



**ECONOMICS  
HIGHER LEVEL  
PAPER 3**

Tuesday 12 May 2009 (morning)

2 hours

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**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.

### Railway network hits 50-year high as people crowd onto trains

- ❶ V/Line, the company that manages the railway system in Australia, is experiencing increased demand for its services, both from rural areas to the city, and within the suburbs around the city.
- ❷ **Rural areas to city train travel**  
There has been a record 50-year high with almost nine million railway journeys made across the rural railway system this year. The number of people using the rail network rose by 9.5%. The chief executive of V/Line said the recent reduction of 20% in fares and 400 extra services helped increase the number of people using the service.
- ❸ Eight years ago the government promised to increase the rail **infrastructure** with new fast trains to the city of Melbourne. The new fast trains have created new private investments, new jobs and more income in the rural areas. They have also led to a housing price boom in these rural areas as more people have moved there.
- ❹ Another result of this increase in demand for train travel is that more travellers are being forced to stand up, or bring their own chairs to sit on when travelling to and from the city. Every available train is being used and the government has just ordered another 24 trains to add to passenger capacity, and has provided more money to employ 24 new train drivers.
- ❺ **Suburban train travel**  
Increased demand is also occurring on suburban railway lines, where passenger use has increased to a 50-year high. This increase in use was totally unexpected. A combination of higher petrol (gasoline) prices, interest rate rises and a society now aware of climate change has led to a public transport problem.
- ❻ As an example, a recent study by transport expert Graham Currie, found that for every 10% rise in petrol (gasoline) prices, rail demand increased by 5%. Based on these figures he estimates the **cross-elasticity of demand** to be 0.5. This figure indicates that rising petrol (gasoline) prices have contributed to increased demand for train travel.

[Source: adapted from *Stephen Moynihan, The Age, 5 May 2007*]

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*(Question 1 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) infrastructure (*paragraph 3*) *[2 marks]*
  - (ii) cross-elasticity of demand (*paragraph 6*). *[2 marks]*
- (b) Using an appropriate diagram, explain why the demand for rail travel increases when the petrol (gasoline) prices rise (*paragraph 6*). *[4 marks]*
- (c) Using an appropriate diagram, explain why the supply of infrastructure is likely to be inelastic in the short term. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate factors that could contribute to increased use of rail services in Australia. *[8 marks]*

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

### Hairdressing industry in the United Kingdom

- ① In the United Kingdom hairdressing is an example of monopolistic competition.
- ② In the United Kingdom around 215 000 people are employed in the hairdressing industry including hairdressers, receptionists, clerical staff and cleaners. There are some 36 000 hairdressing businesses throughout the United Kingdom. This is a sector where small businesses dominate, employing five people or less, and the competition between them is very strong.
- ③ Consumers have clearly defined preferences and producers attempt to differentiate their services from those of their competitors. The **market** for hairdressers' services can be differentiated in many ways including the type of haircut, the style of the shop, the position of the shop, even the quality of the conversation! This leads to customer loyalty, giving producers a degree of independence when deciding the price.
- ④ Hairdressers can further differentiate their services by advertising, which can encourage even more consumer loyalty. In the short run, this can enable a hairdresser to earn abnormal/economic profit. Because there is ease of entry into and exit from the hairdressing industry, abnormal/economic profit will attract more firms into the industry, forcing the price of haircuts down and leading to **normal profit** being earned and greater efficiency.
- ⑤ This industry is experiencing continued expansion, but this expansion will depend on an adequate supply of trained staff. In the United Kingdom the quantity of trained hairdressers demanded exceeds the available number of hairdressers, creating a skill shortage. The problem is compounded by a high dropout of trainees. Hairdressing is not a preferred career choice anymore.

[Source: adapted from [http://www.prospects.co.uk/allabout work/pro/sub-industry.asp?sID](http://www.prospects.co.uk/allabout%20work/pro/sub-industry.asp?sID), 1 May 2007]

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*(Question 2 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) market (*paragraph 3*) *[2 marks]*
  - (ii) normal profit (*paragraph 4*). *[2 marks]*
- (b) Using an appropriate diagram, explain how a firm in monopolistic competition can earn abnormal/economic profit. *[4 marks]*
- (c) Using a demand and supply diagram for haircuts, explain how a shortage of staff in the hairdressing industry could affect the price of haircuts. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the costs and benefits of monopolistic competition for consumers and producers. *[8 marks]*

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

**A tale of two economies**

- ❶ Both Russia and Poland faced serious challenges in transition when moving from centrally planned to free market economies. In the 1990s, both countries decided to open themselves to international trade and foreign direct investment.
- ❷ Poland reformed its economic institutions, strengthened property rights, tightened monetary policy using interest rates, and built a competitive market sector through the use of supply-side policies. However, Poland’s labour market is still “rigid” and suffers from significant **structural unemployment**, resulting in a high rate of natural unemployment.
- ❸ Russia did not reform all its economic institutions, including the property rights system, before opening its economy to competition. This resulted in corruption and crime. Poor economic restructuring has worsened inequality of income and concentrated economic power of firms in an **oligopoly** market structure. Russia has come to depend on the performance of a small number of companies in the natural resource area, especially oil, but these industries are not expected to sustain its economic growth, unless new oil reserves are discovered.

Figure 1  
Current account % of GDP

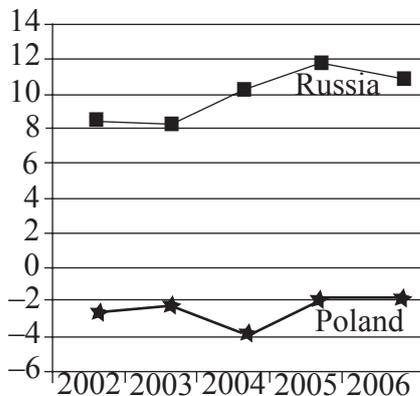


Figure 2  
Unemployment rate

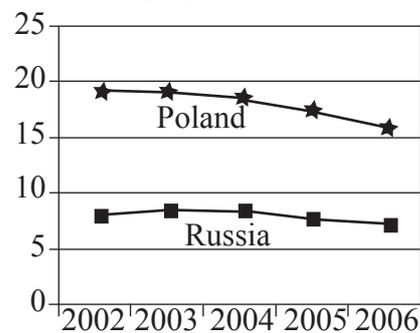


Figure 3  
GDP % change on year before

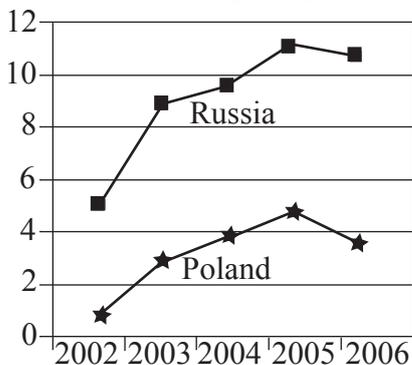
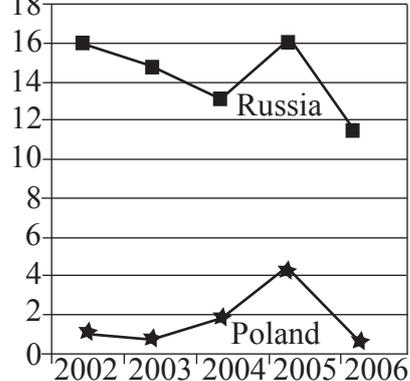


Figure 4  
Consumer prices % change on year before



[Source: adapted from <http://www.economist.com/countries>, accessed July 2007]

*(Question 3 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) structural unemployment (*paragraph 2*) *[2 marks]*
  - (ii) oligopoly (*paragraph 3*). *[2 marks]*
- (b) Using an AD/AS diagram, explain how supply-side policies could affect real output in the long-run. *[4 marks]*
- (c) Using a production possibility curve diagram, explain how the discovery of new oil reserves might affect the Russian economy. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the economic performance of Russia and Poland since the 1990s. *[8 marks]*

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

**India’s strong rupee**

**❶ India with a fixed exchange rate**

Until the 1980s, the Indian government did not make exports a priority. The government aimed for self-sufficiency through **import substitution**, including tariff protection. Foreign trade was subject to strict government controls, which included direct control over exports and imports and capital flows, and a fixed exchange rate. The result, unfortunately for India, was a worsening balance of trade that resulted in record current account deficits. In 1993, India began moving toward a floating exchange rate.

**❷ India now with a floating exchange rate**

The Indian rupee appreciated nearly 10% in the first half of 2006, creating a problem for Indian policy-makers. The main reason for the rupee’s appreciation since 2005 has been the increase of money flows into India; a major factor being increased foreign direct investment.

**❸** The impact of these money flows has been to add to India’s economic growth, which has created a large domestic market that offers more opportunities for employment. Despite these positive developments, exporters, who are benefiting from India’s growth, are increasingly concerned as their goods are becoming less competitive due to the appreciation.

**Key Indian statistics:**

	<b>2005</b>	<b>2006</b>
<b>Real GDP growth (%)</b>	8.5	9.2
Inflation (%)	4.2	6.2
Interest rate (short-term rate)	5.23	5.72
Current account balance (% of GDP)	–0.9	–1.6

[Source: adapted from [http://www.photius.com/countries/india/economy/inda\\_economy\\_trade](http://www.photius.com/countries/india/economy/inda_economy_trade), 21 July 2007 and various issues of *The Economist*]

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*(Question 4 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) import substitution (*paragraph 1*) [2 marks]
  - (ii) real GDP (*table*). [2 marks]
- (b) Using a tariff diagram, explain why the introduction of a tariff might reduce the quantity of imports demanded in India. [4 marks]
- (c) Using an appropriate diagram, explain how an increase in foreign direct investment can lead to an appreciation of the Indian rupee. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the impact of increased foreign direct investment on the Indian economy. [8 marks]

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

### Micro-credit schemes help Colombian refugees rebuild lives in Venezuela

- ❶ When Andres fled to Venezuela from Colombia one of the first things he did was to call the local police to ask if he was entitled to look for work. The answer was yes. Andres decided to switch from farming; and with a talent for mechanics, and a reputation for being able to fix tractors and trucks, he wants to open a small car repair workshop.
- ❷ Andres is applying for micro-credit to begin his business. His loan is less than US\$200, but it will allow him to buy some tools and even print leaflets to advertise his workshop. He intends to repay the money quickly to apply for a larger loan.
- ❸ “Micro-credits are not only about income generation”, says Jose Sieber, United Nations Refugee Head, “they also serve to rebuild the self-confidence of people who have lost everything. The vast majority of people who get a loan, repay it, not just on time, but even before schedule. The money goes back into the programme with the idea that little by little we will have more money to lend out”.
- ❹ Micro-credit is seen as an invaluable tool for reducing poverty, promoting self-sufficiency and stimulating economic activity in some of the world’s poorest communities. It is seen as a wise investment in **human resources**. When the poorest, especially women, receive credit, they become economic participants with power, to not only determine their own lives, but also the lives of their families and communities.
- ❺ Micro-credit can enable a poor person with some skills and capabilities to enter the labour market. However, micro-credit must also be supported by other government assistance to help improve services such as health care, clean water, schools and roads.
- ❻ In addition, foreign direct investment should be encouraged. It can add to a country’s savings and increase **investment** expenditure, and in so doing, potentially increases the amount of employment and income in the economy.

[Source: adapted from <http://www.unrefugees.org.au/situation-reports/micro-credit-scheme-helps-colombian>, 1 May 2007]

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*(Question 5 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) human resources (*paragraph 4*) [2 marks]
  - (ii) investment (*paragraph 6*). [2 marks]
- (b) Using an appropriate diagram, explain how investment in human resources can lead to an increase in the potential output of a country. [4 marks]
- (c) Using an AD/AS diagram, explain how an increase in investment expenditure can, potentially, increase employment (*paragraph 6*). [4 marks]
- (d) Using the information from the text/data and your knowledge of economics, evaluate the role of micro-credit as an instrument of economic development in Venezuela. [8 marks]
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