a late ride home.
- (4) According to the Tokyo Taxi Association, the number of taxi drivers in Tokyo peaked at 95,335 in 1997, while average monthly wages fell to the lowest level for more than 10 years. Unlike workers who are paid salaries, taxi drivers' earnings are determined by how much they work, and they have earned less each year since the early 1990s. The average monthly Tokyo taxi driver's salary decreased by 11.3 % compared with a year earlier.
- (5) Most new drivers come from the depressed construction and real estate industries, as well as small stores and restaurants. These businesses reduce their workforce in times of recession but increase it again in good times, so that taxi drivers go back in search of higher wages. Thus the number of taxis will actually decrease during a boom.
- (6) The drivers' associations say that **cyclical downturns** are typical of the taxi industry, but by deregulating now the government has had a devastating effect on the finances of Tokyo's hundreds of taxi companies – between a third and a half of them are losing money. Some drivers are working as long as 18 hours on the road at a time to meet their regular financial commitments.

[Source: *Financial Times* 7 February 1999. Adapted from Alexandra Harney, *Liberalisation backfires on Japan's bumper-to-bumper taxi industry*, page 3]

- (a) Explain what is meant by the following terms used in the passage:
- (i) market liberalisation (paragraph 2); *[2 marks]*
 - (ii) cyclical downturns (paragraph 6). *[2 marks]*
- (b) If the Japanese economy recovers from recession, what would you expect to happen to taxi fares? Explain your answer. *[4 marks]*
- (c) Using your understanding of business economics, explain which market structure is indicated by the characteristics of the Japanese taxi industry. *[5 marks]*
- (d) In paragraph 6 it is claimed that between a third and a half of Japanese taxi companies are losing money. What would you expect to happen to these loss-making companies in the short run and in the long run? Use diagrams to illustrate your answer. *[5 marks]*
- (e) Using the text and your knowledge of economic theory, explain why the Japanese government is trying to solve the problems of the taxi industry through deregulation (paragraph 3). *[7 marks]*

Question 2

Study the table below and answer the questions which follow.

Planned government receipts and expenditure 1999-2000			
Where the money comes from	%	Where the money goes	%
Income tax	27	Welfare payments	31
Company tax	10	Health	18
Value-added tax	15	Education	15
Customs (tariffs)	12	Defence	7
Welfare (Social Security) Contributions	18	Debt interest	7
Others	18	Others	22

[Source: *Economics Today*, September 1999]

- (a) Using the data in the table,
 - (i) identify an item which is a public good. Justify your choice. [2 marks]
 - (ii) identify an item which is an indirect (expenditure) tax. Justify your choice. [2 marks]
- (b) If the government collected 50 billion dollars in company tax, how much did it collect in value-added tax? [2 marks]
- (c) Do you think that the above data comes from the government of a less developed country or a more developed country? Justify your answer with reference to both revenue and expenditure percentages. [4 marks]
- (d) Health and education are often referred to as merit goods. Why do governments feel it necessary to spend money on supplying merit goods? [4 marks]
- (e) (i) How might this government change its pattern of spending and taxation to bring about more equal distribution of income? [4 marks]
- (ii) To what extent would a supply-side economist support these changes? [7 marks]

SECTION B

Answer **one** question from this section.

Question 3

- (a) How does a monopoly maintain supernormal (or abnormal) profit in the long run? *[12 marks]*
- (b) Is monopoly always undesirable? *[13 marks]*

Question 4

‘What is wanted is not inflation (a rise in the general price level) or deflation (a fall in the general price level) but price stability.’ Discuss. *[25 marks]*

Question 5

- (a) What are the arguments in favour of unrestricted flows of financial capital between countries? *[15 marks]*
- (b) How might unrestricted capital flows be damaging to less developed countries? *[10 marks]*

Question 6

“According to the World Bank, an extra 10 billion dollars in aid could lift 25 million people a year out of poverty - so long as it went to poor countries that manage their economies well. The same sum spent across the current distribution of aid recipients would lift only 7 million out of poverty.”

- (a) What are the economic arguments in favour of using aid as part of a development policy for less developed countries? *[12 marks]*
- (b) How far would you agree with the World Bank view, that aid has failed as a development policy because of the poor economic management policies that less developed countries have adopted? *[13 marks]*
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