



**ECONOMICS
HIGHER LEVEL
PAPER 3**

Thursday 8 November 2007 (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.

Jakarta opens case against big US mining company

- ❶ The Indonesian government has brought criminal charges of polluting the environment against an American mining company. The company's president in Indonesia appeared before a panel of five judges as prosecutors accused him and his company of allowing toxic waste to be put in the sea near its gold mine at Buyat Bay.
- ❷ The prosecution described 125 examples over the eight-year life of the mine in which the waste had exceeded government regulations on legal limits for heavy metals, including arsenic and mercury. It said the company did not have the proper license for disposing of the waste.
- ❸ The opening of the trial, an unusual case of an American corporate giant facing criminal charges in a developing country, comes after villagers at Buyat Bay complained last year of illnesses that they said were the result of the mine's operations.
- ❹ The Denver-based company, which is the world's biggest gold producer, has denied responsibility for the tumors, skin rashes and dizziness suffered by local residents, saying that those health problems are common to poor coastal communities. Most of the villagers, afraid for their health, moved away in June to another area.
- ❺ An investigation by the Indonesian police that included the testing of water samples near the mine resulted in the arrest last September of five employees. In Manado, a provincial city where the multinational company has provided employment and tax revenue, the case has created strong feelings both for and against the company. Local officials, worried about **economic growth**, say they are in favour of the foreign direct investment provided by the corporation, and they appear uncomfortable that the national government is prosecuting the company in their area.
- ❻ For Indonesia's environmental community, the first day of the trial offered hope of change from past practices of weak regulatory enforcement. "For 30 years, giant mining companies have operated in Indonesia with carelessness despite shocking environmental consequences," said a spokesperson for the Indonesian Forum for the Environment. "It is about time that the government made **sustainable development** a priority. Businesses must be forced to adopt appropriate ways to dispose of their waste."

[Source: adapted from Jane Perlez "Jakarta opens case against the big US mining company", *The New York Times*, 6 August 2005]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) economic growth (*paragraph 5*) *[2 marks]*
 - (ii) sustainable development (*paragraph 6*). *[2 marks]*
- (b) Using an appropriate diagram, explain how the company’s mining of gold near Buyat Bay is a source of market failure. *[4 marks]*
- (c) Using an appropriate diagram, explain how “appropriate ways to dispose of their waste” (*paragraph 6*) would affect the Indonesian gold market. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the arguments for and against the “foreign direct investment” (*paragraph 5*). *[8 marks]*

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

Rich travellers fuel a budget flight boom as mini-break mania takes off

- ❶ Research has found that in the UK, a minority of wealthy people taking an increasing number of short breaks on budget airlines is increasing the **demand** for new runways and airport terminals. The Civil Aviation Authority (CAA) found that the poorest quarter of society took only 10 per cent of the flights last year. By contrast, more than half the passengers on budget airlines came from the richest quarter.
- ❷ Passengers using Stansted, the main budget airline airport that is due to gain a new runway by 2013, had an average income of £50 000 last year. It also found that the three or four-day foreign holiday (vacation) is by far the fastest-growing sector of the air travel market.
- ❸ The government has approved the expansion of more than twelve airports, including four new runways, on the basis that, “air travel is essential to the UK’s economic growth and to our continued prosperity”. The transport secretary argues that the boom in air travel is helping to keep 200 000 jobs in the aviation industry.
- ❹ The overall effect of the explosion in cheap airfares, however, has been to withdraw funds from the economy. British tourists travelling abroad outnumbered foreign tourists coming to Britain by 2.5 to 1 last year, according to national statistics. The tourism deficit, which is the difference between what British travellers spend abroad and foreign visitors spend here, has widened from £4.7 billion in 1997 to £17.6 billion in 2004.
- ❺ A CAA report showed that most of the future growth in air travel would result from wealthier sections of society taking more trips. “As wealth and income increases, so does the willingness to spend money on foreign holidays.” “When average annual incomes rose from £40 000 to £50 000, the average number of foreign holidays rose by 50 per cent.”
- ❻ The falling price of airfares has also contributed to the boom. The average holiday ticket cost £150 last year, £70 cheaper in real terms than in 1998, thus lowering the **opportunity cost** of holidays.
- ❼ There is much opposition to the proposed expansions to the airports, mainly from the large numbers of nearby residents who pay the external costs of the huge boom in the industry.

[Source: adapted from Ben Webster, *The Times*, 19 December 2005]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) demand (*paragraph 1*) *[2 marks]*
 - (ii) opportunity cost (*paragraph 6*). *[2 marks]*
- (b) Using an appropriate diagram, explain how the “tourism deficit” (*paragraph 4*) might affect the value of the UK currency. *[4 marks]*
- (c) Using information from the text, calculate the value of income elasticity of demand for foreign holidays and explain what the value signifies. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the possible effects of the expansion of airports and runways on the UK economy. *[8 marks]*

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

Basic mobility now costs less

- ❶ In June, the Kenyan government announced the elimination of bicycle import tariffs and **quotas**. The decision comes just after a rise in petrol prices, and should lead to a significant increase in bicycle sales.
- ❷ The lower bicycle prices will enable more bicycle ownership among commuters. This will also allow many bicycle taxi operators who are currently renting bicycles to purchase their own bicycles for their small businesses. Some existing bicycle taxi operators complain that the low price of bicycles will lead to a big increase in the number of taxi operators, creating too much competition to maintain **normal profit** (zero economic profit). Others say that this fear is unrealistic because the rising petrol prices will create more demand for bicycle taxi journeys.
- ❸ In contrast, the government in neighbouring Tanzania has not removed import tariffs on bicycles, although they have recently reduced the tariff on bicycle tires by 10%. While tires account for only 1/6 of the price of a new bicycle, tires are the most expensive part that needs routine replacement, so it will be more affordable for people to keep their bicycles in working order. In a country where the average price of a bicycle is 60 000 Tanzanian Shillings, which is 22% of the annual *per capita* income of 270 000 Tanzanian Shillings, the lower price of tires is an important first step but does not go far enough.
- ❹ The Association for the Advancement of Low-Cost Mobility, the organization that put pressure on the government for the reduction, is taking their campaign further, hoping to convince the government to follow Kenya's lead and reduce the tariff on the entire bicycle.
- ❺ The benefits of reducing or eliminating the tariff are numerous. With access to this low-cost transportation, villagers can take grain to the market in larger quantities and more quickly; children in rural areas can reduce their travel time to school by hours and traditionally disadvantaged groups, such as women, can increase their access to self-employment opportunities. In short, the benefits of the reduction or elimination of the tariff in terms of economic development are significant.

[Source: adapted from "Basic mobility now costs less", *The Bulletin for the Institute for Transportation and Development Policy*, 01 September 2002]

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(Question 3 continued)

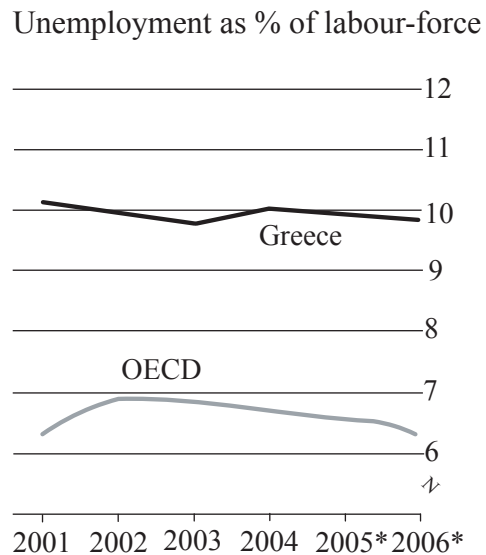
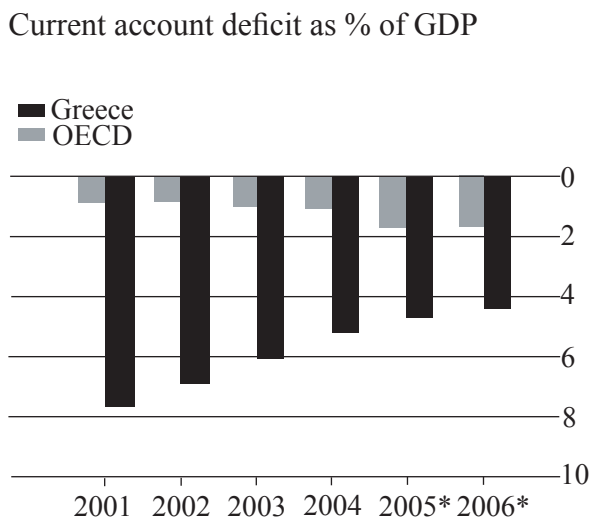
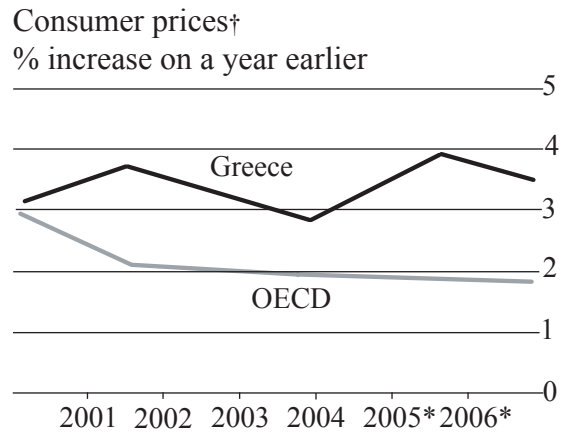
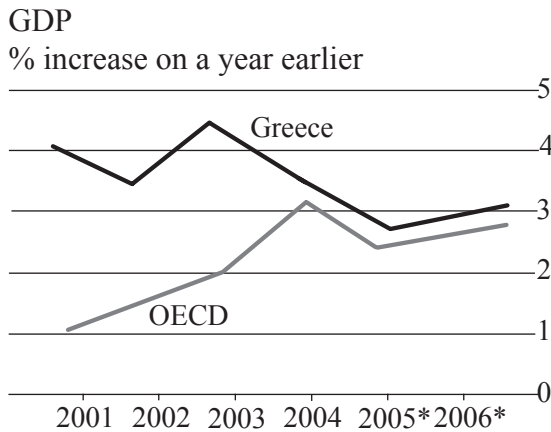
- (a) Define the following terms indicated in bold in the text:
 - (i) quotas (*paragraph 1*) *[2 marks]*
 - (ii) normal profit (*paragraph 2*). *[2 marks]*
- (b) Using an appropriate diagram, explain how the potential increase in the number of bicycle taxi operators in Kenya will create “too much competition to maintain normal profit (zero economic profit)” (*paragraph 2*). *[4 marks]*
- (c) Using an appropriate diagram, explain how the elimination of the tariff will affect the level of bicycle imports into Kenya. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the implications for economic development in Tanzania of a reduced tariff on bicycles. *[8 marks]*

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

Greece

The Greek economy grew in the last four years, performing far better than the OECD* average. However, unemployment and **inflation** are a concern, and income per capita is still lower than the OECD average. Also, there is a persistent current account deficit. According to OECD economists, living standards would rise if the government were to pursue market-orientated **supply-side policies**. The OECD argues that the government should reduce its own spending, because the budget deficit is unacceptably high, and is creating the problem of crowding out.

* 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 "Greece", *The Economist*, 11 August 2005]

* Forecast † Private consumption deflator

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(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) **inflation** *[2 marks]*
 - (ii) **supply-side policies.** *[2 marks]*
- (b) Using an appropriate diagram, explain to what extent the data for Greece, from the beginning of 2003 to the beginning of 2004, supports the theory suggested by the short-run Phillips curve. *[4 marks]*
- (c) Using an appropriate diagram, explain why the Greek budget deficit may be causing crowding out as suggested in the last line of the text. *[4 marks]*
- (d) Using information from the text and data, and your knowledge of economics, evaluate the policies that might be used by the Greek government to improve the performance of its economy. *[8 marks]*

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

After a 7-year decline, Japanese banks increase lending

- ① Japan reached an important point in its slow economic recovery when the government announced that bank lending increased in August, which is the first time since the country started measuring lending activity seven years ago.
- ② The Bank of Japan said that the value of all loans by Japanese banks rose 0.2 per cent from last August to ¥387 trillion, or US\$3.6 trillion. The increase stopped the trend in which lending had fallen for 56 consecutive months since October 1998.
- ③ The change has been widely awaited by economists as proof that Japan, the second-largest economy after the United States, is finally escaping a more than decade long period of slowdown and **recession**. For most of the past decade, banks had reduced the number of new loans after the early 1990s collapse of Japan's stock market and housing market.
- ④ While small, the increase in lending shows that Japanese banks are feeling confident enough to extend new loans to companies and individuals, economists said. This means that money is once again starting to flow into new businesses and investments, starting a positive cycle that has not been seen in Japan for years.
- ⑤ “This is a sign of the return to health of the banking system,” said a Tokyo-based economist. “It's also a sign of the normalization of the economy.”
- ⑥ Many economists expect lending to keep rising, as enthusiastic banks start making cash deposited from savers available for investment. By pumping money into the economy, banks could also help raise **consumption**, which is necessary if Japan is to escape deflation. The hope is that the increased investment will lead to a multiplier effect, which will in turn lead to an accelerator effect, bringing about an upturn in the business cycle (trade cycle).

[Source: adapted from “After a 7-year decline, Japanese banks increase lending”, Martin Fackler, *The New York Times*, 8 September 2005]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) recession (*paragraph 3*) *[2 marks]*
 - (ii) consumption (*paragraph 6*). *[2 marks]*
- (b) With the help of an appropriate diagram, explain how the fall in lending after 1998 (*paragraph 2*) contributed to the “decade long period of slowdown and recession” (*paragraph 3*). *[4 marks]*
- (c) Using the circular flow of income diagram, explain the link between saving and investment implied in the text (*paragraph 6*). *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the consequences of increased lending on the Japanese economy. *[8 marks]*
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