



22085105



**ECONOMICS
STANDARD LEVEL
PAPER 2**

Wednesday 14 May 2008 (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 references to the text / data where appropriate.

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

Free Public Transport for Melbourne

- ❶ One can make a case for free public transport on social grounds, similar to such **merit goods** as free health care and free public education.
- ❷ Public transport carries only 6% of all travel in Melbourne. Free train, tram and bus rides would boost the number of trips by up to 30% and reduce **negative externalities** such as traffic congestion, pollution, greenhouse gases and road accidents.
- ❸ It would also transform railway stations into activity and business centres and generally make Melbourne a happier place to live, experts say.
- ❹ When everything is taken into account, it would cost the State Government about \$340 million a year to provide free transport. Logically, this has to be weighed up against the alternative, which is to spend an additional \$340 million a year on improved services.
- ❺ Critics of free public transport argue that what primarily deters people from using public transport is not its price but factors like flexibility, convenience and door-to-door travel times. If you live or work in one of the many Melbourne suburbs with no public transport at all, the fact that it's free isn't going to make it any more attractive. Economists acknowledge the existence of these non-financial barriers when they say that public transport has a "low price elasticity of demand" and "low cross elasticity of demand".
- ❻ International experience, such as Hasselt in Belgium, points to a more effective strategy for shifting travel habits from cars to public transport than just cutting fares. It involves such measures as high service frequencies, central coordination of timetables, traffic priority for trams and buses, and a conspicuous staff presence. Provided fares are set at a level competitive with car travel, these measures have been proved more effective in boosting public transport use than making public transport free – and at a much lower cost to the government.

[Source: adapted from *The Age*, 5 March 2006 and <http://www.ptua.org.au/myths/free.shtml>]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) merit goods (*paragraph ①*) *[2 marks]*
 - (ii) negative externalities (*paragraph ②*). *[2 marks]*
- (b) Using an appropriate diagram, explain how excessive use of private transport and the resulting traffic congestion is an example of market failure. *[4 marks]*
- (c) Using an appropriate diagram, explain how a decision to provide free public transport is likely to impact on the market for cars in Melbourne. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate a decision to provide free public transport in Melbourne. *[8 marks]*

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

Table 1 – Macroeconomic data 2005

	Indonesia	Thailand	Vietnam
GDP (% real change)	4.9	6.1	7.7
GDP per capita (\$US)	3500	8100	2700
Consumer price inflation (%)	6.1	2.8	9.5
Unemployment rate (%)	9.2	1.5	1.9
Current account balance (\$US billion)	7.3	6.7	–2.1
Foreign debt (\$US billion)	141.5	50.6	16.6
Foreign currency reserves (\$US billion)	35.8	48.3	6.5

Table 2 – Income distribution data 2005

	Indonesia	Thailand	Vietnam
Household income (% share): lowest 10%	4	2.8	3.6
highest 10%	26.7	32.4	29.9

[Source: *The Economist Intelligence Unit* and <http://www.cia.gov/library/publications/the-world-factbook/index.html>]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) **inflation** (*Table 1*) *[2 marks]*
 - (ii) **foreign currency reserves** (*Table 1*). *[2 marks]*
- (b) In 2005, rising imported oil prices were a major factor contributing to Vietnam’s high current account deficit. Using an appropriate diagram, explain how this could have contributed to Vietnam’s relatively high inflation rate. *[4 marks]*
- (c) In 2006, Indonesia’s unemployment rate passed 10%. One reason given was an increase in the minimum wage. Using an appropriate diagram, explain how an increase in the minimum wage could lead to an increase in unemployment. *[4 marks]*
- (d) Using information from Table 1 and Table 2, and your knowledge of economics, evaluate which country you feel is in the strongest economic position in 2005. *[8 marks]*

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

India's economy on fast track

- ❶ India has the world's largest number of poor people in a single country. Of its nearly one billion inhabitants, an estimated 350-400 million people are living below the poverty line. The main causes of poverty in India have been illiteracy, rapid population growth and **inward-oriented policies** that prevented large amounts of foreign direct investment into the country.
- ❷ Economic growth, according to India's finance minister, "is the best antidote to poverty". The Indian economy has grown by an annual average of about 8% for the past three years. The government now says it wants to see even stronger growth of 10% per annum. This should help boost the current employment growth rate of 2.3% per annum.
- ❸ The rapid growth seen recently in India, supported by a savings rate of 29% of GDP and an investment rate of 30% of GDP, has been a great help to government revenue. Despite this growth in revenue, the central government's budget deficit last year rose to 4.1% of GDP as the government tried to reduce poverty through big spending increases in health, education and **infrastructure**. This spending contributed to the strong economic growth in India.
- ❹ The finance minister lists the main threats to the economy as inflation, environmental issues and growing debt. With this in mind, the Reserve Bank (the central bank) raised interest rates in January. This will help contain the expansion of bank credit, currently at 30%, but could be a threat to economic growth.

[Sources: adapted from *The Economist*, 2 March 2006 and <http://www.indiaonestop.com/povertyindia.htm>]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) inward-oriented policies (*paragraph 1*) *[2 marks]*
 - (ii) infrastructure (*paragraph 3*). *[2 marks]*
- (b) The text states that India’s economic growth has been “supported by a savings rate of 29% of GDP and an investment rate of 30% of GDP” (*paragraph 3*). Using a circular flow of income diagram, explain the difference between savings and investment. *[4 marks]*
- (c) Using an AD/AS diagram, explain how a rise in interest rates could be a “threat to economic growth” (*paragraph 4*). *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the Indian government’s objective to see “even stronger growth of 10% per annum” (*paragraph 2*). *[8 marks]*

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

The strong peso is a cause for concern

- ❶ The Philippines peso has increased more than 8% in the last six months, but not everyone is happy.
- ❷ “We are not only losing, we are dying,” Roberto Amores, president of the country’s largest food exporters’ association and the mango exporters’ group said. Mango customers have turned to Mexico.
- ❸ Exports account for about 40% of the country’s output and they are finding it increasingly difficult to make money due to the **currency appreciation**. The peso touched a 3-year high of 50 pesos per US dollar last week. The peso’s rise had more than halved food exporters’ profit margins. Exporters have recommended the central bank reduce the exchange rate to 52 pesos per US dollar. The central bank has rejected the proposal, saying it only intervenes to reduce volatility.
- ❹ The Philippines has 8.5 million workers overseas sending home money, worth about 10% of gross domestic product. For them, the peso’s strength means their earnings buy less at home. For the millions of families who rely on handouts from relatives working abroad, the loss of five pesos in the dollar’s value means they have about 60 billion pesos less to spend annually.
- ❺ Some economists say the impact on exporters could have a consequential effect on consumer spending, employment and growth. “If exporters are losing money, then economic growth will be at risk,” said the economic planning secretary. Annual growth of 7 to 8% is needed to significantly improve living standards in the Philippines.
- ❻ Despite the problems associated with a currency appreciation, there are those who say the benefits to the Philippines outweigh the costs. The cost of repaying US\$76 billion of debt is reduced, leaving more public funds to improve welfare.
- ❼ The peso’s gains have also helped dampen inflation pressures, allowing the central bank to avoid tightening **monetary policy**.

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) currency appreciation (*paragraph 3*) [2 marks]
 - (ii) monetary policy (*paragraph 7*). [2 marks]
- (b) Using an appropriate diagram, explain how the Philippines' central bank could reduce the value of the peso from 50 pesos per US dollar to 52 pesos per US dollar (*paragraph 3*). [4 marks]
- (c) Using an appropriate diagram, explain how the 8% rise in the Philippines peso (*paragraph 1*) has affected the market for mangos in Mexico. [4 marks]
- (d) Using information from the text and your knowledge of economics, evaluate the impact of a currency appreciation on the Philippines economy. [8 marks]

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

Farewell to the forests

- ❶ The 14 million hectares of tropical rainforests in Papua New Guinea (PNG) are the Pacific's last great, unspoilt rainforests.
- ❷ These forests, and the riches within them, have for years been exploited by loggers. Timber from PNG's hillsides is shipped south and sold to major furniture manufacturers in Australia.
- ❸ A bitter battle to preserve the forests from unsustainable logging has begun. **The World Bank** is refusing to release \$50 million in desperately needed aid to PNG unless the government implements policies to ensure the timber industry is sustainable. This pressure has forced the government to review the operations of major logging projects.
- ❹ The government's own review team has found that almost every major logging project in PNG is run illegally and the industry is characterized by corruption and a lack of care for conservation and environmental values. Police and company officers are alleged to have discharged firearms when landowners complained about the destruction of burial grounds and sacred sites. Chemicals from a timber processing plant have flowed directly into the river system. The review also found that promised infrastructure for isolated areas, such as roads and bridges, had not been built or was so poorly built that it soon crumbled. The problem for the government is that logging provides revenue equal to about 5% of the government annual budget, and so moves to end logging could have severe economic consequences.
- ❺ Special criticism is reserved for a **multinational company** that dominates the industry. This company has great political and economic influence in PNG and has also diversified into restaurants and supermarkets, and even runs one of the nation's two daily newspapers. It is receiving most of the revenue from the sale of timber. Despite this, most landowners wanted logging to continue, as they have no other source of income.

[Source: adapted from *The Age*, 11 June 2004]
Mark Forbes and Melissa Fyfe / Courtesy of The Age

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) The World Bank (*paragraph 3*) *[2 marks]*
 - (ii) multinational company (*paragraph 5*). *[2 marks]*
- (b) Using an appropriate diagram, explain how a reduction in logging in Papua New Guinea will impact on furniture prices in Australia. *[4 marks]*
- (c) Using an AD/AS diagram, explain the likely future impact on the economy of Papua New Guinea of “unsustainable logging” (*paragraph 3*). *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the impact on economic development of continued logging in Papua New Guinea. *[8 marks]*
-