



VICTORIA SHANGHAI ACADEMY



IB DP ECONOMICS
Past Year Papers
(Higher Level)



**ECONOMICS
HIGHER LEVEL
PAPER 1**

Tuesday 13 May 2008 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer one question. Each question is worth [25 marks].

1. (a) Explain how a firm operating in an oligopolistic market might attempt to increase its market share. *[10 marks]*
(b) Evaluate the view that producers, and not consumers, are the main beneficiaries of oligopolistic market structures. *[15 marks]*

 2. (a) “The effect of a decrease in aggregate demand on output and the price level depends on the shape of the aggregate supply curve.” Explain this statement. *[10 marks]*
(b) Evaluate the likely effects of a falling rate of inflation on the performance of an economy. *[15 marks]*

 3. (a) Explain the principle of comparative advantage and the benefits which might arise from free trade. *[10 marks]*
(b) Evaluate the importance of membership of a trading bloc for the export performance of a country. *[15 marks]*

 4. (a) Explain how development might be measured. *[10 marks]*
(b) Evaluate the view that the most effective way that a government could improve the welfare of its citizens is through the pursuit of faster economic growth. *[15 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Wednesday 19 November 2008 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer one question. Each question is worth [25 marks].

1. (a) Explain the determinants of price elasticity of demand. *[10 marks]*

(b) “A deterioration in a country’s terms of trade will always be disadvantageous for the current account balance.” Evaluate this statement using the concept of price elasticity of demand. *[15 marks]*

 2. (a) Explain the concepts of allocative and productive (technical) efficiency. *[10 marks]*

(b) “Monopolies are inefficient and therefore always act against the public interest.” Discuss this statement. *[15 marks]*

 3. (a) Explain the difference between progressive taxation and regressive taxation. *[10 marks]*

(b) Evaluate the possible effects of a decrease in direct taxation on a country’s inflation rate, unemployment rate and balance of payments. *[15 marks]*

 4. (a) Explain **three** barriers to economic development for developing countries. *[10 marks]*

(b) Evaluate the view that trade is more effective than aid in achieving economic development. *[15 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Monday 11 May 2009 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer *one* question. Each question is worth [25 marks].

1. (a) In the theory of the firm, a distinction is made between short-run cost curves and long-run cost curves. Using appropriate cost curve diagrams, explain this distinction. [10 marks]
- (b) Evaluate the view that greater economic efficiency will always be achieved in perfect competition as compared to monopoly. [15 marks]
2. (a) Explain the possible causes of a rise in the rate of inflation in an economy. [10 marks]
- (b) Evaluate the possible impact on economic performance that may result from a government decision to bring inflation under control. [15 marks]
3. (a) Explain the importance of price elasticity of demand in relation to a country's balance of payments on current account. [10 marks]
- (b) Evaluate the view that supply-side policies are more successful in correcting a country's current account deficit than demand-side policies. [15 marks]
4. (a) Institutional and political factors such as an ineffective taxation structure, political instability and an unequal distribution of income, as well as social and cultural factors such as gender issues and tradition, may all act as barriers to economic development.
- Explain how any **three** of these factors may act as barriers to economic development. [10 marks]
- (b) Evaluate the view that, in terms of achieving economic development in less developed countries, interventionist strategies, with a role for the government, are preferable to market-led strategies. [15 marks]
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Friday 6 November 2009 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer one question. Each question is worth [25 marks].

1. (a) Explain why a firm may practice price discrimination and the necessary conditions for it to take place. *[10 marks]*
(b) “Although a firm may pursue a range of goals, economists usually assume that profit maximization is the main goal.” Discuss this statement. *[15 marks]*

 2. (a) Explain how the rate of inflation might be measured and the factors which might make accurate measurement difficult. *[10 marks]*
(b) Evaluate the extent to which an individual government can influence the rate of inflation in its economy. *[15 marks]*

 3. (a) Explain **two** possible consequences of a sustained current account deficit in a country’s balance of payments. *[10 marks]*
(b) Evaluate the methods available to a government to reduce a current account deficit. *[15 marks]*

 4. (a) Explain how buffer stock schemes/commodity price agreements may be used to reduce wide fluctuations in primary commodity prices. *[10 marks]*
(b) Evaluate the view that, to achieve greater growth and development, developing countries must lessen their dependence on the production of primary commodities. *[15 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Wednesday 19 May 2010 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer one question. Each question is worth [25 marks].

1. (a) Explain the importance of price elasticity of demand **and** cross-elasticity of demand for business decision-making. *[10 marks]*

(b) Studies have shown that the demand for tobacco tends to be highly price inelastic. Evaluate the view that governments can best reduce smoking by substantially increasing taxes on cigarettes. *[15 marks]*

 2. (a) Explain why a country may wish to reduce its rate of inflation. *[10 marks]*

(b) Evaluate the likely impact on the economy of relying on higher interest rates to reduce the rate of inflation. *[15 marks]*

 3. (a) There has been an increasing trend in different parts of the world for countries to engage in economic integration through the formation of trading blocs. Using suitable examples, explain the different types of trading bloc that may be formed. *[10 marks]*

(b) Evaluate a country's decision to join a free trade area (FTA). *[15 marks]*

 4. (a) Explain the difference between economic growth and economic development, and how each of these may be measured. *[10 marks]*

(b) Evaluate the view that the best way that developed countries can help the growth and development process of very poor, highly indebted countries is through a general cancellation of debts. *[15 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Wednesday 10 November 2010 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer **one** question. Each question is worth [25 marks].

1. (a) Explain why negative externalities are an example of market failure. [10 marks]
(b) Evaluate **three** policies that governments might implement to reduce negative externalities associated with the environment. [15 marks]
 2. (a) Explain how supply-side improvements to an economy may be achieved through the use of taxes and government spending. [10 marks]
(b) Evaluate the use of supply-side policies to reduce unemployment. [15 marks]
 3. (a) Explain **two** factors which may cause a depreciation of a country's exchange rate. [10 marks]
(b) Evaluate the extent to which a depreciating exchange rate may benefit or harm an economy. [15 marks]
 4. (a) Explain why economic growth rates may differ between developing countries. [10 marks]
(b) Evaluate the role of foreign direct investment in assisting a developing country to achieve greater growth and development. [15 marks]
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Monday 16 May 2011 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer **one** question. Each question is worth [25 marks].

1. (a) Using an appropriate diagram, explain how a monopolist might be able to make supernormal (abnormal) profits in the short-run, and why these profits might continue to be earned in the long-run. [10 marks]
 - (b) Evaluate the view that monopolistic competition is a more economically desirable market form than monopoly. [15 marks]
 2. During the global financial crisis of 2008–2009, there was a fall in consumer spending in many countries.
 - (a) Explain the factors which might be responsible for causing consumer spending to fall. [10 marks]
 - (b) Evaluate the possible consequences of falling consumer spending for a country's macroeconomic performance. [15 marks]
 3. (a) Using the theory of comparative advantage, explain how specialization and free trade might lead to welfare gains for developed countries. [10 marks]
 - (b) Evaluate the possible impact of globalization on the economies of developed countries. [15 marks]
 4. (a) Explain the main features of market-led strategies used to achieve economic development in less-developed countries (LDCs). [10 marks]
 - (b) Evaluate the view that economic development in less-developed countries (LDCs) can best be achieved through market-led strategies rather than interventionist strategies. [15 marks]
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Monday 14 November 2011 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.

Answer one question. Each question is worth [25 marks].

1. (a) Explain the different objectives that a firm in an oligopolistic market structure might try to achieve. *[10 marks]*
(b) Evaluate the view that an oligopolistic market is an inefficient market structure. *[15 marks]*

 2. (a) Explain what the multiplier is and, using a numerical example, demonstrate how it can be calculated. *[10 marks]*
(b) Evaluate whether real Gross Domestic Product (GDP) can be increased by the use of demand-side policies. *[15 marks]*

 3. (a) Explain, using a diagram, how government intervention can change the exchange rate of a currency. *[10 marks]*
(b) Reducing the value of a country's currency is an effective solution for a balance of payments deficit on the current account. Evaluate this view. *[15 marks]*

 4. (a) Explain the differences between foreign direct investment (FDI) and aid. *[10 marks]*
(b) Evaluate the view that aid is an effective means to achieve economic growth and development in less-developed countries (LDCs). *[15 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Tuesday 15 May 2012 (afternoon)

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use fully labelled diagrams and references to examples where appropriate.
- The maximum mark for this examination paper is *[25 marks]*.

Answer *one* question. Each question is worth [25 marks].

1. (a) Explain the economic factors which may encourage the formation of a monopoly. [10 marks]
- (b) Evaluate the view that natural monopoly is a more desirable market structure than perfect competition. [15 marks]
2. (a) Explain why governments may view deflation as a threat. [10 marks]
- (b) Evaluate the view that a low and stable rate of inflation is beneficial for an economy. [15 marks]
3. (a) Explain the differences in the operation of fixed and floating exchange rate systems. [10 marks]
- (b) Evaluate the view that any imbalance in the current account will be corrected automatically under a freely floating exchange rate system. [15 marks]
4. (a) Explain how **three** of the following factors may act as barriers to development in a less developed country:
- capital flight
 - income inequality
 - ineffective taxation structure
 - lack of infrastructure. [10 marks]
- (b) Evaluate the view that foreign direct investment (FDI) is the key factor in determining whether a developing country will be able to achieve economic growth and development. [15 marks]
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Thursday 2 May 2013 (afternoon)

1 hour 30 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to examples where appropriate.
- The maximum mark for this examination paper is *[50 marks]*.

SECTION A

Answer **one** question from this section.

Microeconomics

1. (a) Distinguish between decreasing returns to scale and the law of diminishing returns. *[10 marks]*
(b) Using diagrams, compare and contrast the market structure of monopoly with that of perfect competition. *[15 marks]*

2. (a) Explain the factors which might influence the cross price elasticity of demand between different products. *[10 marks]*
(b) Examine the importance of income elasticity of demand for the producers of primary products, manufactured goods and services. *[15 marks]*

SECTION B

Answer *one* question from this section.

Macroeconomics

3. (a) Using a diagram, describe how expansionary monetary policy might be used to close a deflationary (recessionary) gap. *[10 marks]*
- (b) Discuss why, in contrast to the monetarist/new classical model, an economy can remain stuck in a deflationary (recessionary) gap according to the Keynesian model. *[15 marks]*
4. (a) Explain how labour market reforms may be used to promote economic growth. *[10 marks]*
- (b) “Market-oriented supply-side policies will always be more effective in promoting economic growth than demand-side policies.” To what extent do you agree with this statement? *[15 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 1**

Monday 4 November 2013 (afternoon)

1 hour 30 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to examples where appropriate.
- The maximum mark for this examination paper is *[50 marks]*.



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SECTION A

*Answer **one** question from this section.*

Microeconomics

1. (a) Using a price ceiling diagram, analyse the impact a maximum price might have on the market for food. *[10 marks]*
(b) Discuss the policies a government might use to make food more affordable to low income groups. *[15 marks]*

2. (a) Explain why governments impose indirect taxes. *[10 marks]*
(b) Discuss **two** possible government responses to threats to sustainability. *[15 marks]*

SECTION B

*Answer **one** question from this section.*

Macroeconomics

3. (a) Explain how changes in the size of the circular flow depend on the relative size of injections and leakages. *[10 marks]*
- (b) Evaluate the use of national income statistics for making comparisons of the standard of living over time. *[15 marks]*
4. (a) Explain why measuring the rate of inflation using a consumer price index (CPI) may not be accurate. *[10 marks]*
- (b) Evaluate **two** government policies to reduce inflation. *[15 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 3**

Tuesday 12 May 2009 (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.

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

- ① 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.
- ② **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.
- ③ 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.
- ④ 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.
- ⑤ **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.
- ⑥ 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*]

(This question continues on the following page)

(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/allaboutwork/pro/sub-industry.asp?sID>, 1 May 2007]

(This question continues on the following page)

(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

- ① 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.
- ② 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.
- ③ 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

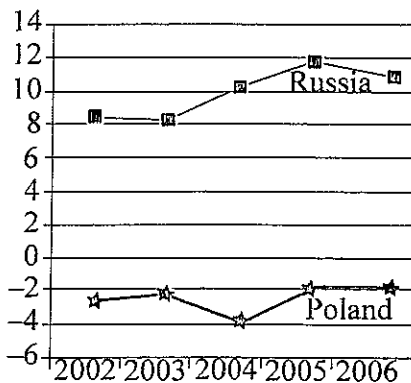


Figure 2
Unemployment rate

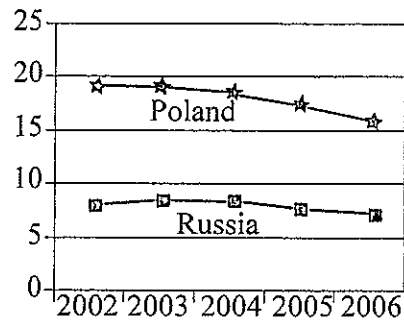


Figure 3
GDP % change on year before

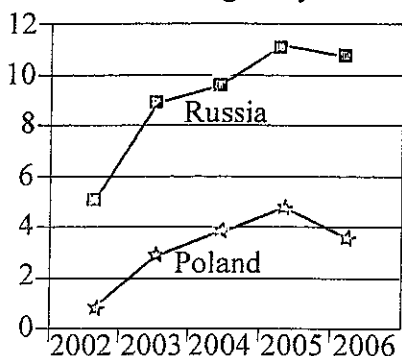


Figure 4
Consumer prices % change on year before



[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:

	2005	2006
Real GDP growth (%)	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, 21 July 2007 and various issues of *The Economist*]

(This question continues on the following page)

(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]

(This question continues on the following page)

(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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**ECONOMICS
HIGHER LEVEL
PAPER 3**

Monday 9 November 2009 (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.

Airlines and passengers urge commission to end BAA's monopoly

- ❶ Airlines and passenger groups have given BAA*, the world's largest private airport company, a strong message by calling for the UK company's break-up. As a result, the Competition Commission announced yesterday that it will investigate whether BAA's monopoly of London's airports is bad for passengers.
- ❷ BAA claims that its ownership of the London airports of Heathrow, Gatwick and Stansted is good for passengers, because it allows BAA to achieve **economies of scale** and to use its profits to invest more efficiently. It argues that the criticisms and the investigation will result in delays to the **investment** that is needed to "improve the passenger experience and increase capacity". BAA is set to double the price it charges airlines for each departing passenger so that it can increase its investment. However, airlines and passenger groups argue that BAA's monopoly means that it may just increase profits instead of investing the profits in new facilities.
- ❸ The Competition Commission has noted the criticisms of BAA's operations, particularly at Heathrow, Gatwick and Stansted. These include delays, inadequate availability of facilities such as lifts (elevators) and escalators, overcrowding and concerns about cleanliness. Its investigation will look at how BAA's monopoly position might affect incentives to improve services and whether it results in high levels of both allocative and productive inefficiency.
- ❹ Some economists suggest that the Competition Commission should force the break-up of the monopoly, allowing the airports, or at least the terminals within the airports, to be run separately, with greater competition.
- ❺ Heathrow Airport is facing another massive challenge from climate change activists who have been demonstrating to draw attention to aircraft greenhouse emissions. Scientists say air transport emissions contribute heavily to global warming. One protester argued that this market failure means that, "we are bringing totally unacceptable levels of risks for future generations and people around the world".

[Source: adapted from Airlines and passengers urge regulator to end BAAs monopoly, *The Times*, 10 August 2007 and IATA boss attacks "out of control" monopoly, *Director of Finance Online*, 13 August 2007]

* BAA: British Airports Authority

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) economies of scale (*paragraph 2*) [2 marks]
 - (ii) investment (*paragraph 2*). [2 marks]
- (b) Using an appropriate diagram, explain why BAA's monopoly operation of London's airports might result in allocative inefficiency (*paragraph 3*). [4 marks]
- (c) Using an appropriate diagram, explain why air transport emissions are seen as an example of market failure (*paragraph 5*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the argument that the BAA monopoly should be broken up by the Competition Commission. [8 marks]

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

The Dutch economy

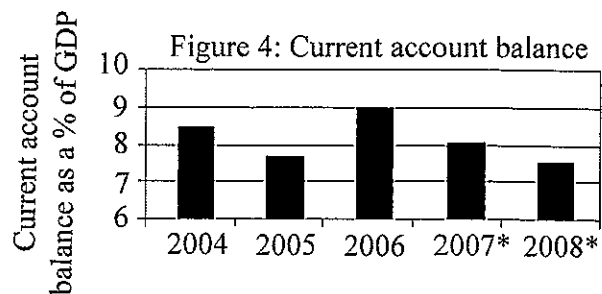
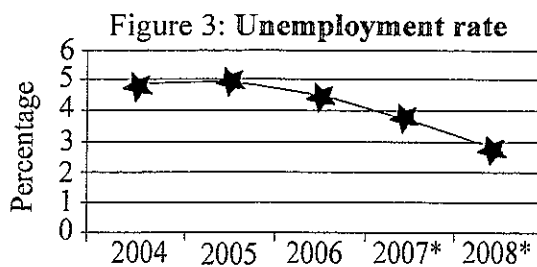
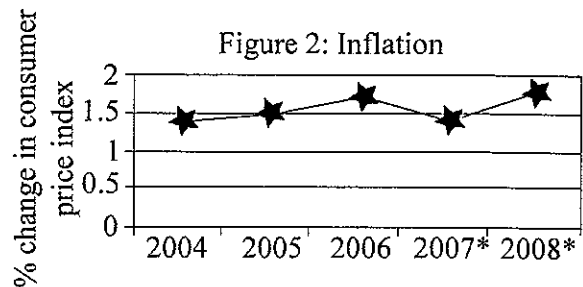
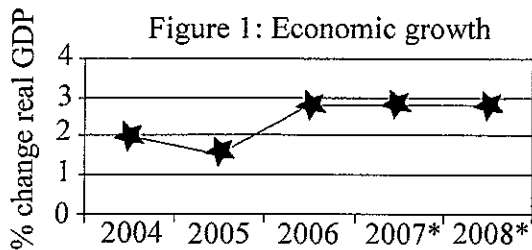
Table 1

Expenditure by sector	Current prices 2003 (€ billion)
Consumption	238
Government spending	117
Investment	93
Exports of goods and services	300
Imports of goods and services	270

Text A

The economy grew well in 2006. Economic growth was almost 3%. Exports benefited from faster demand in the Euro area, but export growth may slow down as a result of the strength of the Euro. Consumption was increased by higher real wages and a decrease in unemployment. If economic growth is higher than expected, it will result in an inflationary gap and the risk of an overheating economy.

If this happens a tighter fiscal policy should be put in place to reduce demand pressures. As well, the government needs to implement policies to increase labour market participation and the number of hours worked.



[Source: adapted from *The OECD Economic Outlook 81 Database*, June 2007]

* Forecast values

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) consumption (*Table 1*) *[2 marks]*
 - (ii) unemployment rate (*Figure 3*). *[2 marks]*
- (b) Using the data in Table 1, calculate the value of GDP. Explain your calculation. *[4 marks]*
- (c) Identify **one** positive statement and **one** normative statement from Text A. Explain your reasoning. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the role of demand-side policies and supply-side policies in maintaining the growth of the Dutch economy. *[8 marks]*

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

Central bank says that China's inflation rate may get bigger

- ① Some economists are predicting that the Chinese central bank is getting ready to announce that China has recorded its highest inflation rate in 10 years. They are predicting that the inflation figure, due to be released shortly, may be 5.5% or more, the highest since February 1997.
- ② Price increases are not only the result of temporary factors, such as rising food prices, but also the result of long-term structural factors such as rising labour costs, the People's Bank of China said in a second-quarter **monetary policy** report today. According to the Bank, the upward pressure on prices is growing, and the inflation risk deserves attention. Energy costs, high foreign demand, and expectations of rising prices are also adding to inflationary pressure. The risk of high inflation rates has increased, it said.
- ③ Rising consumer prices may add pressure on the central bank to increase interest rates for the fourth time this year to slow down the economy.
- ④ The world's fourth-biggest economy expanded by 11.9%* in the second quarter, powered by record trade surpluses caused by increased demand for Chinese exports.
- ⑤ The **current account surplus** may "stay at a relatively high level", the bank said, noting that export gains are usually larger in the second half of the year.
- ⑥ The central bank repeated its commitment to increase the flexibility of the yuan. Trading partners including the US have urged China to allow the exchange rate to strengthen. The yuan has climbed 9.3% against the dollar since the end of a fixed exchange rate in July 2005. However, many do not feel that this is enough of an appreciation and urge the Chinese government to allow market forces to set the price of the yuan.

[Source: adapted from *Bloomberg* by Zhang Dingmin and Nipa Piboontanasawat, 8 August 2007]

* 11.9%: an annualized figure

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) monetary policy (*paragraph 2*) *[2 marks]*
 - (ii) current account surplus (*paragraph 5*). *[2 marks]*
- (b) Using an appropriate diagram, explain why rising labour costs could contribute to high inflation rates (*paragraph 2*). *[4 marks]*
- (c) Using an appropriate diagram, explain why market forces are likely to lead to an appreciation of the yuan. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the likely consequences for the Chinese economy if the government allows the yuan to appreciate. *[8 marks]*

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

**The European Union (EU) and South Korea
hold second round of talks on free trade agreement**

- ① The EU has opened a second round of discussions on a free trade agreement with South Korea. “The EU has never before taken such an ambitious position in a bilateral free trade negotiation” said an EU spokesperson. An agreement could increase two-way trade by up to 40% – or €24 billion a year. The South Korean president said a trade deal would “expand opportunities for both sides, while giving valuable momentum to the liberalization of global trade. Opening our market is not a matter of choice but a matter of survival”.
- ② The EU is South Korea’s second-biggest trading partner after China. Important EU exports to South Korea include machinery (despite South Korea being more efficient at producing machinery), chemicals and transport equipment, along with more than €1 billion in agricultural products such as pork and wines. South Korea wants easier access to European markets for its ships, automobiles, consumer electronics and semi-conductors. South Korea has a lower opportunity cost in the production of ships compared to all other goods it produces.
- ③ Although both sides have stressed the benefits of a deal, they face a number of difficult issues, most notably in the automobile sector. The export of cars accounts for the largest share of South Korea’s trade surplus with the EU. Currently, the EU places a 10% tariff on imported cars. South Korea sets an 8% tariff on imported cars and is offering to reduce it to zero over seven years. Tariff-free access of South Korean cars to the European market could increase South Korean car exports by up to 124 000 cars per year, worth \$1.4 billion. European car-makers also expect great advantages from a free trade agreement.
- ④ The EU also wants investment to be discussed in the negotiations. The EU is the biggest investor in South Korea with a total investment accounting for 45% of **foreign direct investment** inflows to South Korea. The EU also wants to discuss the non-tariff barriers to trade that reduce EU-South Korean trade. The EU stressed that a global deal (multilateral agreement) remains a priority and such bilateral talks are not aimed at replacing the **WTO**.

[Source: adapted from *The Associated Press*, 16 July 2007 and *People’s Daily online*, 17 July 2007]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) foreign direct investment (*paragraph 4*) [2 marks]
 - (ii) WTO (*paragraph 4*). [2 marks]
- (b) Explain **two** non-tariff barriers that might reduce EU-South Korean trade (*paragraph 4*). [4 marks]
- (c) Using a comparative advantage diagram, explain why free trade in machinery and ships between South Korea and the EU may be beneficial to both economies (*paragraph 2*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the possible outcomes of the proposed free trade agreement between South Korea and the EU. [8 marks]

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

Growers hurt by the low price of tea

- ① The world produces so much tea that British people are paying far less for their favourite drink than they did 30 years ago.
- ② Global overproduction, supermarket price wars and a weak dollar mean that the price is less than a penny a cup. The real price of a cup of tea is actually a quarter of what it was in 1977, industry research has revealed.
- ③ The figures are good news for the world's second-biggest *per capita* tea-drinking nation, but bad news for the 36 tea-growing countries, which last year produced 3.5 million tonnes of tea, of which 160 000 tonnes were shipped to Britain.
- ④ Tea is grown in some of the poorest countries in the world and is often a primary source of income; for Uganda, for example, it is the third-largest export earner. For many growers and pickers it is their only source of income.
- ⑤ A tea consultant said: "continuing low prices and deteriorating terms of trade mean that planned investment in **infrastructure** has to be postponed or cancelled and this is likely to result in a less than expected rate of economic growth. This impacts on the individual small farmers and puts more pressure on their day-to-day existence".
- ⑥ British tea importers argue that many countries, led by Bangladesh and Vietnam, are planting and growing far more tea bushes than the world needs, under pressure from poor local farmers desperate to make a living.
- ⑦ The chairman of the UK Tea Council, said: "there is too much being grown in some countries, and producers need to balance supply with demand".
- ⑧ Some in the industry believe that Britain is not paying enough for the 165 million cups it drinks every day, and that a slightly higher price would benefit farmers without hurting consumers.
- ⑨ Cafédirect, Britain's largest ethical tea and coffee wholesaler (distributor) which deals only in fair trade products, said: "we are the only major brand to guarantee a **minimum price** for tea, and this year announced an increase of 8%".

[Source: adapted from *The Times*, 25 July 2007]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) infrastructure (*paragraph 5*) *[2 marks]*
 - (ii) minimum price (*paragraph 9*). *[2 marks]*
- (b) Using an appropriate diagram, explain the main reason for the change in the real price of tea since 1977 (*paragraph 2*). *[4 marks]*
- (c) Explain why falling tea prices may result in deteriorating terms of trade for countries where income from tea is the primary source of income. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate **two** possible measures which might be used to improve the standard of living of tea farmers. *[8 marks]*
-



**ECONOMICS
HIGHER LEVEL
PAPER 3**

Thursday 20 May 2010 (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 and data below and answer the questions that follow.

Rising prices blamed on the “big” supermarkets

- ❶ Since 1990, supermarket prices in Australia have risen twice as fast as anywhere else in the developed world. An inquiry into supermarket prices has established that consumers are paying much more for basic items such as bread, milk, meat and eggs compared to other developed countries as shown in Table 1.

Table 1

	Australia	USA	France	Germany	Japan
Food inflation rate (1990–2006)	68%	46%	28%	17%	4%

- ❷ The inquiry conducted by the Australian Competition and Consumer Commission into supermarket prices, concluded that the three largest supermarket chains, Coles, Woolworths and Franklins, are charging higher prices for their goods and services. They are acting as a **collusive oligopoly**. They are earning **abnormal profits** (sometimes called supernormal profits or economic profits) and are allocating resources inefficiently.
- ❸ In opening remarks at the commission, it was said that competition had collapsed at the expense of consumers, creating an oligopolistic market structure, where the three largest supermarkets control over 80% of Australia’s food sales, as Table 2 indicates. They are also diversifying into other areas such as banking, takeaway food, cut flowers and gasoline (petrol).

Table 2

	Australia	USA	France	Germany	Japan
% share of food sales of three largest supermarket chains	80.4%	21%	38%	47%	17.5%

- ❹ Small independent food stores want the government to intervene and not allow the total market share of these three supermarket chains to be larger than 75%, with no supermarket chain controlling more than 25% of the market. Over the last 20 years, many small independent food stores have closed due to the extended trading hours of the large supermarkets, favourable rental agreements for these large stores, the economies of scale generated by their size, and because independent food stores have been bought by the three larger companies.
- ❺ The three large supermarket chains claim the existing situation should be maintained because of the number of people they employ (173 000 people in Australia), the long-term careers in the retail sector they provide and the service businesses they attract to rural parts of Australia.

[Source: adapted from *The Age*, 9 April 2008 and http://www.regional.org.au/articles/agriculture/beef/bin_retail1.htm]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) collusive oligopoly (*paragraph 2*) [2 marks]
 - (ii) abnormal profits (*paragraph 2*). [2 marks]
- (b) Using an appropriate diagram, explain how collusive oligopolies can earn abnormal profits. [4 marks]
- (c) Using an appropriate diagram, explain how the increased size of the supermarkets has led to economies of scale (*paragraph 4*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate a decision by the Australian government to reduce the total market share of the three largest supermarket chains to 75% (*paragraph 4*). [8 marks]

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

Moving towards a recession

- ① Economic performance in the United States (USA), Western Europe and Japan according to economic indicators such as the growth of output, investment, employment and wages, has been getting worse in each downward phase of the business cycle since 1973. The current cycle in the USA, which began in early 2001, has been the worst of all. Gross Domestic Product (GDP) growth has been the slowest in any comparable cycle since the 1940s; growth in investment is down 30% and the creation of jobs is down 65%. In addition, hourly wages have not increased in real terms since 1979. This forms the background for the current economic problems that began in 2007.
- ② Many economists believe that the USA economy is now in recession. Falling house prices have reduced the ability of homeowners to borrow against their property, which in turn reduces their ability to spend freely on consumer goods and services. This fall in consumer spending has led to businesses hiring less labour in some industries, which has further slowed consumer spending. The construction of new homes has fallen, with sales of new homes falling even faster, resulting in a large oversupply of homes, which will continue to force down prices even more.
- ③ The USA Federal Government is considering tax cuts and additional government spending to stimulate the economy, even if this increases the budget deficit. The hope is to encourage consumer spending and business investment although this may add to inflationary pressures. The chairman of the Federal Reserve (the central bank) in the USA has indicated that he is happy to support the use of fiscal policy by lowering interest rates.
- ④ Cuts in **indirect taxes** and direct taxes affect production costs, disposable income and the spending power of consumers, and have an impact on the allocation of **resources (factors of production)**. They may also have a psychological effect on investors.

[Source: adapted from *The New York Times*, 13 and 17 January 2008]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) indirect taxes (*paragraph 4*) *[2 marks]*
 - (ii) resources (factors of production) (*paragraph 4*). *[2 marks]*
- (b) Using an appropriate diagram, explain how a fall in consumer spending could lead to a recession. *[4 marks]*
- (c) Using a demand and supply diagram, explain why the price of labour (wages) will fall if businesses hire less labour. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the role of fiscal policy in stimulating the USA economy. *[8 marks]*

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

Pakistan’s economy

- ❶ There was a positive transformation in the Pakistani economy in the early 2000s. The **exchange rate** was allowed to float, exports of primary commodities increased along with **foreign direct investment** and foreign reserves, while government debt fell.
- ❷ By 2007, however, Pakistan faced a number of political and economic problems. In addition to political instability, there were hailstorms and diseases destroying crops, which led to large increases in food imports. The price of imported raw materials continued to increase with 27% of the higher import expenditure due to the increase in oil prices. Industrial production began to fall. Foreign investment in shares fell from US\$1.5 billion in 2006 to US\$97 million.
- ❸ These events have led to Pakistan’s highest current account deficit ever, amounting to 8.6% of Gross Domestic Product (GDP) (June 2008).

Table 1

	2007	2008	2009 (estimated)
Real GDP growth (%)	6.0	5.8	4.4
Current account balance (% of GDP)	-5.7	-8.6	-8.3
Exchange rate (Pakistani rupees to US\$)	61	66	64
Consumer price inflation (%)	7.6	19	11

- ❹ What is the government doing? The new budget (2008–2009) aims to reduce the budget deficit from 7% of GDP to 4.7% (by raising tax revenue and reducing government expenditure). It will also introduce tariffs and quotas. While the introduction of tariffs could help reduce the twin deficits (budget deficit and current account deficit), it could reduce consumer welfare and lead to an inefficient allocation of resources.
- ❺ The government is preparing a plan aimed at increasing foreign exchange earnings through export-led growth. The intention is to diversify production and exports in industries in which Pakistan has a comparative advantage, making better use of the country’s abundant labour supply and natural resources.

[Source: © The Economist Newspaper Limited, London (12 June 2008)]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) exchange rate (*paragraph 1*) [2 marks]
 - (ii) foreign direct investment (*paragraph 1*). [2 marks]
- (b) Using an appropriate diagram, explain how increased spending on food imports (*paragraph 2*) could affect Pakistan's exchange rate. [4 marks]
- (c) Using an appropriate diagram, explain how the continuing increase in prices for imported raw materials (*paragraph 2*) could have contributed to the impact on the general price level and output in 2008 (*Table 1*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the impact on the Pakistani economy of the decision to introduce tariffs (*paragraph 4*). [8 marks]

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

Vietnam's changing economy

- ① Vietnam has achieved an impressive turnaround in its agricultural sector. Whereas in the mid-1980s the country was on the verge of famine, today it is the second-largest rice exporter in the world. In addition, it produces and exports a variety of farm, fishery and forest products, though these activities are not always consistent with **sustainable development**.
- ② Important factors behind the success of Vietnam's agriculture were privatization of farms and equitable distribution of land ownership, stabilization of the economy in the mid-1980s, liberalization (freeing) of farm prices and its policies based on **free trade**.
- ③ Vietnam's economic transformation is often measured in terms of the declining share of the agricultural sector in Gross Domestic Product (GDP) and the corresponding increase in the shares of the industrial sector and the service sector. Where the primary sector (agriculture, forestry and fisheries) used to provide over two-thirds of all jobs 10 years ago, now it provides only about half of all jobs.
- ④ Until recently, the government and international agencies were advising Vietnamese farmers to diversify their production, partly by moving towards non-farm industries, and partly by diversifying crops within agriculture. An example of the diversification suggested is the development of "craft industries" producing simple homespun products and tourism that would bring rich tourists who would buy these products. However, in recent months there have been rapid increases in rice prices due to increases in world demand for rice. This would provide large benefits for rice farmers. The government is now concerned that diversification has gone too far, as some rice farmers have already switched out of rice production.
- ⑤ In the long term, Vietnam may face a far more serious danger. Scientists predict a rise in the sea levels along its coast that by the year 2100 could submerge one-eighth of its land area, as well as give rise to extreme weather conditions. As most of Vietnam's agricultural land and population are near the sea, such developments would be highly destructive to the country and its economy.

[Source: © The Economist Newspaper Limited, London (24 April 2008)]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) sustainable development (*paragraph 1*) *[2 marks]*
 - (ii) free trade (*paragraph 2*). *[2 marks]*
- (b) Using the concept of income elasticity of demand, explain the change in relative importance of the agricultural sector in comparison to the industrial and the service sectors in Vietnam (*paragraph 3*). *[4 marks]*
- (c) Using an appropriate diagram, explain the likely long-term impact of a rise in sea levels on the productive capacity of the Vietnamese economy (*paragraph 5*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate diversification as a policy option for improving export performance in Vietnam. *[8 marks]*

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

Fair trade in Malawi

- ❶ Malawi is one of the world's least developed countries, with about 85% of the population living in rural areas. Agriculture accounts for more than 30% of Gross Domestic Product (GDP) and 90% of exports. The economy depends on economic assistance from the International Monetary Fund (IMF), **World Bank** and individual donor nations.
- ❷ The district hospital at Mchinji in Malawi was built nearly 20 years ago to provide basic healthcare services to the population. Healthcare services also have major external benefits for the economy (positive externalities), such as more productive workers, lower absenteeism from work and higher economic growth. The hospital was originally built to serve 275 000 people, but now serves 600 000. Malawi has the lowest number of doctors *per capita* in the world.
- ❸ Work started recently on a hospital extension. The extension has been paid for by fair trade groundnuts, grown in Malawi and sold to British shoppers. This story is being repeated throughout Malawi with fair trade revenues being used to improve infrastructure and better educational opportunities. Disadvantaged producers and families are benefiting from fair trade funds.
- ❹ Fair trade is seen as a form of aid. The **free market** was not providing enough income to farmers, but now groundnut farmers receive a guaranteed payment above the world equilibrium price for their goods, and use the extra payments to make improvements in their communities. Fair trade advocates payment of fair prices and social and environmental standards in the production of a wide range of goods. The focus is on exports from developing to developed countries, working with very poor producers to help them achieve a position of greater economic security and self-sufficiency.
- ❺ Fair trade has become one of the fastest growing retail sectors in Great Britain. Consumers are spending more than UK£450 million (US\$900 million) annually on fair trade products.
- ❻ Fair trade, however, has its critics. Free market economists argue that by encouraging oversupply, fair trade agreements result in the inefficient allocation of resources and may drive prices down in the long term. Other critics have pointed out that the major beneficiaries of free trade agreements are the large supermarkets rather than the poor producers in developing countries.

[Source: adapted from *The Guardian Weekly*, 15 February 2008]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) World Bank (*paragraph 1*) [2 marks]
 - (ii) free market (*paragraph 4*). [2 marks]
- (b) Using an appropriate diagram, explain how a guaranteed price above the equilibrium price will benefit groundnut farmers (*paragraph 4*). [4 marks]
- (c) Using an appropriate diagram, explain how the provision of hospital services has positive externalities (*paragraph 2*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate fair trade as a means of improving the welfare of people in Malawi. [8 marks]
-



**ECONOMICS
HIGHER LEVEL
PAPER 3**

Thursday 11 November 2010 (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.

Thailand calls for a rice cartel

- ❶ Poor harvests, rising **demand** from growing populations as well as hoarding due to the expectation of further price rises have all been blamed for soaring rice prices. The price of Thai rice rose above US\$1000 per tonne for the first time last month, up from US\$383 in January.
- ❷ At this time, Thailand, the world's biggest rice exporter, plans to talk to Laos, Burma, Cambodia and Vietnam about cooperating on prices. It wants to form a rice **cartel** similar to the oil cartel, Organization of the Petroleum Exporting Countries (OPEC). The rice cartel aims to ensure food stability and to address food shortages. A Laos government spokesman said his country would consider the idea, saying a cartel would give the group of countries bargaining power. "By forming an association, we can help prevent a future price war and exchange information about food security."
- ❸ The proposal has met with opposition from the Philippines, the world's biggest importer of rice. It argues that the formation of an oligopoly may deprive a large number of people of their right to basic food. "Almost three billion people are rice eaters," said a spokesperson. "It's a bad idea. It's against humanity."
- ❹ The Food and Agriculture Organization (FAO) also objects to the proposal arguing that, at a time when the global food market is experiencing continuous price increases, hoarding and panic buying, it may not be beneficial to the rice-exporting countries and their farmers in the long-term.
- ❺ Even inside Thailand, the Rice Exporters Association says that a rice cartel is impractical. It says that, unlike oil, rice is renewable and sustainable, and it can be grown almost anywhere. Furthermore, the rice-exporting countries cannot fix prices as OPEC does because they cannot control world production. Analysts say that even if the five countries agree on a broad price band in the style of a buffer stock scheme, it would be difficult to enforce, since buyers could purchase rice from other countries. Also, while maintaining rice prices would please large-scale rice farmers and traders in countries like Thailand and Vietnam, it would cause huge damage to nations which rely heavily on imported rice.
- ❻ The Asian Development Bank (ADB) also objected to the idea of setting up an OPEC-style rice cartel, suggesting that it would be better to allow market forces to operate freely.

[Source: adapted from http://news.xinhuanet.com/english/2008-05/08/content_8131385.htm, 8 May 2008 and <http://news.bbc.co.uk/2/hi/business/7379368.stm>, 2 May 2008]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) demand (*paragraph 1*) [2 marks]
 - (ii) cartel (*paragraph 2*). [2 marks]
- (b) Using an appropriate diagram and evidence from the text, explain how “expectation of further price rises” has affected the price of rice (*paragraph 1*). [4 marks]
- (c) Using an appropriate diagram, explain how rice producers could implement a “broad price band in the style of a buffer stock scheme” (*paragraph 5*) to help stabilize prices. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the proposal to form a rice cartel. [8 marks]

[Question removed for copyright reasons]

[Question removed for copyright reasons]

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

United Kingdom (UK) economy heads for recession as growth slumps

- ❶ After years of boom, official figures on the UK economy published recently will show that actual economic growth has fallen to nearly 0%, leaving the nation close to recession.
- ❷ The Office for National Statistics' figures for economic growth during the second quarter of this year are forecast to show growth of between 0% and 0.3% in the first three months of 2008. That would push the average annual growth in the economy down from 2.3% to about 1.6% – the sharpest deceleration since 1995.
- ❸ The deputy governor of the Bank of England warned that “there is a risk that we are facing a deeper and more prolonged slowdown”.
- ❹ Especially bad retail sales figures for June, after surprisingly good figures in May, show that households are spending less and consumer confidence is weakening. Sales were down 3.9% compared to the previous month – the worst figure since figures began in 1986.
- ❺ The only positive sign comes from exports, helped by a massive 12% **depreciation** in the value of the pound sterling since last summer. However, that will not be enough to save the economy from further problems, as **consumption**, investment, the housing market and public finances are all set to worsen. Unemployment is already increasing, a critical factor in consumer confidence.
- ❻ Amit Kara, of UBS, an investment bank, believes Britain is “very close to a recession”, and Alan Clarke, a UK economist at another bank, BNP Paribas, said “I think there will be a recession from the third quarter of 2008 onwards. The survey data are consistent with stagnant GDP growth as of June. Rising costs and weakening demand have severely squeezed profits and this is expected to continue. This suggests bad news for the second quarter and worse news ahead”.
- ❼ Meanwhile, rapidly increasing inflation may force the Bank of England to raise interest rates from their current level of 5%, another blow to a housing and property market which is already in trouble.

[Source: Sean O'Grady, “Economy heads for recession as growth slumps”,
The Independent newspaper, Friday 25 July 2008. Used with permission.]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) depreciation (*paragraph 5*) *[2 marks]*
 - (ii) consumption (*paragraph 5*). *[2 marks]*
- (b) Using an AD/AS diagram, explain the likely impact on the UK economy of falling consumer confidence (*paragraph 4*). *[4 marks]*
- (c) Using a business cycle diagram and information from the text, explain in which phase of the business cycle (trade cycle) the UK economy appears to be. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the consequences for the UK economy if the Bank of England were to raise interest rates from 5% as suggested in paragraph 7. *[8 marks]*

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

Costs up, so dry cleaners want their hangers back

- ① If American people think that their dry cleaning bills are high now, they will not be happy. Wire coat hangers are getting more expensive due to import tariffs on cheaper hangers from China. So dry cleaning companies are asking customers to return their coat hangers to help keep costs down.
- ② A flood of cheap Chinese coat hanger imports in recent years forced all but one major United States (US) coat hanger manufacturer out of business. In 2007, the US imported 2.7 billion wire coat hangers from China – up 52 % from 2006.
- ③ The president of M&B, a US coat hanger company, complained to the US Commerce Department that Chinese manufacturers were **dumping** coat hangers in the US. In March 2008, the government responded by imposing a **tariff** on all wire coat hangers from China.
- ④ “I had almost come to the conclusion that we couldn’t make coat hangers in this factory anymore,” the president of M&B said. However, M&B is currently doing very well. It makes more than a million coat hangers a day, and M&B expects to double its workforce in two years.
- ⑤ Since the tariff was imposed, nearly every dry cleaner in the US has had to pay more for coat hangers, on average about US\$4000 a year. But the president of M&B says most customers probably won’t notice it. “If I pay US\$12.95 to have my suit cleaned and the increased cost of the hanger increases the price by two cents, that’s US\$12.97,” he says. “It’s not a factor that will affect me when I get my suit dry cleaned.”
- ⑥ Bill Fisher, an analyst with the Drycleaning & Laundry Institute, an industry trade group, says that a number of former US coat hanger manufacturers have made a comeback since the tariff ruling. One company has reopened a plant in Wisconsin and opened another in California.
- ⑦ The increased supply of domestic coat hangers will not help the dry cleaners much. Fisher says that “the cleaners are really struggling right now”. Hangers aren’t the only source of increased costs. Higher energy prices have also had a negative effect on profits.

[Source: National Public Radio (US).]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) dumping (*paragraph 3*) *[2 marks]*
 - (ii) tariff (*paragraph 3*). *[2 marks]*
- (b) Using a demand and supply diagram, explain why dry cleaners might have to increase the price of their services (*paragraph 5*). *[4 marks]*
- (c) Using a cost/revenue diagram, explain how increased costs are having a negative effect on profits of dry cleaners (*paragraph 7*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the decision to impose a wire coat hanger tariff. *[8 marks]*

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

Promised food yet to appear amid crisis

- ① Food riots across Haiti have left at least six Haitians and a UN peacekeeper dead. They also resulted in a large increase in international promises of food and agricultural aid, but only a small fraction of the food has been delivered – less than 2% as of early July 2008.
- ② According to aid workers, the poorest families need immediate help, and little of the promised emergency food has reached them. Most of what has reached Haiti is stuck in ports or in warehouses. It has not been possible to distribute the food aid due to high fuel prices, poor **infrastructure** and a weak and corrupt national government.
- ③ A World Food Programme spokesman said that it is difficult to get food into Haiti, and that his agency is focusing on urban areas that are easiest to reach. “We’re trying to help as much as we can, but that doesn’t mean we’ll solve everything,” he said.
- ④ Emergency food aid programmes are only temporary measures. Programmes to create jobs and help Haitian farmers increase production are more critical to ending the country’s chronic hunger and helping both urban and rural Haitian households to break out of the poverty cycle.
- ⑤ As a means of addressing Haiti’s development problems, Spain is proposing a different aid model. Spain has promised US\$100 million to help revitalize agriculture in Haiti and rebuild roads and schools. The **bilateral aid** will be provided from 2009 to 2012. However, the Deputy Prime Minister of Spain urged Haiti to improve its security so Spain could continue investing in the Caribbean nation.

[Adapted from: ‘Slow aid delivery, failing farms deepen hunger crisis in Haiti’, available at http://www.nydailynews.com/latino/2008/07/21/2008-07-21_slow_aid_delivery_failing_farms_deepen_h-1.html.]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) infrastructure (*paragraph 2*) *[2 marks]*
 - (ii) bilateral aid (*paragraph 5*). *[2 marks]*
- (b) Using an appropriate diagram, explain why it remains difficult for “Haitian households to break out of the poverty cycle” (*paragraph 4*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate aid as a means of achieving economic development in Haiti. *[8 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 3**

Tuesday 17 May 2011 (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.

Low-emission cars a future priority

- ① China's campaign to bring cleaner, low-emission vehicles to its roads may have to wait as the government first tries to stimulate growth and prevent falling sales in the world's largest car market. BYD Ltd, and other Chinese car manufacturers with ambitions to be among the first to market all-electric vehicles globally, are hoping for support from the government to stimulate **demand**.
- ② However, creating a low-emission vehicle market is unlikely to be a priority. While China has made much progress in setting standards regulating vehicle emissions, it has not gone as far as providing incentives for buyers of these expensive but low-emission cars. According to Henry Li, general manager of BYD Ltd, **subsidies** can help boost the quantity of cars demanded, because this is good technology, though expensive compared to conventional cars.
- ③ Car sales growth in China slowed in 2008 as consumer confidence fell in a weaker economy. This has caused the government to take steps to increase demand. Beijing unveiled a number of policies in January to attract buyers back into showrooms, including halving the indirect tax on cars with smaller engines.
- ④ The government has also eliminated some road fees. However, given the high cost of developing hybrid (partly-electric) and all-electric cars, car manufacturers require more than the reduction of road fees and tax breaks to stimulate demand, experts said. "There should be some incentives in place to convince consumers to switch to electric cars," said the chief executive officer of EuAuto Technology Ltd, which recently began marketing a small, low-emission car, made in China.

[Source: adapted from http://www.chinadaily.com.cn/china/2009-04/20/content_7695337.htm, 20 April 2009]

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(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) demand (*paragraph ①*) *[2 marks]*
 - (ii) subsidies (*paragraph ②*). *[2 marks]*
- (b) Using an appropriate diagram, explain why, in a free market, low-emission vehicles may be under-provided. *[4 marks]*
- (c) Using an appropriate diagram, explain how “halving the indirect tax on cars with smaller engines” (*paragraph ③*) is likely to affect the car market in China. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate **three** of the policies the Chinese government has introduced or might introduce to bring cleaner, low-emission vehicles to its roads (*paragraph ④*). *[8 marks]*

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

Increasing poverty, cash transfers and cheaper rice in the Philippines

- ① The rate of growth of real GDP in the Philippine economy is expected to be 5.9% in 2008. However, due to high population growth, increases in real GDP *per capita* are substantially lower. Moreover, the economy shows structural weaknesses, including poor tax collection, high unemployment and **underemployment**, and increasing poverty.
- ② A major challenge for the Philippine economy is the inflationary effect of increasing food and fuel prices, mainly because of its severe impacts on the poor. In May 2008, inflation rose to 9.6%, the highest in nine years. Real incomes have declined significantly because of the increase in food prices, contributing to an increase in poverty. The price of rice, a food staple, has nearly doubled in just a few months. Economic growth has not prevented an increase in poverty, as the proportion of the population that cannot meet its daily food needs increased to 64%.
- ③ Poverty reduction in the Philippines has not been as successful as in some neighbouring countries, such as Indonesia, Thailand, Vietnam and China. Government spending on health care, education and infrastructure in the Philippines has been lagging behind that of the more successful countries. To achieve better outcomes in human development and poverty reduction, the Philippine government could place a greater emphasis on alternative policies such as spending on health care, education and infrastructure, family planning and the environment.
- ④ The increase in poverty has prompted the government to introduce cash transfer payments to poor families of up to 1400 Philippine pesos (approximately US\$33) per month, as well as rice subsidies, as emergency relief to help the poorest families meet their basic food consumption needs. The programme is expected to assist about 300 000 families, and will cost the government an estimated 5 billion Philippine pesos (approximately US\$120 million) a year.
- ⑤ The government plans to distribute “rice passes” that will enable the poorest families to buy government-subsidized rice. This programme in effect involves a maximum price that is set for the holders of “rice passes”, enabling the poor to buy rice at about half the market price. It is intended to ensure that the poor will have priority in the **rationing** of rice.
- ⑥ However, there are fears that dishonest traders may buy rice at the low government-subsidized price and re-sell it at higher prices. “Rice passes” will therefore have barcodes to set off warnings if fraud is attempted.

[Source: adapted from <http://www.irinnews.org/report.aspx?ReportId=78632>, 9 June 2008; “Philippine economy to slow down in 2008: World Bank”, *Deutsche Press Agentur*, 1 April 2008; “Philippines introduces cash subsidies and cheaper rice for the poor”, *New York Times*, 28 April 2008 and “Extreme poverty: the Philippine story”, <http://www.filipinoforum.net>, 18 February 2008]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) underemployment (*paragraph 1*) *[2 marks]*
 - (ii) rationing (*paragraph 5*). *[2 marks]*
- (b) Using a Lorenz curve diagram, explain how the introduction of cash transfer payments is likely to affect the distribution of income in the Philippine economy (*paragraph 4*). *[4 marks]*
- (c) Using an appropriate diagram, explain how it may be possible for dishonest traders to “buy rice at the low government-subsidized price and re-sell it at higher prices” (*paragraph 6*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate alternative policies that the Philippine government could pursue in an effort to reduce poverty. *[8 marks]*

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

The French economy

- ❶ The French government is preoccupied with how best to deal with the recession. The most urgent problem is how to confront high and rising unemployment, particularly the high rate of structural unemployment among young French adults. In addition, France experienced a record deficit on its balance of trade in 2008. While there was a surplus on its invisible balance, its **current account** deficit continued to deteriorate.
- ❷ As France is a member of the European Monetary Union, with a single currency (the euro), it cannot conduct an independent monetary policy, and must rely on interest rates set by the European Central Bank. It can, however, pursue expansionary **fiscal policy**, though it faces a high budget deficit.
- ❸ The OECD* urges France to pursue supply-side policies involving labour market reforms, such as avoiding increases in minimum wages, increasing incentives to work, and making it easier for firms to reduce their workforce. However, there is no guarantee that supply-side policies will always be successful and, in some cases, such policies are likely to meet with resistance from French trade unions.

* OECD: the Organization for Economic Cooperation and Development (formed in 1961). The members in 2006 were: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea (South), Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States.

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(Question 3 continued)

Figure 1:
GDP, % change on a year earlier

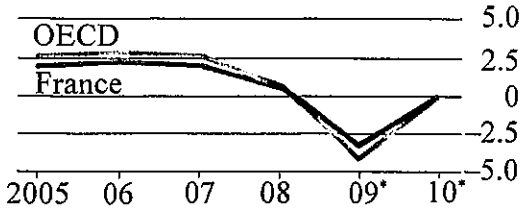


Figure 2:
Consumer prices[†], % change on a year earlier

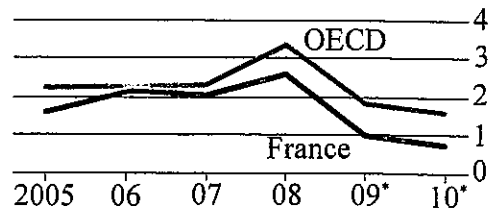


Figure 3:
Current account, as % of GDP: France

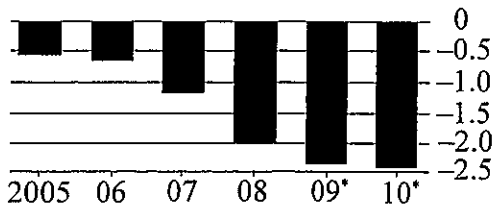
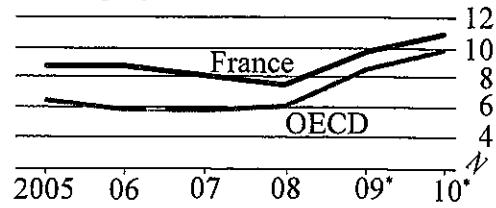


Figure 4:
Unemployment, as % of labour force



Key
* Forecast
† Private consumption deflator

[Source: adapted from "Vive la différence", *The Economist*, 30 April 2009; "France Factsheet", *The Economist*, 6 May 2009 and OECD, *Economic Survey of France 2009*, 28 April 2009]
The Economist, France Factsheet, 6 May 2009

- (a) Define the following terms indicated in bold in the text:
 - (i) current account (*paragraph 1*) [2 marks]
 - (ii) fiscal policy (*paragraph 2*). [2 marks]
- (b) Using an appropriate diagram and referring to the data, explain the theory of the short-run Phillips curve. [4 marks]
- (c) Explain why a record deficit on the balance of trade (*paragraph 1*) may be of special concern to a country like France, which is a member of the European Monetary Union, having adopted a single currency (the euro) (*paragraph 2*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate some supply-side policies that the French government could pursue to lower its current account deficit. [8 marks]

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

Thai finance minister happy with exchange rate

- ❶ The Thai finance minister said the current level of the Thai baht (Thailand's currency) was appropriate and that the Bank of Thailand was broadly allowing the **exchange rate** to be set by the market. The central bank's responsibility is only to prevent the value of the Thai baht from disrupting the economy. The minister also said that he was certain official interest rates would go even lower. The Bank of Thailand has cut its benchmark rate by 2.25 % since December 2008, taking it to a four and a half year low of 1.5 %.
- ❷ Asked if the Thai baht needed to weaken further, he said "it has been weakening, but relative to other currencies, I think its current value is fair. Exporters always want to see their currencies weaker, but I think the relative exchange rate for Thailand is appropriate. I also believe the central bank has left it to market forces, which I think is correct," he added. The Thai baht hit its lowest value against the US dollar in over a year recently, and some dealers believed the central bank was pushing it down to help exporters.
- ❸ The minister was asked if he thought **interest rates** had reached the lowest possible level. "Given the struggling export sector, which contributes to a lack of aggregate demand and a danger of increased unemployment, I am quite certain there is more to come. I would expect to see interest rates fall further unless there is a very rapid change in economic conditions."
- ❹ Thailand's state planning agency reported last week that GDP fell a record 6.1 % in the fourth quarter of 2008. It expects zero GDP growth at best in 2009, and says the economy could shrink by as much as 1 %. According to this agency, unemployment is expected to rise to 2.5 %, up from 1.4 % in 2008, while the Commerce Ministry announced that exports had fallen 26.1 % compared with the previous year.

[Source: adapted from "Thai exports drop 26 % in April", <http://www.chinaview.cn>, 20 May 2009;
"Thai unemployment to jump in 2009 – planning agency", 8 December 2008 and
"Thai finmin sees rates lower, happy with baht", 2 March 2009, <http://www.reuters.com>]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) exchange rate (*paragraph 1*) *[2 marks]*
 - (ii) interest rates (*paragraph 3*). *[2 marks]*
- (b) Using an appropriate diagram, explain how Thailand’s central bank might intervene to lower the value of the Thai baht. *[4 marks]*
- (c) With the aid of an AD/AS diagram, explain the likely effect on the Thai economy of a further cut in interest rates (*paragraph 3*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the view that Thailand’s central bank should intervene in the foreign exchange market in order to weaken the Thai baht. *[8 marks]*

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

Is Africa too dependent on aid?

- ❶ According to Zambian economist Dambisa Moyo, aid programmes have failed to improve the lives of most Africans and have created a damaging mutual dependence between donors and often corrupt governments. Moyo says that aid has done more harm than good in Africa.
- ❷ For example in Zambia, the government has given up its responsibility for health care, turning much of its administration over to foreign donors. African countries too often suffer from a cycle of corruption, disease, poverty and aid-dependence. Educated young people have few opportunities. Moyo opposes assistance which is not targeted for particular uses, but supports emergency financial relief from the International Monetary Fund (IMF).
- ❸ A former World Bank President defended aid programmes, praising the 12 to 15 African countries that are doing well, with several years of **economic growth** exceeding 6%.
- ❹ The president of The Centre for Development and Population Activities (CEDPA), says that the evidence just doesn't support Moyo's view. "Malawi, while still among the poorest countries in the world, has seen real progress because of strong cooperation between donor agencies, the government of Malawi, international organizations and local community groups."
- ❺ Over the past decade, **investment** in improving the lives of women and children in Malawi has paid off enormously. Child deaths have been reduced by nearly half (from 221 per thousand in 1990 to 120 per thousand in 2007); more children are going to school than ever before, and the number who complete primary school has doubled. Also, the number of women who are now using family planning services has more than tripled.
- ❻ These real results should not be ignored when we look at aid effectiveness. The CEDPA president argues that Moyo is really looking at only one particular kind of aid: the transfer of financial resources to governments. Good aid involves more than money; it responds to locally-driven needs, includes technical assistance and institution building to strengthen efficient and honest public administration.

[Source: adapted from http://www.huffingtonpost.com/carol-peasley/is-aid-really-dead_b_189613.html, 21 April 2009 and "Zambian economist says Africa too dependent on aid", <http://www.voanews.com>, 21 April 2009]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) economic growth (*paragraph 3*) *[2 marks]*
 - (ii) investment (*paragraph 5*). *[2 marks]*
- (b) Explain how foreign aid can help a country such as Malawi to break out of a poverty cycle. *[4 marks]*
- (c) Using a production possibility curve (PPC) diagram, explain why economic growth may not necessarily lead to economic development. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the effectiveness of different forms of aid in promoting economic development. *[8 marks]*
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**ECONOMICS
HIGHER LEVEL
PAPER 3**

Tuesday 15 November 2011 (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.

Taxes on cigarettes

- ① Lawmakers in the state of West Virginia in the United States are proposing an increase in the state tax on cigarettes from US\$0.55 to US\$1.20 per pack.
- ② One justification for the increase in the cigarette tax is that cigarettes are a **demerit good**. Smoking can cause premature deaths, and it leads to negative externalities in the form of additional health care costs and health hazards for non-smokers. It is estimated that the tax increase may prevent 6600 smoking-related deaths, and stop 13200 children from becoming smokers. Some anti-smoking groups claim that increasing cigarette taxes is the most effective smoking prevention measure.
- ③ Other groups claim that the largest impact on smoking prevention is made by anti-smoking advertising on television and by programmes to help smokers quit. Cigarettes tend to have a lower price elasticity of demand (PED) than most other goods and services. Each 10% increase in the price of cigarettes results in a 6.5% drop in youth smoking, a 2% drop in adult smoking, and a 4% total drop. This means that the increase in the tax may not contribute significantly to smoking prevention, although it does generate large increases in tax revenues for the government. It is expected that the proposed increase in the cigarette tax will more than double annual cigarette tax revenues.
- ④ Also, the effectiveness of the tax as a smoking prevention measure may be lessened by the availability of cheaper cigarettes in states that are close to West Virginia that have lower cigarette taxes, such as Kentucky.
- ⑤ It is further argued that indirect taxes such as those on cigarettes are **regressive taxes**, and impact more strongly on lower income people. Since lower income people also tend to smoke more, they are even more strongly hit by the cigarette tax.

[Source: adapted from "W. Va. cigarette sales likely to fall if tax goes up", *Charleston Daily Mail*, 13 March 2009]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) demerit good (*paragraph 2*) [2 marks]
 - (ii) regressive taxes (*paragraph 5*). [2 marks]
- (b) Calculate the price elasticity of demand (PED) for cigarettes for youths **and** for adults (*paragraph 5*), and explain the significance of the PED figures you have calculated. [4 marks]
- (c) Using an appropriate diagram, show how the incidence of tax on cigarettes is likely to be shared between producers and consumers of cigarettes. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the policy of increasing the tax on cigarettes as a measure to reduce the negative externalities caused by smoking. [8 marks]

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

Anti-monopoly legislation in China

- ① In August 2008, the Chinese government passed an anti-monopoly law. As China is a transition economy, many foreign economists welcomed this law on the grounds that it might encourage China's transition to a **free market economy**.
- ② This law is being applied in the area of acquisitions (or the purchase) of one firm by another, the objective being to prevent the establishment of very large firms that would limit competition. In the six months since the law was passed, the commerce ministry had decided on 25 such cases. All were approved except one: the commerce ministry rejected Coca-Cola's application to buy Huiyuan, China's largest juice company.
- ③ Coca-Cola offered to buy Huiyuan at a price (US\$2.4 billion) estimated to be three times the Chinese firm's value. This purchase would have represented a type of foreign direct investment (FDI) in which a foreign firm acquires control of a domestic firm. Coca-Cola already holds about half the Chinese market for carbonated drinks, but the juice market is far less dominated by a single large firm. If the purchase had gone ahead, Coca-Cola together with Huiyuan would control just over 20% of the juice market.
- ④ The rejection of the acquisition came as a surprise to many who expected the deal to go through. Coca-Cola had offered a very high price, and it has made major investments in China, making it one of the most attractive buyers of local firms. Many economists wondered if this was a government attempt to prevent a popular local brand from falling into foreign ownership.
- ⑤ The Chinese authorities argue that the rejection of the acquisition was based on possible negative impacts on domestic competition. The acquisition would have concentrated too much power in one firm. Coca-Cola's brand name would make it difficult for new firms to enter the juice market because of brand loyalty that acts as a barrier to entry. Coca-Cola's economies of scale and dominant position in the market would hurt small competitors and prevent entry of new firms, while consumers would face higher prices and less choice as a result of Coca-Cola's **monopoly** power.

[Source: adapted from "Hard to swallow: Coca-Cola and China (China's anti-monopoly law)": *The Economist*, 21 March 2009 and "Ministry denies nationalism behind Coke decision", *South China Morning Post*, 25 March 2009]
© Jasmine Wang/South China Morning Post

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) free market economy (*paragraph 1*) [2 marks]
 - (ii) monopoly (*paragraph 5*). [2 marks]
- (b) Using an appropriate diagram, explain how Coca-Cola’s economies of scale could “hurt small competitors” (*paragraph 5*). [4 marks]
- (c) Using an appropriate diagram, explain how Coca-Cola’s “dominant position” (*paragraph 5*) may enable it to make supernormal (abnormal) profits in the long run. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate China’s commerce ministry’s decision to reject Coca-Cola’s application to buy Huiyuan. [8 marks]

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

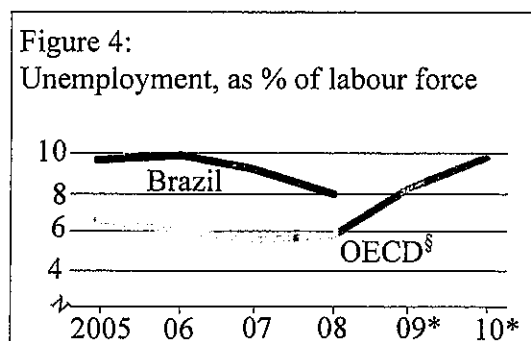
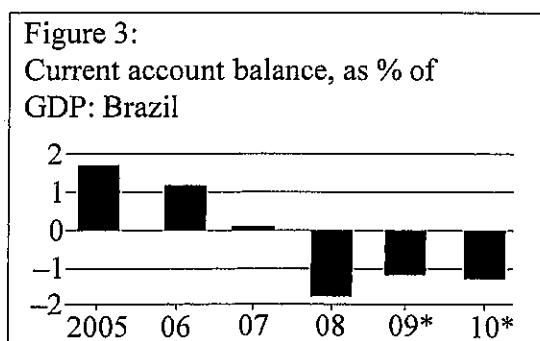
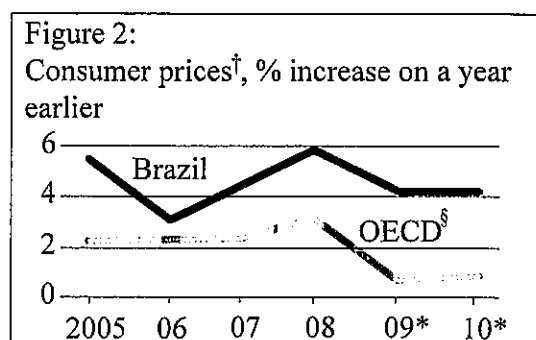
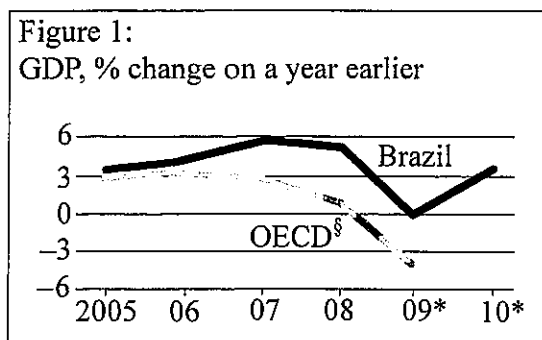
The Brazilian economy

- ❶ In the final quarter of 2008, the Brazilian economy went into recession, although this did not last long. This was partly due to Brazil's ability to follow an expansionary fiscal policy, it was also due to the central bank's policy of lower interest rates. In the past, Brazil used to raise interest rates in times of recession in order to avoid **capital flight**.
- ❷ Positive economic growth has resumed, and the economic expansion is leading economists to expect the central bank to raise interest rates again.
- ❸ At the same time, the real (Brazil's currency) has strengthened, contributing to a widening current account deficit, and leading to complaints from exporters and local manufacturers. There are expectations that the government may try to manage the exchange rate in order to avoid a further **appreciation** of the real. On the other hand, a strong real provides the benefits of lower inflation and cheaper imported capital goods.

[Source: adapted from "Juggling technocrats and party hats", *The Economist*, 15 October 2009]

(This question continues on the following page)

(Question 3 continued)



Key:

* Forecast

† Private consumption deflator

§ OECD is the Organization for Economic Cooperation and Development (formed in 1961). The members in 2006 were: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea (South), Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States.

[Source: adapted from http://www.economist.com/markets/indicators/displaystory.cfm?story_id=14045385, 16 July 2009]
© The Economist Newspaper Limited, London (16 July 2009)

- (a) Define the following terms indicated in bold in the text:
- (i) capital flight (*paragraph 1*) [2 marks]
 - (ii) appreciation (*paragraph 3*). [2 marks]
- (b) Using an appropriate diagram, explain the effect of an expansionary fiscal policy in fighting Brazil's recession (*paragraph 1*). [4 marks]
- (c) Using an appropriate diagram, explain the likely impact of higher interest rates on the value of the real (*paragraphs 2 and 3*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the effect on the Brazilian economy of a decision to raise interest rates (*paragraph 2*). [8 marks]

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

Thai farmers and the Thailand-China free trade agreement (FTA)

- ❶ In 2003, Thailand and China entered into a **free trade agreement (FTA)** on farm products, in which they agreed to eliminate all tariffs for 188 types of fruits and vegetables.
- ❷ According to non-governmental organizations (NGOs), farmers' groups and academics, Thai farmers have been negatively affected by the FTA. Many farmers lost their only source of income because they could no longer compete with cheaper Chinese imports. For example, whereas Thai production costs for garlic average 21 baht (Thai currency) per kilogram, Chinese garlic costs only 10 baht. As a result, Thai production of garlic fell.
- ❸ While the government had promised compensation to garlic farmers, the compensation actually paid was very small compared to the losses of the garlic farmers. Many had difficulties switching to other crops, because the soil and weather conditions of garlic-growing areas were not so suited to other crops. Many small farmers went out of business, while the benefits of the FTA went to large commercial farmers who were better able to compete with cheaper imports.
- ❹ Garlic is an important ingredient in Thai cuisine. Consumers and health groups complain that Thai garlic has a better taste and more medicinal properties than Chinese garlic. Yet Thai garlic is now more difficult to find and consumers, as a result, have less choice. There is also concern about safety standards, as some Chinese farm products have high levels of pesticide residues.
- ❺ Recently, farmers' protests led the government to promise a minimum price on garlic to support local production.
- ❻ Supporters of the FTA argue that this is important in order to allow countries to specialize in production according to their comparative advantage. Free trade, they claim, allows consumers to obtain higher quality goods at lower prices, and allows overall output to increase. Some negative consequences for less competitive producers are inevitable. For this reason, the government should provide support and training for those who are affected, including efforts to improve agricultural practices that are consistent with **sustainable development**.

[Source: adapted from "Thailand: Agricultural sector may come under pressure as free trade agreements take effect", *Thai Press Reports*, 27 February 2009 and "Thai food hit by garlic crisis", *The Nation*, 2 March 2008]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) free trade (*paragraph 1*) *[2 marks]*
 - (ii) sustainable development (*paragraph 6*). *[2 marks]*
- (b) Using an appropriate diagram, explain the effect of a minimum price on the garlic market (*paragraph 5*). *[4 marks]*
- (c) Using an appropriate diagram, explain the impact of removing the tariff on garlic on the quantity of garlic imported. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the consequences of the Thailand-China free trade agreement (FTA) on Thailand's growth and development. *[8 marks]*

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

As trade slows, China rethinks its growth strategy

- ① Ships are leaving Chinese ports half empty. In the Guangdong province, many factories are shutting down without paying employees.
- ② This is the effect of millions of Americans cutting down on their spending. Chinese exports decreased by 9.6% in one month. A drastic decrease in export revenues is a major problem in a country that has relied for many years on exports to pursue its growth and **economic development** goals.
- ③ For the Chinese economy to rely more on domestic demand instead of export demand is not easy. Chinese families are forced to save a lot and do not spend much on consumer goods and services. They need to save a lot to be able to meet any medical emergencies and to help them in retirement as the government does not currently provide the general population with health care insurance and pensions.
- ④ To prevent a further increase in unemployment the Chinese government is forced to help increase the exports of low-skill, labour-intensive industries such as textiles. “China will resort to export **subsidies** to help the export of labour-intensive industries,” the minister of industry and information technology said. Increased subsidies by China have the potential to create trade difficulties with the United States (US), particularly regarding textiles, only weeks before American quotas on the import of Chinese clothing are about to expire.

[Source: adapted from “As trade slows China rethinks its growth strategy”, *New York Times*, 1 January 2009]

(This question continues on the following page)

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

EU court rules minimum price for cigarettes illegal

- ① The European Court of Justice has ruled that Ireland cannot impose a **minimum price** on cigarettes. It said that member countries would have to find other ways to combat smoking. This could be achieved by increasing indirect tax on tobacco, but imposing a minimum price would distort fair competition in the market. The ruling is designed to maintain the freedom of manufacturers and importers to benefit from lower costs and greater efficiency.
- ② The judgment said the aim of ensuring that tobacco prices are high can be “adequately” achieved by increasing tax, since any indirect tax rises are, sooner or later, reflected in an increased retail price, without removing the freedom of manufacturers to set prices.
- ③ The Irish government had claimed that it needed to fix a high minimum price to discourage smoking. This followed government legislation to ban tobacco advertising and promotion in July 2009. According to a spokesperson from the anti-smoking group ASH (Action on Smoking and Health), this measure helped to prevent retail outlets from making young people feel attracted to buying cigarettes. “Close to 30% of our population still smoke and 7000 die from tobacco-related disease each year,” he said.
- ④ It has been argued that increasing the price of cigarettes is one of the most effective ways of curbing harmful smoking and there is a need to make cigarettes less appealing, particularly to young people. The evidence is that banning advertising, introducing minimum pricing and increasing health warnings can all work.
- ⑤ The head of a major retail organization has attacked the idea of minimum pricing for cigarettes. He argued that artificially fixing a minimum price would not be effective. Also, since the demand for tobacco is inelastic, raising the price would not work. Moreover, it was against the **free market** for a government to set prices for any product available to consumers, limiting their freedom to choose.

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) minimum price (*paragraph ❶*) *[2 marks]*
 - (ii) free market (*paragraph ❸*). *[2 marks]*
- (b) Using an appropriate diagram, explain the possible effect on the market for cigarettes of the ban on tobacco advertising in Ireland. *[4 marks]*
- (c) Using an appropriate diagram, explain why, if the demand for cigarettes is inelastic, raising the price may not be effective. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the economic effects of the imposition of a minimum price for cigarettes. *[8 marks]*

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

Australia carbon trading plan

- ① From 2007, Australian Prime Minister Rudd often talked about climate change, calling it “the great moral and economic challenge of our time”. Despite being one of the most sparsely populated nations, Australia’s 22 million inhabitants emit the third largest amount of carbon dioxide *per capita* in the world.
- ② Soon after his election victory, he proposed the Emissions Trading Scheme (ETS) which aimed to achieve a 5% cut in Australia’s carbon emissions by 2020. The ETS is a system aimed at tackling the market failure arising from carbon emissions. The total amount of pollution that could be emitted by Australian businesses each year would be calculated by the government. Each business would then be given a permit allowing it to emit a fixed amount. Companies that emit beyond their allocation would be penalized by having to buy licenses to pollute from companies that had successfully reduced their greenhouse gas emissions below the fixed level. This would reduce the **negative externalities** resulting from industrial production.
- ③ Opponents have said that the additional cost to high-polluting businesses like utilities and gas companies would trickle down to consumers through increased prices for petrol and electricity. Companies in those heavy-polluting sectors are also worried about potential job losses, saying the scheme would affect profits, which in turn would reduce productivity, eventually forcing heavy-polluting businesses to shrink and causing **structural unemployment**.
- ④ An opposition politician argued that industries exposed to international trade using the best available technology should have “100% free allocations of permits [...] until such time as our international competitors introduce similar schemes”. For some companies, paying for even 10% of their permits will still force the price of their exports to rise, limiting their ability to compete on the global market. The Australian Green Party, however, believe that a 90% free allowance is far too high, giving the nation’s highest polluters too many concessions.

[Source: adapted from “Australia’s Rudd backs off carbon trading plan”, *Time*, 6 May 2010]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) negative externalities (*paragraph 2*) *[2 marks]*
 - (ii) structural unemployment (*paragraph 3*). *[2 marks]*
- (b) Using an appropriate diagram, explain why the Emissions Trading Scheme (ETS) could lead to higher prices for electricity. *[4 marks]*
- (c) With the aid of a diagram, explain how carbon emissions are a form of market failure. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the possible economic effects on the Australian economy of the Emissions Trading Scheme (ETS). *[8 marks]*

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

A new age dawns for Greece

- ❶ In a proposed deal aimed at rescuing Greece from near bankruptcy, European Union (EU) and International Monetary Fund (IMF) loans of €120 billion should replace the need for Greece to borrow at extremely high interest rates. This would be the biggest rescue package for any EU country.
- ❷ In return, the Greek government has agreed to reduce its budget deficit from nearly 14% to 8.1% of gross domestic product (GDP) by imposing even steeper cuts in public sector wages, lower pensions and an additional 2% rise in VAT, the main **indirect tax**, to 23%. Other taxes are liable to rise. In one of the biggest changes of all, there will be a change in pensions policy. The average age of retirement in Greece is 53 and this could now move to 67.
- ❸ The change in circumstances in Greece has been rapid. Greece's once booming economy was based on consumption. Joining the eurozone* in 2001 brought interest rates down, and people rushed to get cheap loans. Huge budget deficits and government debt have taken Greece into a deep crisis, shaking international markets and the euro. It ran up debts equal to 115% of GDP. In effect, it cannot easily borrow more money because investors fear that they may not be repaid. Analysts now think the country's €240 billion economy is likely to contract in 2010 by more than last year's 2%, as the spending cuts and rising unemployment take effect. The IMF said it expects Greece will take 10 years to overcome its financial crisis.
- ❹ Many economists warn that the medicine is so strong that it could kill the patient and push Greece into a deep economic depression. There have been demonstrations in the streets to protest at the measures. A spokesman for a trade union representing the interests of workers, said: "These measures are tough and unfair. They will lead workers into misery and the country deeper into recession".

Economic indicators for 2009		
	Greece	eurozone
GDP growth	-1.96%	-4.09%
Inflation	1.35%	0.29%
Government net borrowing (% of GDP)	12.87%	6.28%
Current account balance (% of GDP)	-11.22%	-0.35%

* eurozone: the group of countries which use the euro as their common currency

[Source: Adapted from 'Europe hopes Greek bailout will calm market', The Independent, 3 May 2010; 'Greece: A new age of austerity and anger dawns', The Independent, 2 May 2010 <http://www.independent.co.uk/news/world/europe/greece-a-new-age-of-austerity-and-anger-dawns-1960388.html>; <http://www.economywatch.com/economic-statistics/country/Greece/year-2009/>, accessed 26 September 2011.]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) indirect tax (*paragraph 2*) *[2 marks]*
 - (ii) inflation (*table*). *[2 marks]*
- (b) Using an appropriate diagram, explain how an increase in VAT is likely to affect the market for consumer goods. *[4 marks]*
- (c) With the aid of an AD/AS diagram, explain the possible effect on the economic growth of Greece of the decision to reduce its budget deficit. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the effects of the measures taken by the Greek government to address its debt problem. *[8 marks]*

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

Venezuela takes steps to end currency speculation

- ① Venezuela's government has approved new legislation in order to curb speculation after its currency, the bolivar fuerte (VEF) fell further in the **informal market**. The reform would give the Central Bank of Venezuela (BCV) exclusive power to authorize the purchase and sale of foreign currencies.
- ② Venezuela has a two-tiered official **exchange rate** of VEF 4.3 per US\$, for most imports, and VEF 2.6 per US\$ for transactions identified as priorities such as food and medicine. However, in the informal market the bolivar fuerte is currently nearly twice as weak as the official rate, trading at VEF 8.5 per US\$.
- ③ Venezuela's economy contracted 3.3% in 2009, and fell into recession for the first time since 2003 after oil production and exports plunged. The economy will probably shrink for a second consecutive year in 2010. In Venezuela, monthly inflation has quickened to a seven-year high and the bolivar fuerte has reached a record low. Venezuelans turn to the informal market when they cannot get government approval to buy US dollars at the official rates of VEF 2.6 and 4.3 per US\$.
- ④ The legislation is aimed at slowing the rapidly falling value of the bolivar fuerte against the US dollar in the informal market in hopes of curbing worsening inflation and reducing capital flight. "We cannot allow businessmen to take money out of the country and exchange it abroad for their own benefit," said a congressman. The price of US dollars on the informal market heavily influences inflation. The BCV said consumer prices jumped 5.2% in April alone, driving the annual inflation rate to 30.4%.
- ⑤ An economics professor said the law would not put an end to informal market trading and he warned that it could push inflation higher. "More and more control is going to make the situation worse," he said.

[Source: Adapted from 'Venezuela Takes Steps to "Smash" Currency Speculation', by Kiraz Janicke in venezuelanalysis.com, 12 May 2010 <http://venezuelanalysis.com/news/5356>, and 'Pro-Chavez lawmakers tighten currency controls', Associated Press, 16 May 2010]

(This question continues on the following page)

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

Reliance on unprocessed exports damages African development

- ① The poor performance of the textile industry in Africa is caused by its reliance on exports of raw cotton. “The heavy dependence on production and export of primary products and the weakness of regional markets are the two major causes of Africa’s high vulnerability to external shocks,” said an African economist.
- ② He said that the world economic crisis hit African economies badly, adding that export prices and earnings have fallen, resulting in declines in government revenue and national incomes as well as rising unemployment and poverty.
- ③ The Kenyan Prime Minister has challenged African firms to focus on the African market before exporting the surplus in order to promote intra-African trade. He said the population in Africa offered a valuable market for local products but urged African nations to eliminate existing barriers to trade, such as tariffs and quotas, to allow trade between African nations. “It is a pity that we do not import African goods directly,” he said. “Instead, we export our goods to other continents and also purchase African goods from there, due to the high barriers to trade between African countries.”
- ④ “African countries have generally purchased fabrics from Asia and designs from Europe and the United States. We must help change that to ensure that fabric, design and fashion (the entire value chain) stems directly from the African continent.” Africa currently produces 12% of the world’s cotton but 90% of this is sold to other countries for processing. The Prime Minister said that Africa, like some European and Asian countries, can use the textile industry to promote **economic development**.
- ⑤ Opponents argue that the African economy has been very weak in recent years, discouraging trade between African nations. Moreover, political differences have led to the tariffs and quotas which restrict such trade. They have pointed out that Europe and the United States are wealthy, stable markets with demand for commodities increasing as the recession ends.

[Source: Used with permission from NewsTime Africa]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) quotas (*paragraph 3*) *[2 marks]*
 - (ii) economic development (*paragraph 4*). *[2 marks]*
- (b) Explain **one** reason why a dependence on exports of primary products may be considered a barrier to economic development. *[4 marks]*
- (c) With the aid of a diagram, explain how the reduction of tariffs is likely to affect the level of trade between African nations. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, discuss the view that African countries should increase their focus on trade within Africa in order to increase economic development. *[8 marks]*
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22135104



**ECONOMICS
HIGHER LEVEL
PAPER 2**

Friday 3 May 2013 (morning)

1 hour 30 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is *[40 marks]*.

SECTION A

Answer **one** question from this section.

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

Rising peso hits Filipinos abroad

- ❶ The Philippine peso has risen sharply against the United States (US) dollar recently, which is bad news for Filipinos working overseas who regularly send home a portion of their earnings (known as remittances) to support their families. For those working in the US and in countries which peg their currencies to the US dollar, the effect on their remittances is becoming more severe. One example is Hong Kong, where around 140 000 Filipinos work.
- ❷ Apart from a weaker US dollar, the Philippine peso has also been boosted by increased remittances – which hit a record US\$17 billion last year – and an increase in foreign investment in the Philippine stock market. Its main index has risen 40% this year, supported by global capital flows into Asia’s emerging markets and optimism over the new government in the country. The Philippine president has voiced concern over the impact of the Philippine peso’s sharp **appreciation** on overseas workers and the country’s export sector.
- ❸ Recently, the US dollar fell below 43 Philippine pesos, while 41 Philippine pesos is predicted by the end of 2010. A business leader said: “There is now a lot of worry over the rising peso among overseas Filipino workers. The Philippine peso may soon rise to a point at which it is no longer worthwhile for Filipinos in low-wage jobs to continue working abroad”.
- ❹ In previous times of currency instability, Filipinos tended not to reduce their remittances to their families, who depend on them, but absorbed the losses themselves. For that reason, the strong **exchange rate** is not expected to cause a fall in remittances, which are vital for the Philippine economy as they finance, among other things, spending on consumer goods and construction. In all, remittances account for over a tenth of the country’s gross national income. Officials expect remittance growth of 8% this year, a reflection partly of more Filipinos working in higher-paid skilled and professional jobs abroad.
- ❺ The Philippine central bank, meanwhile, is trying to slow the currency’s advance by purchasing US dollars on the currency market, but this is a costly exercise for a less-developed country. Despite this, the Philippine peso is set to rise further.

[Source: adapted from *The Straits Times*, 5 November 2010]

(This question continues on the following page)

(Question 1 continued)

- (a) (i) Define the term *appreciation* indicated in bold in the text (*paragraph 2*). [2 marks]
- (ii) Define the term *exchange rate* indicated in bold in the text (*paragraph 4*). [2 marks]
- (b) Using a diagram, explain how the “increase in foreign investment in the Philippine stock market” has affected the value of the Philippine peso (*paragraph 2*). [4 marks]
- (c) Using an AD/AS diagram, explain how the Philippine peso remittances affect the national output of the Philippine economy. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the likely impact of an appreciating currency on the performance of the Philippine economy. [8 marks]

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

India-Malaysia trade agreement to double trade by 2015

- ❶ An India-Malaysia trade agreement is expected to almost double trade between the two countries by 2015, allowing the two nations to reduce dependence on traditional trade partners such as China and the United States. The **preferential trade agreement** will be signed by 31 January 2011 and come into force six months later. The agreement is predicted to increase the level of trade to US\$15 billion by 2015.
- ❷ The deal will further strengthen trade ties between India and Malaysia. Malaysia is India's 19th largest trading partner, with bilateral trade totaling US\$6.5 billion between January and August 2010 after growing at an average of 14.9% between 2004 and 2009. The deal will support a trade pact that came into effect in January 2010 between India and the 10-member Association of Southeast Asian Nations (ASEAN)*, which became a free trade area in 2003. However, this agreement between India and Malaysia will be more extensive, covering services, investments, trade protection and other areas.
- ❸ Malaysia exports electrical and electronic products, crude petroleum, palm oil and chemical goods to India, its main export destination in South Asia. However, some tariffs have been imposed by India on these products. India, meanwhile, has invested US\$1.11 billion in nearly 100 manufacturing projects in Malaysia. Malaysia and India will also bolster defence cooperation through frequent talks between their defence ministers, senior officials and chiefs of the armed services, according to a joint statement.

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* ASEAN: is a free trade area comprising Brunei Darussalan, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

(This question continues on the following page)

(Question 2 continued)

- (a) (i) Define the term *preferential trade agreement* indicated in bold in the text (*paragraph ①*). [2 marks]
- (ii) State **two** examples of trade protection (*paragraph ②*). [2 marks]
- (b) Using an appropriate diagram, explain the effect on Malaysian palm oil producers of the tariffs imposed by India (*paragraph ③*). [4 marks]
- (c) Distinguish between a free trade area (such as ASEAN), a customs union and a common market. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the possible effects of this agreement on trade between India and Malaysia. [8 marks]

SECTION B

Answer **one** question from this section.

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

China: Money to invest for a better future

- ❶ In 2005, Madam Xiao Jinqiu was barely making enough to feed her two sons. Now she earns a living by weaving traditional fabrics, bags and scarves for sale and rearing livestock – all with the help of an annual micro-loan given out by a local non-profit group.
- ❷ By borrowing between 1000 yuan and 3000 yuan (US\$152 and US\$456 respectively) a year, she has been able to earn enough to invest in a better life for her family. She is among a growing number of poor villagers in China who have found a lifeline in **micro-credit**, which allows families the opportunity to escape from the **poverty trap**. Such schemes have existed in China for some years, but the number of borrowers remains low.
- ❸ China’s state banks are now trying to offer its 720 million rural residents more access to micro-credit, but two key barriers still stand in the way. Many remote areas remain inaccessible to banks and farmers often do not have belongings or assets that can be used as security for the loans. Almost 3000 rural townships in China – around 9% of the country’s total – do not have a bank. This is where private banks and non-profit groups can make a difference.
- ❹ Almost half of the 170 000 population of Yunnan Province lives under China’s poverty line of 1196 yuan per capita annually. Almost 36 million of China’s rural residents, or 3.6% of the population in the countryside, were living below the poverty line at the end of 2009, according to official data.
- ❺ Micro-credit is still rare in China, but it is a very effective way to reduce poverty. The key is to find a way to establish trust between lender and farmer. China’s farmers do not own the land they cultivate. They have only land-use rights, which means that they cannot use the land they farm as security for a loan.
- ❻ One solution to this problem is to group several farming families together and make them co-guarantors of one another’s loans, spreading the risk. An official from one lending organization, which lends only to married women, said: “Women are less likely to default. They take charge of household finances. They have self-respect”.

[Source: *The Straits Times*, 15 November 2010]

(This question continues on the following page)

(Question 3 continued)

- (a) (i) Define the term *micro-credit* indicated in bold in the text (*paragraph 2*). [2 marks]
- (ii) Define the term *poverty trap* indicated in bold in the text (*paragraph 2*). [2 marks]
- (b) Using a diagram, explain how the use of micro-credit might affect the distribution of income in rural areas of China. [4 marks]
- (c) Using a production possibility curve (PPC) diagram, explain how micro-credit schemes can affect the actual output and the production possibilities of an economy. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the use of micro-credit in promoting economic development in economically less-developed countries. [8 marks]

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

Cambodia encouraged to review international partnerships

- ❶ The United States (US) Secretary of State has urged Cambodians to pursue a variety of economic partnerships throughout Asia-Pacific and not become over-reliant on China. She said that Cambodia should look for partnerships that cut across regional geographic lines.
- ❷ Both China and the US are working to extend their influence in Cambodia. Nearly 400 Chinese companies have invested billions of dollars in Cambodia, including key **infrastructure** projects such as hydropower dams and coal-power plants. While acknowledging the attraction of Chinese investment, the Secretary of State said: “One of the challenges for Cambodia is the construction of dams on the Upper Mekong river”. China has been criticised by environmental groups over the building of a series of hydropower projects on the Mekong river. Concerns over the project include a possible loss of water quality and a loss of biodiversity.
- ❸ The Secretary of State also indicated that the US was willing to cooperate with Cambodia to resolve an outstanding debt of about US\$445 million that the country owes to the US.
- ❹ The Cambodian Foreign Minister had asked the Secretary of State at a meeting to help his country convert the debt into development aid. She said she was ready to explore creative ways Cambodia could be relieved of the debt, possibly by agreeing to preserve key environmental areas or investing in education. In this way, the debt repayment would be treated as development aid.

[Source: AFP 2010]

Human Development Report 2010 Statistics for Cambodia

	Life expectancy at birth	Expected years of schooling	Mean years of schooling	GNI per capita (Constant 2005 PPP US\$)	HDI value
1980	38.7	6.1	5.0	—	—
1985	52.6	6.1	5.2	—	—
1990	55.6	6.1	5.3	—	—
1995	56.2	6.5	5.5	793	0.407
2000	57.6	7.5	5.7	975	0.438
2005	60.1	9.7	5.7	1390	0.491
2010	62.7	9.8	5.8	1753	0.518

[Source: <http://hdrstats.undp.org/images/explanations/KHM/.pdf>
2011 Human Development Report, United Nations Development Programme.]

(This question continues on the following page)

(Question 4 continued)

- (a) (i) Define the term *infrastructure* indicated in bold in the text (*paragraph 2*). [2 marks]
- (ii) State **two** forms of development aid (*paragraph 4*). [2 marks]
- (b) Using an appropriate diagram, explain why hydropower dam projects on the Mekong River might lead to market failure. [4 marks]
- (c) Explain why the Human Development Index (HDI) is considered a better measure of economic development than GNI. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the possible effects on the economic development of Cambodia of investment from China and the United States (US). [8 marks]
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88135104



**ECONOMICS
HIGHER LEVEL
PAPER 2**

Tuesday 5 November 2013 (morning)

1 hour 30 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is *[40 marks]*.



SECTION A

Answer one question from this section.

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

Bolivia reacts to global economic change

- ① During the twentieth century, Bolivia experienced deteriorating terms of trade due to declines in prices of commodity exports on which the economy was highly dependent. Bolivia diversified its exports, but has remained highly dependent on commodity exports. These include natural gas, which accounts for nearly 40% of export earnings and also silver and zinc.
- ② Bolivia succeeded in avoiding **recession** during the global economic downturn in 2009, though its rate of growth was affected by lower demand for natural gas from Brazil and lower prices for its key export products. Growth began again in 2010 due to the recovery of commodity prices and the global economy (*Figure 1*).
- ③ Strong inflationary pressures have appeared with the recovery, partly due to the removal of fuel subsidies. A key government policy objective is to hold down inflation and imported input costs. About 80% of Bolivia's imports are used by the manufacturing sector in various industries. Since late 2010 the government has adopted a managed float to achieve appreciation of the Bolivian Boliviano (the Bolivian currency).
- ④ Bolivia's **current account** surplus reached a maximum in 2008–2009 (*Figure 2*) due to the recovery of commodity prices, which led to an improvement in its terms of trade (*Figure 3*). The resulting decrease in the surplus is due to a more rapid rise in imports than in exports. The current account surpluses have led to large increases in international reserves (reserve assets).

[Source: adapted from "Gradual revaluation on higher inflation", *Business Monitor International*, 11 February 2011; "Bolivia: Country Outlook", *Economist ViewsWire*, 4 March 2011 and "About Bolivia Economic Outlook", *Amcham Bolivia*, 2010]

(This question continues on the following page)

(Question 1 continued)

Figure 1

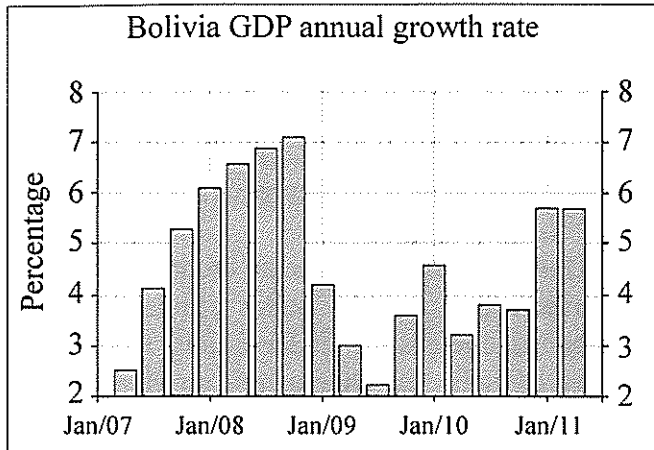


Figure 2

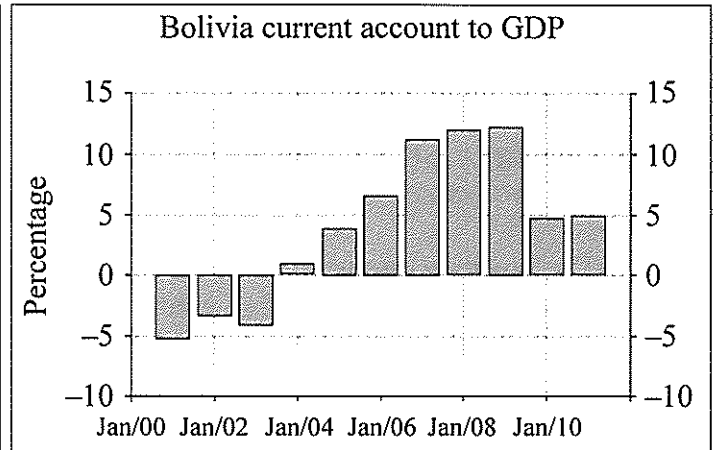


Figure 3

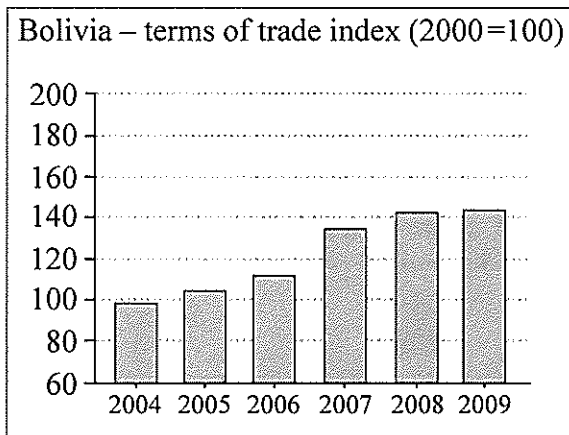
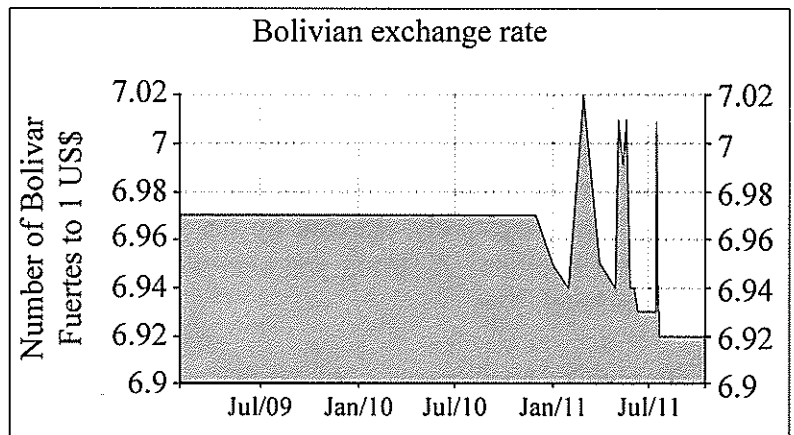


Figure 4



[Source: adapted from www.tradingeconomics.com, accessed 2011]

- (a) (i) Define the term *recession* indicated in bold in text (paragraph ②). [2 marks]
- (ii) Define the term *current account* indicated in bold in the text (paragraph ④). [2 marks]
- (b) Using an appropriate diagram, explain the reason for the improvement in Bolivia's terms of trade (paragraph ④). [4 marks]
- (c) Explain what is likely to have happened to any of the components of Bolivia's financial account as a result of its current account surplus from 2004–2010 (assuming no change in the capital account). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the change in Bolivia's exchange rate policy in moving from a fixed exchange rate to a managed float in late 2010 (paragraph ③). [8 marks]

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

Japan fights recession

- ① Following statements by the Japanese Finance Minister that the yen was “strongly overvalued”, Japan intervened in the yen market by buying US dollars, one day after the Swiss central bank cut interest rates to lower the value of the Swiss franc. These moves risked criticism that Japan and Switzerland may be initiating currency wars, involving competitive depreciations.
- ② The Japanese intervention was the third in a year. The first intervention, nine months earlier, aimed to improve **business confidence**. It was criticized by United States officials, who argued that Japan was seeking to gain unfair trade advantages by undervaluing the yen. In the past, Japan has been accused of using other forms of trade protection to gain an advantage in international markets.
- ③ The Japanese economy has been suffering a long-lasting recession, deepened by an earthquake, tsunami and nuclear crisis in spring 2011. It faces **deflation** which is currently –0.9%, yet there is little room for action by the central bank as interest rates have fallen to zero.
- ④ Japan has a current account surplus, which has increased pressure for the yen to rise. The rising yen was unwelcome because Japan is strongly export-oriented. Large exporters like Toyota, Honda and Nissan have complained about lower export earnings, which already had been negatively affected by the global recession and a rise in trade protection in their export markets. A strong yen also works to increase the downward pressure on the general price level.
- ⑤ In view of Japan’s excessive dependence on exports, some analysts note that the economy must restructure to depend more on domestic consumption.

[Source: adapted from “Japan’s yen intervention shows welcome activism”, *Reuters BreakingViews*, 15 September 2010;

“Top US lawmaker: Japan yen intervention deeply disturbing”, *Agence France-Presse*, 15 September 2010;

“The domino that never falls”, *The Economist*, 21 July 2011; “Finance Minister say yen is strongly overvalued”, *Japan Today*, 2 August 2011 and “Japan buys dollars to weaken the surging yen”, *New York Times*, 3 August 2011]

(This question continues on the following page)

(Question 2 continued)

- (a) (i) Describe the term *business confidence* identified in bold in the text (*paragraph 2*). [2 marks]
- (ii) Define the term *deflation* indicated in bold in the text (*paragraph 3*). [2 marks]
- (b) Using an appropriate diagram, explain a possible effect of the overvalued yen on the Japanese economy. [4 marks]
- (c) Using an appropriate diagram, explain the impact of the Japanese current account surplus on the value of the yen (*paragraph 4*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the likely consequences of intervention in the yen market. [8 marks]

SECTION B

Answer **one** question from this section.

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

Chinese and Indian foreign direct investment (FDI) in Africa

- ① The high growth experienced by many African countries has made them attractive to multinational corporations (MNCs), originating in China and India, which seek to expand and diversify their sources of energy and raw materials. In recent years, MNCs have begun to rapidly diversify into other sectors beyond oil and minerals.
- ② Chinese and Indian MNCs differ in their approaches. Most Chinese MNCs are large government-owned firms. They usually enter new markets by building their own new facilities, and buy most of their inputs or sell their output through their own branches. They buy a large portion of their inputs from China, and usually do not hire local managers and workers. Most sales in Africa are made to government bodies. Chinese MNCs tend to be focused on resource extraction.
- ③ Indian MNCs are of varying size, and are mostly privately-owned. They usually enter markets by buying local, established businesses, and they buy far fewer of their inputs in Indian markets, preferring increasingly to buy them in other international markets. They often hire and train local managers and staff. Most sales in Africa are made to private firms rather than government bodies. Indian MNCs are expanding into telecommunication technologies, information technologies, education and health services and are encouraging **diversification**.
- ④ Rapid **economic growth** in China, India and Africa, together with Chinese and Indian foreign direct investment (FDI), have strongly encouraged trade links between them. Africa's bilateral trade with India increased from \$1 billion in 2001 to \$46 billion in 2010. Africa's bilateral trade with China was \$120 billion in 2010.
- ⑤ Yet there are worries. Both Chinese and Indian MNCs have been accused of ignoring human rights violations and corruption by the government in countries they operate in. In some cases they have not been required to follow environmental laws.

[Source: adapted from "What are the Chinese firms doing in Africa?", *International Trade Forum*, 2010;
"Foreign investment: lessons learnt at home foster success in Africa", *Financial Times*, 19 May 2011 and
"India must tread carefully in Africa", *Financial Times*, 29 May 2011]

(This question continues on the following page)

(Question 3 continued)

- (a) (i) Define the term *diversification* identified in bold in the text (paragraph ③). [2 marks]
- (ii) Define the term *economic growth* identified in bold in the text (paragraph ④). [2 marks]
- (b) Explain **two** reasons why multinational corporations (MNCs) expand into economically less developed countries. [4 marks]
- (c) Explain **one** reason why over-specialization on a narrow range of products may be a barrier to development for economically less developed countries. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the likely effects of Chinese and Indian foreign direct investment (FDI) in Africa on the development of countries in Africa. [8 marks]

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

Economic growth and poverty in India

- ❶ Although India has one of the fastest growing economies in the world, it is unlikely that the Millennium Development Goal of halving the rate of poverty by 2015 will be achieved. An important factor is growing income inequality. Calculations of Gini coefficients show that inequality increased by about 14% between 2001 and 2011.
- ❷ India has about one third of the world’s population living in extreme poverty (living on less than \$1.25 a day). Three quarters of its population live in moderate poverty (less than \$2 a day). It is estimated that nearly half the Indian population suffers from malnutrition. Part of India’s poverty problem is a result of poor governance and failure to address the underlying causes of poverty.
- ❸ Growth averaged 8.6% per year in the years 2005–2011 compared with the 10% needed over 20 years to lift the poor out of their poverty. The central bank governor says that the lack of steps to improve the supply-side of the economy will make it difficult for India to maintain its high growth rates.
- ❹ The Indian Nobel Prize winner Amartya Sen argues that **economic growth** should not be “our ultimate objective, but a very useful means to achieve ... a better quality of life”.

[Source: adapted from “Growth and other concerns”, *The Hindu*, 14 February 2011;
 “Poverty reduction in India briefing”, uk.oneworld.net, May 2011
 and “Addressing income distribution”, *The Financial Express*, 15 January 2011]

Table 1

	India	Moldova
GNI (GNP) per capita (PPP \$) (2007)	2840	2980
GDP per capita (PPP \$)(2007)	2753	2551
Human Development Index (HDI) (2007)	0.612	0.720

[Source: adapted from “World Development Indicators”, *The World Bank*, accessed 2011 and
 “Human Development Reports”, *United Nations Development Programme*, accessed 2011]

(This question continues on the following page)

(Question 4 continued)

	India	Bangladesh
GNI (GNP) per capita (PPP \$) (2007)	2840	1350
Average annual growth rate (%) (1990–2007)	4.5	3.1
Improved sanitation facilities (% of population with access) (2008)	31	53
Life expectancy at birth (years) (2009)	64	67
Malnutrition rate (% of population that is malnourished) (2006)	47.9	47.0
Infant mortality rate (per 1000 live births) (2009)	50	41

[Source: adapted from “World Development Indicators”, *The World Bank*, accessed 2011]

- (a) (i) Define the term *economic growth* indicated in bold in the text (*paragraph 4*). [2 marks]
- (ii) State why the GNI (GNP) per capita for Moldova and India is higher than their GDP per capita (*Table 1*). [2 marks]
- (b) Referring to Table 1, explain **two** possible reasons why India and Moldova have different Human Development Index (HDI) values from each other. [4 marks]
- (c) Using a Lorenz curve diagram showing India’s changing income distribution, explain how India’s Gini coefficient will have changed (*paragraph 1*). [4 marks]
- (d) Using information from the text/data in Table 2 and your knowledge of economics, examine Amartya Sen’s argument that economic growth should not be “our ultimate objective, but a very useful means to achieve ... a better quality of life” (*paragraph 4*). [8 marks]



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**ECONOMICS
HIGHER LEVEL
PAPER 3**

Friday 3 May 2013 (morning)

1 hour

Candidate session number

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Examination code

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INSTRUCTIONS TO CANDIDATES

- Write your session number in the boxes above.
- You are permitted access to a calculator for this paper.
- Do not open this examination paper until instructed to do so.
- Answer two questions in the boxes provided.
- Unless otherwise stated in the question, all numerical answers must be given exactly or correct to two decimal places.
- You must show all your working.
- The maximum mark for this examination paper is [50 marks].



0124

Answer **two** questions. Each question is worth **[25 marks]**. Write your answers in the boxes provided.

1. (a) In the small town of Burbia, the weekly demand and supply functions for a pack of cigarettes are as follows

$$Q_D = 700 - 25P \qquad Q_S = 100 + 50P$$

Where Q_D and Q_S are quantities in packs per week and P is the price per pack in dollars.

- (i) Calculate Q_D and Q_S at a price of \$14 per pack. [2]

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- (ii) Calculate the price which would result in a demand of 475 packs per week. [2]

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(Question 1 continued)

(iii) Calculate the equilibrium price and quantity.

[2]

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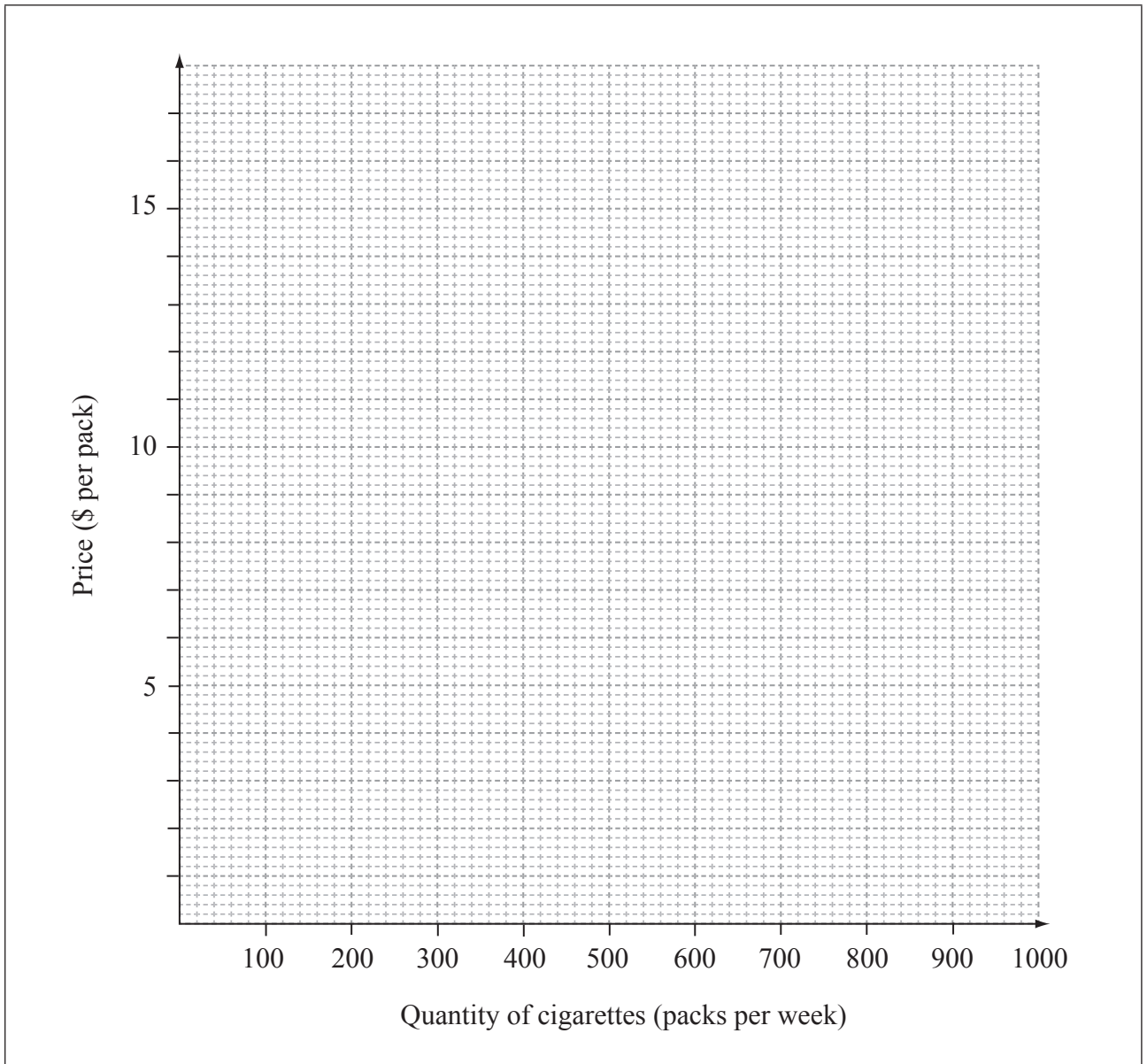
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(Question 1 continued)

- (b) On the axes below, draw the demand and supply curves using a price range from \$2 to \$16 per pack. Each curve should be labelled. [4]



- (c) In order to discourage the consumption of cigarettes, the government imposes a specific indirect tax of \$6 per pack.

On the above graph, plot the new supply curve to illustrate the effect of the indirect tax. [2]

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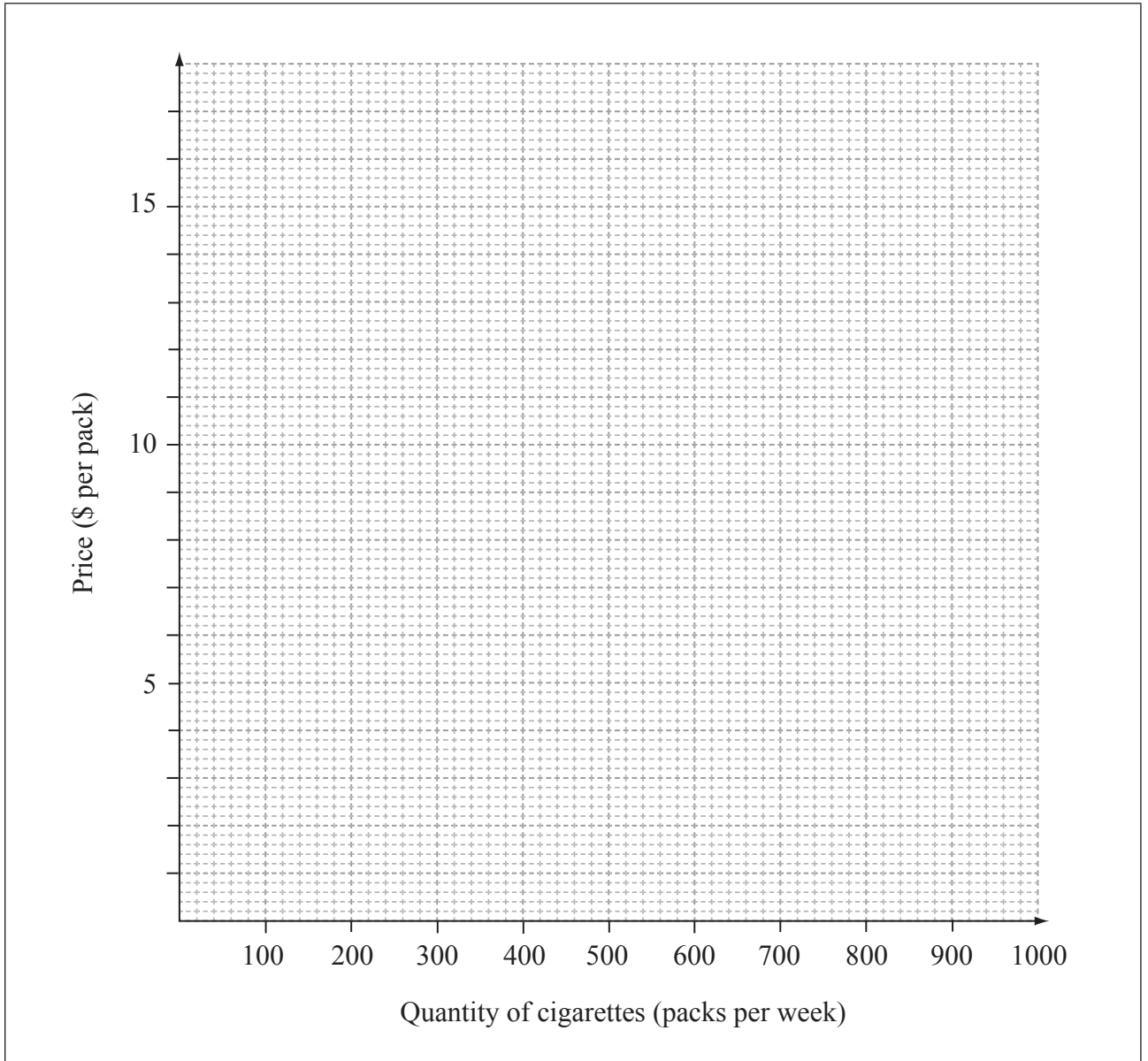


0524

Turn over

(Question 1 continued)

- (d) On the axes below, sketch a diagram and use it to explain how the new supply curve would have been different if the government had imposed an *ad valorem* tax on cigarettes. [4]



(This question continues on the following page)



(Question 1(d) continued)

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(e) Calculate the total weekly revenue earned by the government from the specific tax. [2]

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(f) Calculate the change in weekly consumer spending on cigarettes in Burbia as a result of the tax. [3]

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(This question continues on the following page)



(Question 1 continued)

- (g) Explain why the value of price elasticity of demand is important for a government which is attempting to use taxation to discourage the consumption of a product.

[4]

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0924

Turn over

2. In Ruritania the government measures changes in the cost of living by calculating a consumer price index (CPI), which measures changes in the cost of a typical basket of goods.

There are five items in the basket. The average prices of each item in 2011 and 2012 are given below, together with the weights used to calculate the index.

Prices are in dollars (\$). The average quantities of each item purchased per month by a Ruritanian family are used to determine the weights.

Data used to calculate the consumer price index in Ruritania, 2011 and 2012			
Good (Item)	Average price in \$ (2011)	Average price in \$ (2012)	Average monthly quantity purchased by a Ruritanian family (= weight)
A	\$2.00	\$2.20	20
B	\$10.00	\$12.00	15
C	\$1.20	\$1.50	10
D	\$1.60	\$3.20	5
E	\$5.00	\$5.00	10

- (a) Calculate the monthly cost of the typical basket of goods in

- (i) 2011;

[2]

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(Question 2 continued)

(ii) 2012.

[2]

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(b) From your results in (a), calculate the percentage change in the cost of living in Ruritania from 2011 to 2012.

[2]

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(Question 2 continued)

- (c) (i) In neighbouring Urbania the cost, in yen (¥), of the typical basket of goods is shown below. Using 2009 as a base year (2009 = 100), construct the consumer price index (CPI) for Urbania from 2010 to 2012. Show your workings and enter your results in the table below. [3]

Year	Cost of the typical basket (¥)	Workings	consumer price index for Urbania (2009 = 100)
2009	1355	—	100
2010	1470		
2011	1705		
2012	1790		

- (ii) From your answers to part (c)(i), calculate the rate of inflation in Urbania between 2010 and 2011. [2]

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(This question continues on the following page)



(Question 2 continued)

- (iii) With reference to the terms inflation and disinflation, describe the changes in the cost of living in Urbania during the period 2009 to 2012. [2]

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- (d) Explain **two** problems which economists face when using a consumer price index (CPI) to measure the rate of inflation. [4]

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(Question 2 continued)

- (e) The GDP of Urbania in 2009 was ¥60 billion, while in 2010 it was ¥65 billion.

The GDP deflator for the same years was

Year	GDP deflator
2009	100
2010	114

Calculate the percentage change in the real GDP of Urbania from 2009 to 2010.

[4]

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- (f) When calculating inflation for the purpose of policy-making, economists might calculate a core/underlying rate of inflation. Explain why they do this.

[4]

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1524

Turn over

3. The information below represents the weekly cost and revenue conditions of a firm, measured in dollars (\$).

Output (Q)	Price per unit	Total revenue (TR)	Average revenue (AR)	Marginal revenue (MR)	Total cost (TC)	Marginal cost (MC)
1	50				35	
2	45				45	
3	40				60	
4	35				80	
5	30				105	
6	25				135	
7	20				170	
8	15				210	

- (a) Complete the table above by entering the total revenue (TR), average revenue (AR), marginal revenue (MR) and marginal cost (MC) information for all levels of output. [4]
- (b) (i) Using your answers from part (a), identify the profit-maximizing level of output for the firm. You **must** outline the reason for your answer. [3]

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(Question 3 continued)

- (ii) Calculate the economic profit/loss which the firm would make at this level of output. [2]

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- (c) (i) Calculate the price elasticity of demand for the product when price falls from \$25 to \$20. [2]

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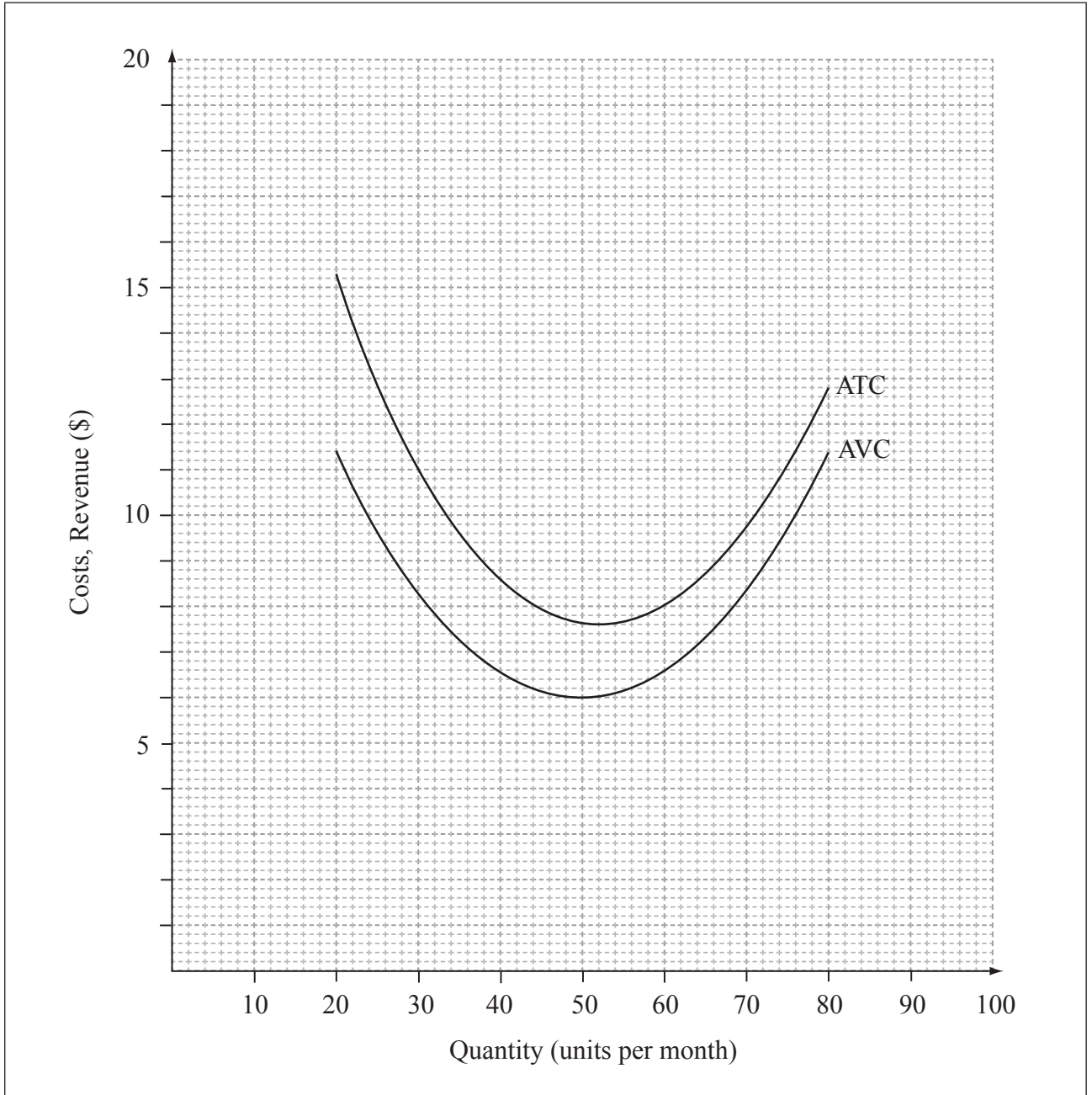


(Question 3 continued)

- (d) The graph below illustrates the average total cost and average variable cost information for a firm.

On the graph, identify the break-even price and the shut-down price for a perfectly competitive firm.

[2]



(This question continues on the following page)



(Question 3 continued)

(e) From the graph in part (d)

(i) calculate the total variable cost if output is 50 units per month; [2]

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(ii) calculate total cost if output is 30 units per month. [2]

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(Question 3 continued)

- (f) With reference to the graph in part (d), explain the difference between the break-even price and the shut-down price. [4]

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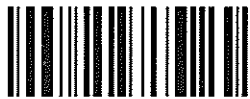
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**ECONOMICS
HIGHER LEVEL
PAPER 3**

Tuesday 5 November 2013 (morning)

1 hour

Candidate session number

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Examination code

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INSTRUCTIONS TO CANDIDATES

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- Do not open this examination paper until instructed to do so.
- Answer two questions in the boxes provided.
- Unless otherwise stated in the question, all numerical answers must be given exactly or correct to two decimal places.
- You must show all your working.
- The maximum mark for this examination paper is [50 marks].



20EP01

Answer two questions. Each question is worth [25 marks]. Write your answers in the boxes provided.

1. The table below shows data for price elasticity of demand and income elasticity of demand for seven product groups in Argentina in 2008.

	Food and Beverages	Clothing and footwear	Housing	House furnishing	Health care	Transport	Recreation
Price elasticity of demand	-0.49	-0.71	-0.79	-0.77	-0.96	-0.84	-1.03
Income elasticity of demand	0.67	0.96	1.07	1.05	1.31	1.16	1.41
Percentage of income spent by the average household on each product group	22%	5%	18%	6%	9%	16%	9%

[Source: adapted from <http://www.ers.usda.gov/publications>, 23 July 2011]

There are concerns about rising food prices and their impact on households. Economists have forecast that rising food prices may have a negative effect on the demand for goods in other product groups.

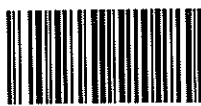
- (a) Outline **one** reason why

- (i) the price elasticity of demand figures are negative;

[2]

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(This question continues on the following page)



(Question 1 continued)

(ii) the income elasticity of demand figures are positive.

[2]

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(b) Using the price elasticity of demand data in the table

(i) calculate the percentage change in quantity demanded for clothing and footwear if the price of clothing and footwear rises by 6%;

[2]

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(ii) calculate the percentage change in the price of house furnishings that can lead to a 2% fall in quantity demanded of house furnishings;

[2]

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20EP03

Turn over

(Question 1 continued)

- (iii) describe what might happen to the revenues of food and beverages firms as the price of food and beverages increases. [2]

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- (c) The cross price elasticity between housing and house furnishing was estimated to be equal to -0.4 . Using this cross price elasticity data, explain the possible impact that an increase in house prices might have on the demand for house furnishing. [4]

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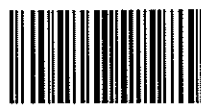
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(Question 1 continued)

(d) Using the income elasticity of demand data in the table

- (i) calculate the percentage change in quantity demanded for housing if household incomes rise by 4%;

[2]

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- (ii) calculate the percentage change in household incomes that can lead to a 5% rise in quantity demanded of recreation.

[2]

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(This question continues on the following page)



(Question 1 continued)

(e) Argentina's average household disposable income is currently US\$11 132 and household incomes are expected to grow in the future. The average Argentinean household income is forecast to rise by 27% by 2015.

(i) Calculate the amount the average Argentinean household currently spends on health care. [1]

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(ii) Calculate the forecasted average Argentinean household income for 2015. [2]

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(This question continues on the following page)



(Question 1 continued)

- (iii) As a result of the forecasted average Argentinean household income for 2015, calculated in part (ii), explain what you would expect to happen to the proportion of income Argentinean households spend on health care. [4]

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2. A firm making handmade shoes is concerned with its productive efficiency. The management has looked at the production levels using different quantities of labour and the product and cost data are set out in the table below.

Labour input	Total product*	Total cost in USD
1	5	80
2	12	104
3	16	128
4	18	152
5	19	176

- (a) Outline the difference between fixed and variable costs of production.

[2]

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- (b) (i) Using the data in the table below, determine the marginal product for the different quantities of labour employed and complete the marginal product column in the table.

[2]

Labour input	Total product	Marginal product
0	0	-
1	5	
2	12	
3	16	
4	18	
5	19	

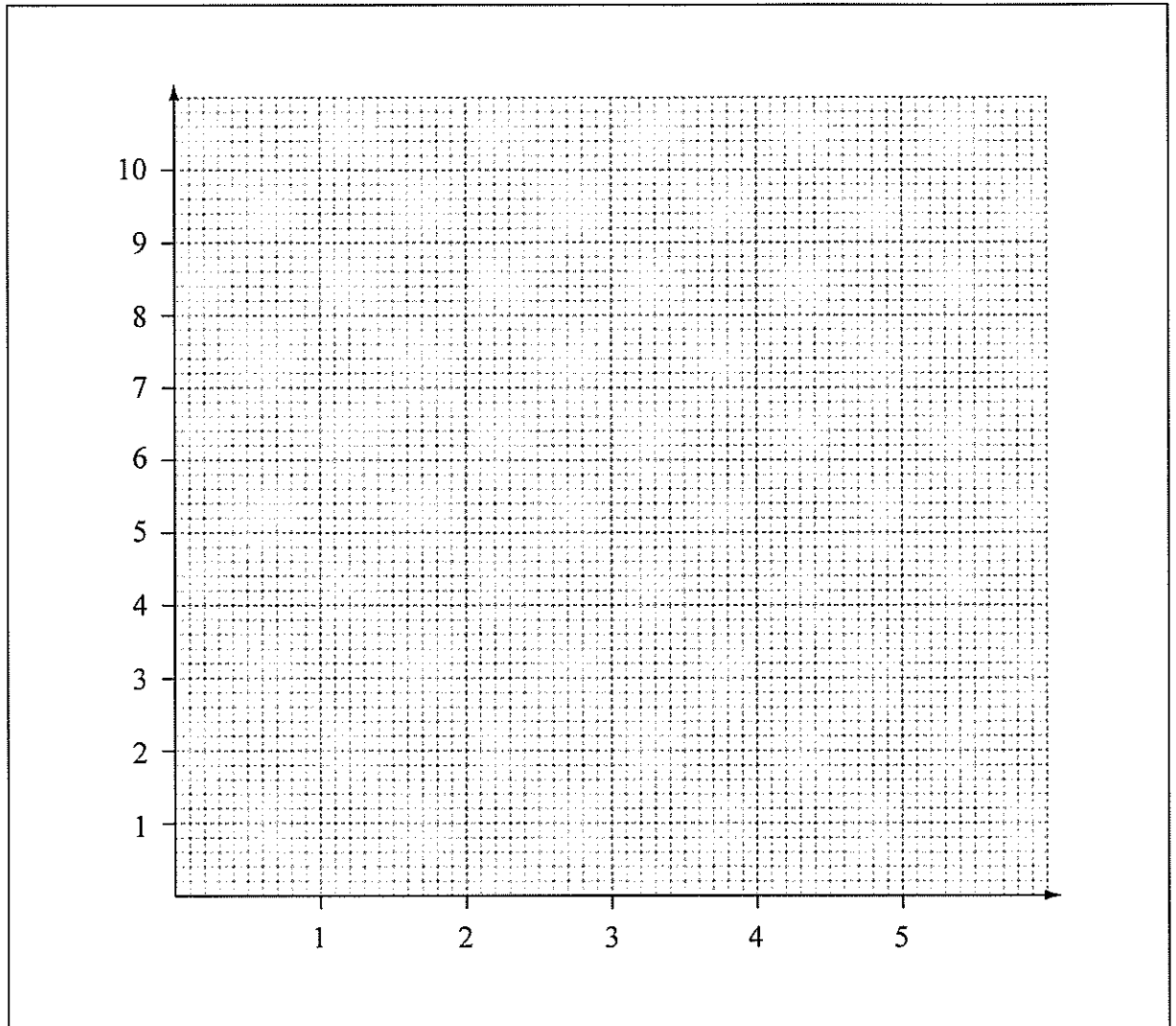
* Total product: the total number of shoes that can be produced in an hour with a fixed amount of capital and with different quantities of labour.

(This question continues on the following page)



(Question 2 continued)

- (ii) Using the data in the table in part (b)(i), draw a graph to show the relationship between marginal product and labour input. The axes and curve must be labelled. [2]



- (iii) On the graph above identify the point where diminishing returns set in. [1]

(This question continues on the following page)



(Question 2 continued)

(c) (i) State the equation used to calculate

[2]

average total cost;

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marginal cost.

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(ii) Using the data in the table, determine the marginal cost and average total cost figures for the different quantities of total product and complete the marginal cost and average total cost columns in the table.

[4]

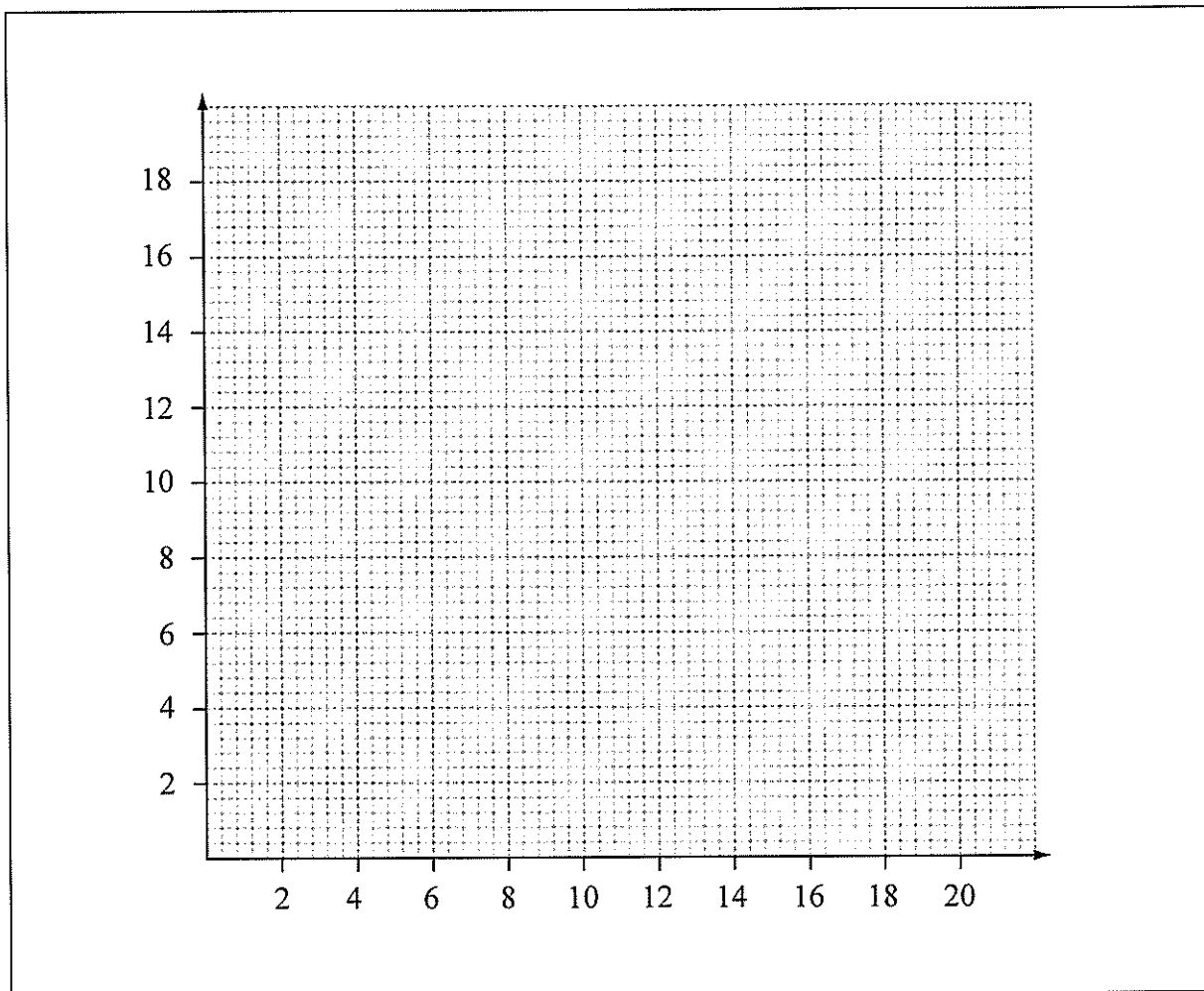
Labour input	Total product (units)	Total cost (in USD)	Marginal cost (in USD)	Average total cost (in USD)
0	0	56	-	-
1	5	80		
2	12	104		
3	16	128		
4	18	152		
5	19	176		

(This question continues on the following page)



(Question 2 continued)

(iii) Using the data in the table in part (c)(ii), draw a graph to show the firm's average total cost curve. The axes and curve must be labelled. [2]



(iv) Define the term *productive efficiency*. [2]

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(This question continues on the following page)



(Question 2 continued)

(d) Explain how the law of diminishing returns affects this firm's marginal costs.

[4]

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(e) Explain **one** possible source of economies of scale that this firm might benefit from if it increases its scale of production.

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will not be marked.



20EP13

Turn over

- 3. Table 1 below sets out data for the South Korean economy for the years 2009 and 2010. These data are used to calculate the South Korean GDP using the expenditure approach. Many economists see the success of South Korea's economy as being due to its strong exports and high level of investment.

Table 1

	2009	2010
Exports	412	448
Investment	205	223
Consumption	386	408
Imports	334	356
Government expenditure	89	93

Figures are in billions¹ of US dollars in nominal terms.

The GDP deflator for South Korea in 2009 is 97 and for 2010 it is 100. Average growth rate of OECD² economies in 2010 is 2.9%.

Table 2 below shows the marginal propensities to save (MPS), tax (MPT) and import (MPM) for South Korea.

Table 2

MPS	MPT	MPM
0.3	0.3	0.2

- (a) Define the term *expenditure approach*.

[2]

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¹ billion: one thousand million (1 000 000 000)

² OECD: the Organization for Economic Co-operation and Development (formed in 1961). The members in 2010 were: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

(This question continues on the following page)



(Question 3 continued)

- (b) (i) Using the data in Table 1, calculate the nominal GDP in 2009 and 2010 for the South Korean economy. [2]

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- (ii) Using the GDP deflator, calculate the real GDP for South Korea for 2009 and 2010. [2]

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- (iii) Calculate the real economic growth rate for the South Korean economy for 2009 to 2010. [2]

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(Question 3 continued)

- (iv) Describe the relative growth performance of the South Korean economy in 2010 compared with OECD countries. [2]

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- (c) (i) Using the data in Table 2, calculate the value of the Keynesian multiplier in South Korea. [2]

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- (ii) Using the multiplier calculated in (c)(i), calculate the change in South Korea's real GDP brought about by the rise in its exports from 2009 to 2010. [3]

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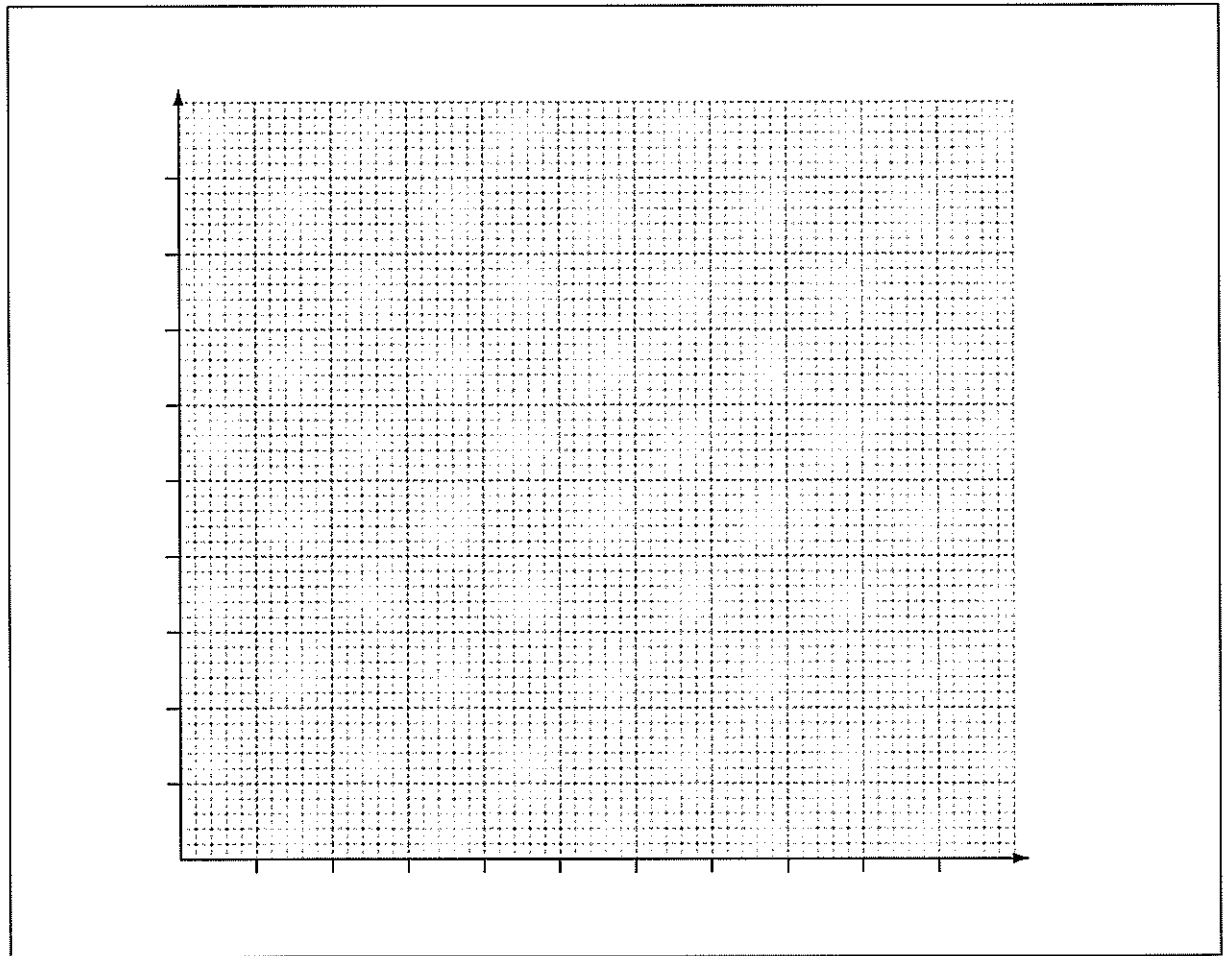
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(Question 3 continued)

- (iii) On the axes below, draw an appropriate AD/AS diagram and use it to explain the impact on South Korean real GDP of the change in South Korean exports from 2009 to 2010. [4]

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