INTERNATIONAL BACCALAUREATE
BACCALAURÉAT INTERNATIONAL
BACHILLERATO INTERNACIONAL

ECONOMICS
HIGHER LEVEL
PAPER 3

Thursday 10 May 2001 (morning)

2 hours

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer one question from Section A and one question from Section B.
- Use diagrams where appropriate.

SECTION A

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

Read the following article and answer the questions which follow.

Question 1

WHY THE WORLD'S ECONOMIES ARE SUFFERING A GLUT REACTION

(1) This week, the oil price sank below $10 a barrel, its lowest price in real terms since before the war in the Middle East in 1973. In Germany, France and Japan, prices of manufactured goods are falling.

(2) We are living in a world of glut. **There is too much of everything.** From grain to steel, copper to microchips, there is **chronic global overcapacity**, a kind of global output gap. While there has been an immense build up of manufacturing capacity in Asia, Europe, Latin America and North America, the world's second largest economy, Japan has been deep in recession and the European Union has grown only slowly.

(3) The price of oil is in some ways a parable of our times. The days when the Organisation of Petroleum Exporting Countries (OPEC) held the West to ransom have long since disappeared. High prices encouraged new sources of supply, notably in the North Sea, and massive diversification programmes, variously into nuclear power (France), domestic oil and gas production (UK and USA) and technical measures to reduce oil bills (Japan). Technology has played a key role in reducing the oil price as formerly inaccessible oil fields are opened up and very high rates of extraction are achieved. At the same time, high prices have made every economy more energy efficient, which, coupled with low growth in Europe and Japan, has restrained the growth in oil demand. The result - an oil price below $10 a barrel.

(4) The falling oil price is **destabilising country after country**. The crisis in Russia was triggered by the collapse of the oil price. The swing from current account surplus to current account deficit was almost entirely explained by the fall in dollar and tax revenues from oil and gas, Russia's single largest dollar earner. In Venezuela, the budget deficit climbed to 9% of GDP as the economy plunged into near slump when the oil price crashed. In Saudi Arabia also, the budget and current account deficits have spiralled. The collapse in commodity prices in general is causing similar problems. Economies that principally export raw materials are witnessing a vicious decline in their export earnings and an accompanying pressure on their currencies.

[Source: adapted from *The Guardian*, 13 December 1998]

(a) (i) Explain what is meant by the phrase **chronic global overcapacity** (paragraph 2). *[2 marks]*

(ii) How would you explain the author's claim that **there is too much of everything** (paragraph 2) in the world when widespread global poverty exists? *[4 marks]*

(b) Use the data (paragraph 3) and a separate supply and demand diagram to explain the change in the price of oil from

(i) the supply side. *[3 marks]*

(ii) the demand side. *[3 marks]*

(c) Explain how the changing price of oil is **destabilising country after country** (paragraph 4) in terms of its effect on the

(i) balance of payments on current account. *[3 marks]*

(ii) budget deficit. *[3 marks]*

(d) "Price movements have an important influence on the decisions of producers and consumers."

With reference to the article, evaluate the possible impact of changes in oil prices on the allocation of resources within an economy. *[7 marks]*

Question 2

Study the following items and answer the questions which follow.

AFRICA IN THE AFTERMATH OF THE ASIAN CRISIS

Item 1

Africa: Macroeconomic Indicators, 1990 to 1998

Indicators	**1990**	**1995**	**1996**	**1997**	**1998**
1. Real GDP Growth Rate	2.5	2.9	5.5	3.4	3.2
2. Real Per Capita GDP Growth Rate	-0.3	0.2	2.7	0.7	0.6
3. Inflation (%)	17	33	25.1	13.7	12
4. Investment Ratio (% of GDP)	22	20	18.9	18.7	20
5. Fiscal Balance (% of GDP)	-4.3	-3	-2.5	-1.8	-2.7
6. Growth of Money Supply (%)	20.1	22.6	18.4	15.8	12.4
7. Export Growth, volume (%)	4.8	9.2	8.1	4.4	-0.7
8. Import Growth, volume (%)	4.8	7.3	3.2	7.9	4.8
9. Terms of Trade (% change)	5	-0.6	2.5	1.5	-5.7
10. Trade Balance ($ billion)	7.1	-4.6	4.4	2.2	-11.4
11. Current Account ($ billion)	-8.9	-13.5	-4.4	-4.2	-19
12. Debt Service (% of Exports)	21.9	23	22.2	18.8	22.5

[Source: *African Development Report 1999*, African Development Bank, OUP 1999]

Item 2

Growth slows following the Asian Crisis

Africa's export of major commodities was adversely affected by the slowdown in the global economy that followed the Asian crisis in 1997. It deepened as a result of the difficulties in Russia and Brazil. As Africa relies heavily on primary commodities, its growth slowed because of reduced export volumes, and especially because of falling commodity prices, including gold, oil and copper.

Sustained economic growth depends on a more robust investment performance but investment and growth continue to be limited by very low domestic savings. Moreover, as a result of the crisis, civil conflicts and social strife made a difficult economic environment even worse. The development costs of these conflicts in terms of social, human and physical capital are high. By destroying the economic and social infrastructure and stopping productive activities, conflicts slow down the process of development and growth and increase poverty.

External debt remains a burden. The level of debt of some low-income African countries could increase due to their declining terms of trade. There is also the possible loss of market share in primary commodities following competitive exchange rate adjustments in East Asian countries.

[Source: adapted from the *African Development Report 1999*, African Development Bank, OUP 1999]

(a) With reference to Item 1, define the following concepts:

(i) terms of trade. *[2 marks]*

(ii) trade balance. *[2 marks]*

(b) Use Item 1 to describe

(i) the possible relationship between the terms of trade and the trade balance. *[2 marks]*

(ii) what has happened to the debt burden over the period shown. *[2 marks]*

(c) Use the data and your knowledge of economics to

(i) give reasons for recent changes in Africa's terms of trade. *[4 marks]*

(ii) explain **two** possible consequences for Africa arising from the changes in its terms of trade. *[6 marks]*

(d) Use the data provided and your knowledge of economics to evaluate future prospects for economic growth in Africa. *[7 marks]*

SECTION B

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

Question 3

(a) Using suitable diagrams, explain why there is likely to be an absence of long run economic profits in perfect competition. *[12 marks]*

(b) To what extent might consumers benefit from increased competition between firms? *[13 marks]*

Question 4

(a) Explain how governments can use fiscal policy to redistribute income. *[12 marks]*

(b) Evaluate the advantages and disadvantages of policies aimed at reducing income inequalities. *[13 marks]*

Question 5

"Whether the exchange rate rises or falls there are always losers."

Evaluate this statement from a domestic **and** / **or** global perspective. *[25 marks]*

Question 6

(a) Why have multi-national corporations grown so rapidly in recent decades? *[10 marks]*

(b) Do multi-national corporations help or hinder the less developed countries? *[15 marks]*