



UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
International General Certificate of Secondary Education

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ECONOMICS

0455/31

Paper 3 Analysis and Critical Evaluation

October/November 2012

1 hour 30 minutes

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READ THESE INSTRUCTIONS FIRST

This Insert contains extracts for Questions 1 and 2.

Anything written on this Insert will not be marked.

This document consists of **3** printed pages and **1** blank page.



Extract for Question 1

Changes in Japan's price level

Governments aim for price stability, seeking to avoid both excessive rises in the price level and falls in the price level.

In the 1990s and in recent years Japan has suffered from a fall in its price level. Changes in a country's price level can influence other economic indicators and be influenced by them. Table 1 shows Japan's unemployment rate and percentage changes in the annual price level in recent years.

Table 1: Japan's unemployment rate and percentage (%) changes in its annual price level in 2007 – 2010

| Year | Unemployment rate (%) | % change in the annual price level |
|------|-----------------------|------------------------------------|
| 2007 | 3.6 | +0.3 |
| 2008 | 3.9 | −0.2 |
| 2009 | 5.0 | −0.1 |
| 2010 | 5.2 | −0.9 |

Just as inflation can be caused by demand-side or supply-side factors, so can a fall in the price level. Economists suggest that the price level can fall for two main reasons, one beneficial and one harmful. Advances in technology and increases in spending on capital equipment can raise labour productivity and push down costs and prices. These changes, in turn, can lead to greater international competitiveness, higher Gross Domestic Product (GDP) and lower unemployment. Such changes are the result of a beneficial fall of the price level.

In contrast, a fall in the price level caused by lower demand in the economy for most products is likely to be harmful. Lower total (aggregate) demand can drive down prices and result in a fall in GDP. Consumers delay their purchases, expecting prices to be lower in the future. They may also want to reduce their purchases because they may be afraid of losing their jobs. Firms, experiencing lower sales, are likely to reduce their output. A harmful fall in prices can be difficult to stop.

The Japanese government has tried a number of ways to reverse the fall in the price level. It has used fiscal and monetary policy. One monetary policy measure that the Japanese central bank has used was to reduce its interest rate to a very low level.

Extract for Question 2**Improving the environment**

On the last Saturday of March each year Earth Hour is celebrated in more than 4000 cities in over 120 countries. The event involves households and firms turning off their non-essential lights and other electrical equipment for one hour. The aim is to increase awareness of the need to preserve non-renewable resources and to improve the environment. Energy use is one of the causes of emissions of carbon dioxide (CO₂) which contribute to global warming.

Some economists claim that encouragement by setting an example is not enough. They suggest that government regulation is needed to reduce consumption of energy from unclean, non-renewable sources. Other economists oppose this view, claiming that, for instance, as coal becomes scarcer, its price will change which will stimulate a search for alternative sources of energy.

Alternatives to conventional energy sources include solar power and biofuels. Solar power involves making use of the sun's rays and does not directly cause CO₂ emissions. There is a variety of biofuels including rapeseed oil, sunflower oil and soya. The most widely used biofuel, however, is palm oil.

Governments have been encouraging the use of biofuels in vehicles as a way of reducing emissions of greenhouse gases. To grow biofuels, however, can involve turning rainforests and grasslands into plantations. This process releases carbon dioxide stored in trees and soil. It has been estimated that it can take up to 840 years for a palm oil plantation to absorb the carbon released when the rainforest is burnt. Indeed, the expansion of the palm oil industry in Indonesia has turned that country into the third largest polluter after China and the US.

Among the major consumers of palm oil are the European Union (27% of the global total), China (14%), Indonesia (12%), India (11%) and Pakistan (6%).

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