IB DIPLOMA PROGRAMME
PROGRAMME DU DIPLÔME DU BI
PROGRAMA DEL DIPLOMA DEL BI

ECONOMICS
HIGHER LEVEL
PAPER 3

Friday 7 November 2003 (morning)

2 hours

INSTRUCTIONS TO CANDIDATES

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

SECTION A

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

Either

Question 1

Over a barrel

1 It is not easy running an oil **cartel** these days. With forecasts for global demand so unreliable and supply figures so weak at best, how is OPEC to decide exactly how many barrels to take out of the ground and how many to leave in?

2 That was the problem facing OPEC ministers when they met in Vienna on January 17th. Over the past two years the price of oil has fallen to $10 per barrel, then increased to $35 per barrel last year. In the days before they met, the price varied within OPEC's target range of $22 – $28 per barrel. Last year, in the face of strong demand, it increased **production quotas** four times by a total of over 3.5 million barrels per day. Yet at the Vienna meeting OPEC ministers unanimously agreed to reduce quotas by around 1.5 million barrels per day from February 1st.

3 Why cut now? After all, stocks of oil remain low in most parts of the world and the big consuming countries, such as the United States and members of the European Union have been arguing for no cuts. The reason for the cut is OPEC's memory of what happened three years ago. They agreed to raise output just as the Asian economic crisis was beginning. This led to a price collapse. To avoid that mistake again they have become very sensitive to any weakening of demand.

4 When they met this week they found plenty to worry about. There are strong signs that the United States economy is slowing down and possibly even heading towards depression. Another factor is seasonal: at the end of the northern hemisphere winter there is often a big drop in oil consumption. Another reason is the present mismatch between production and consumption. The increases in production agreed last year have led to production being greater than consumption by a significant amount.

5 Will prices remain within that comfortable $22 – $28 band? It is unlikely. OPEC has a poor record in dictating prices to the market.

[Source: adapted from *The Economist*, 20 January 2001]

(a) Explain the meaning of the following terms that appear in bold in the article:

(i) cartel *(paragraph 1)* *[2 marks]*

(ii) production quotas *(paragraph 2)*. *[2 marks]*

(b) Use a supply and demand diagram to show how OPEC might keep prices within its "target range of $22 – $28 per barrel" *(paragraph 2)*. *[5 marks]*

(c) With reference to the concept of price elasticity of demand, explain the likely consequences of oil price changes on the oil revenues of OPEC countries. *[4 marks]*

(d) Why are governments generally hostile to cartels? Illustrate your answer with a suitable diagram. *[5 marks]*

(e) Using the information in the article and your knowledge of economic theory, discuss why OPEC might not succeed in stabilizing prices "within that comfortable $22 – $28 band". *[7 marks]*

Or

Question 2

New Zealand, NAFTA and Protectionism

1 New Zealand business is generally in favour of joining the North American **Free Trade Area** (NAFTA) which unites Canada, the USA and Mexico in the world's biggest free trade pact.

2 Last week, former Canadian Prime Minister, Brian Mulroney described a free trade deal with the USA as one of the few measures that could truly transform the whole New Zealand economy. In a seminar in Auckland he focused on the transformational effects Canada had enjoyed through NAFTA membership, and urged New Zealand to do the same within two years, either through NAFTA or a bilateral deal with the USA.

3 New Zealand's Trade Negotiations Minister, Jim Sutton, prefers a bilateral free trade deal with the United States only. He is concerned over North America's extensive protectionism of its dairy industry. Dairy products are not included in NAFTA. All three NAFTA countries impose tariffs on dairy products, which form New Zealand's biggest exporting industry.

4 Agricultural protectionism is probably the biggest issue and the biggest opportunity for New Zealand which has zero **subsidies** for its entire agricultural sector. Other nations such as Japan, the USA and the EU still maintain heavy subsidies (see table below). If a way could be found to bring dairy products into a broader NAFTA agreement, the benefits would be enormous. It would also be good for the consumers of the USA, Canada and Mexico, who are the chief victims of tariff protectionism.

Agricultural Support Levels Compared (1998)

	NZ	USA	EU	Japan
Total Producer Support ($USm estimate)	44	46 960	129 808	40 059
Support per farmer ($US estimate)	0	19 000	19 000	21 000
Increase in farm income from subsidies (%)	1	28	83	172
Agriculture as percentage of GDP	7	2	2	2

[Source: adapted from an article by Fran O'Sullivan, *New Zealand Herald*, 9 July 2001 Statistics from *OECD]*

(a) Define the following terms highlighted in bold in the text:

(i) Free Trade Area *(paragraph 1)* *[2 marks]*

(ii) subsidies *(paragraph 4)*. *[2 marks]*

(b) With reference to the table, which country or trade bloc

(i) subsidises its agricultural producers most heavily? *[2 marks]*

(ii) appears to have the most efficient agricultural sector? *[4 marks]*

(c) Support per farmer is the same in the USA and EU *(see table, row 2)*. Why then is the increase in farm income from subsidies so much greater in percentage terms in the EU *(see table, row 3)*? *[2 marks]*

(d) Using the article and your knowledge of tariffs and subsidies, explain why the consumers of the USA, Canada and Mexico are described by the author as "the chief victims" of protectionism. *[6 marks]*

(e) A free trade deal with the USA is described as "one of the few measures that could truly transform the whole New Zealand economy" *(paragraph 2)*. Evaluate this claim. *[7 marks]*

SECTION B

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

Question 3

"National policies and international agreements must be implemented in order to reduce global environmental problems."

(a) Using the concept of market failure, explain the statement above from an economist's point of view. *[10 marks]*

(b) With reference to both national policies and international agreements, discuss **three** solutions that could be recommended by economists. *[15 marks]*

Question 4

With the help of diagrams

(a) distinguish between demand-pull and cost-push inflation *[10 marks]*

(b) explain which policies would be appropriate to deal with these **two** types of inflation. *[15 marks]*

Question 5

(a) Explain the factors which cause the value of a currency to change under a floating exchange rate. *[12 marks]*

(b) To what extent does an appreciation of the currency harm an economy? *[13 marks]*

Question 6

Discuss the view that investment in human capital is the most effective way to provide development. *[25 marks]*