

**ECONOMICS
STANDARD LEVEL
PAPER 2**

Friday 21 May 2004 (morning)

2 hours

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.
- Section B: answer one question.
- Use diagrams and real-world examples where appropriate.

SECTION A

Answer **one** question from this section.

Either

Question 1

Study the items below and answer all the parts of the question that follow.

THE HEALTH CARE DEBATE

Item 1

THE CASE FOR GOVERNMENT PROVISION

- ❶ Government provision of health care, free to the user at the point of consumption, is based on the principle that everyone, irrespective of means or age, should benefit from the medical services available, so that **human need rather than effective demand determines who gets what**. This is fairer than market provision and the charging of prices.
- ❷ Government provision may also be justified on efficiency grounds as market provision is likely to lead to a misallocation of resources. There may be external as well as private benefits when an individual consumes health care and becomes healthier. With individuals acting on the basis of their private benefits, the **social benefits** will not be fully achieved unless the government intervenes in some way.

Item 2

THE CASE FOR MARKET PROVISION

- ❶ The demand for health care appears to rise constantly from year to year. This rise can largely be attributed to demographic changes in the population and rising living standards. Most governments spend more in real terms each year, but demand persistently outstrips the supply of services available; and costs in the health care sector tend to rise more rapidly than they do in the rest of the economy.
- ❷ Governments inevitably fail when they remove health care from the market place. When a commodity is offered free at the point of consumption, with the discipline of price removed, inevitably there will be excess demand. Instead of price being allowed to perform its rationing function, some other rationing device has to be found: some patients are not treated, some join waiting lists or go to private health schemes, and more urgent cases are treated according to informal and often arbitrary priority schemes.
- ❸ The result is that **consumer sovereignty**, competition and efficiency are lost, and a misallocation of resources results. All this points to a greater role for the market.

[Source: adapted from various sources]

- (a) Define the following terms which are in bold in the text:
- (i) social benefits (**Item 1**) *[2 marks]*
 - (ii) consumer sovereignty (**Item 2**). *[2 marks]*
- (b) With reference to **Item 1**, explain why a situation in which “human need rather than effective demand determines who gets what”, may be fairer than market provision. *[3 marks]*
- (c) With reference to **Item 2**, explain **two** reasons why the demand for health care constantly rises. *[5 marks]*
- (d) In **Item 1**, it is claimed that market provision leads to a misallocation of resources, while in **Item 2**, it is claimed that government provision of health care leads to a misallocation of resources.
- Use the text and your knowledge of economics to explain how a misallocation of resources might arise in each case. *[6 marks]*
- (e) With reference to a country that you have studied, discuss the possible constraints on the ability of a government to meet the increasing demands for health care. *[7 marks]*

Or

Question 2

Study the items below and answer all the parts of the question that follow.

ARGENTINA’S ECONOMY

Item 3

ARGENTINA’S ECONOMIC COLLAPSE

- ❶ In 1991 Argentina adopted a “currency board” which pegged the peso at par to the US dollar. This immediately solved the hyperinflation then present in the economy and so appealed to foreign investors. Capital poured in from abroad. Between 1991 and 1997 Argentina’s economy grew at an average annual rate of 6.1 %.
- ❷ In January 2002, Argentina officially defaulted on its US \$155 billion foreign debt. Foreign exchange markets closed on 21 December 2001 to avoid a run on the peso. Meanwhile, unemployment rose to 18 %, wages were slashed by 20 % and bank withdrawals were severely restricted to prevent a crippling flight of liquidity.
- ❸ Amid the chaos of early 2002, the government of Argentina decided to use a **floating exchange rate** system to determine the value of the peso. The IMF* and the World Bank refused any additional loans until several conditions were met, including a reduced **budget deficit**.

* IMF: International Monetary Fund

[Source: adapted from various newspaper articles]

Item 4

SELECTED ECONOMIC STATISTICS FOR ARGENTINA

Gross Domestic Product (GDP) (% change on year earlier)	–10.7 %
Industrial Production (% change on year earlier)	–16.7 %
Consumer Prices (% change in CPI on year earlier)	+18.4 %
Trade Balance (latest 12 months)	+ \$9.8 Billion
Current Account (latest 12 months)	– \$4.4 Billion
Foreign Reserves	+ \$12.8 Billion
Currency (before the float)	1 peso = \$1 US
Currency (29 May 2002)	3.51 peso = \$1 US
Short Term Interest Rates	55.1 %
Stockmarket (% change in \$ terms since 31/12/01)	– 67.3 %

[Source: adapted from *The Economist*, 1 June 2002]

- (a) Define the following terms which are in bold in the text:
- (i) budget deficit (**Item 3**) *[2 marks]*
 - (ii) floating exchange rate (**Item 3**). *[2 marks]*
- (b) Describe the relationship between GDP and industrial production as shown in **Item 4**. *[2 marks]*
- (c) (i) With reference to **Item 4**, describe the change in the peso. *[2 marks]*
- (ii) What are the implications of this change in the peso for the economy of Argentina? *[4 marks]*
- (d) Examine the impact of interest rates at the level shown in **Item 4** on the economy of Argentina. *[6 marks]*
- (e) Evaluate the IMF view that reducing the budget deficit will assist an economic recovery in Argentina. *[7 marks]*

SECTION B

Answer **one** question from this section.

Question 3

- (a) Briefly outline the various methods of price control open to governments. *[10 marks]*
- (b) Evaluate the effectiveness of using price controls to reduce poverty. *[15 marks]*

Question 4

- (a) The world economy may be subjected to economic shocks, such as a sudden increase in oil prices and terrorist attacks. With the help of an aggregate demand/aggregate supply diagram, explain the possible economic effects of such shocks. *[12 marks]*
- (b) Evaluate the main economic policies that governments might use to minimize these effects. *[13 marks]*

Question 5

- (a) Identify the main types of trading blocs and their characteristics. *[10 marks]*
- (b) With reference to real-world examples, evaluate the advantages and disadvantages of membership of a trading bloc. *[15 marks]*

Question 6

Critically evaluate the significance of foreign direct investment (FDI) in the process of economic development for less developed countries (LDCs). *[25 marks]*
