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**ECONOMICS
HIGHER LEVEL
PAPER 3**

Thursday 20 November 2008 (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.

Luxpro sues Apple for \$100 million

- ❶ Taiwanese manufacturer Luxpro is suing Apple for \$100 million after a court ruled that Luxpro could continue producing its MP3 music player that closely resembles Apple's iPod shuffle. Luxpro first upset Apple back in March 2005 when it introduced its copy of the iPod shuffle. Apple claimed that the copy, known as Tangent, too closely resembled the iPod shuffle and so Apple believed it would unfairly lose **abnormal profits** if Luxpro's Tangent MP3 player was allowed into the market.
- ❷ In July 2005, a court in Taiwan accepted Apple's case against Luxpro and forced Luxpro to stop manufacturing its Tangent MP3 players. But this week, an appeals court reversed that decision and now Luxpro wants \$100 million as compensation for the losses it suffered when it was forced to stop production over the past 18 months. According to Luxpro, it lost valuable market opportunities and a substantial number of orders.
- ❸ In its case against Apple, Luxpro claims Apple threatened retaliation against stores that carried the Tangent line. Those threats, according to Luxpro, included the removal of iPod products from any store that did not take Luxpro's players off the shelves.
- ❹ Luxpro maintains that its MP3 players are significantly different from the iPod shuffle. The company says its Luxpro logo is clearly displayed on the player and it has an organic light emitting diode (OLED) display that the iPod shuffle doesn't have. This is clear evidence of **product differentiation**.
- ❺ Although Apple enjoyed one of its best years on record in 2006, the computer and electronics maker started 2007 on difficult legal grounds. Aside from the Luxpro case, there have been several lawsuits against the company. According to news reports, one case complains about Apple's use of a copy-protection system that prevents iTunes music and videos from easily being transferred to non-iPod media players.
- ❻ The case claims that Apple has created an illegal monopoly by linking the iTunes store to the iPod. It also claims iPods do not easily play songs purchased from music stores other than iTunes.

[Source: adapted from http://www.newsfactor.com/news/Luxpro-Levels--100M-Suit-Against-Apple/story/xhtml?story_id=011000MXIDJX NewsFactor.com, Tim Gray, 5 January 2007]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) abnormal profits (*paragraph 1*) [2 marks]
 - (ii) product differentiation (*paragraph 4*). [2 marks]
- (b) Using an appropriate diagram, explain how Apple might have thought it would lose abnormal profits due to the introduction of the Tangent MP3 player (*paragraph 1*). [4 marks]
- (c) With reference to the text, explain which market structure the MP3 player industry most closely represents. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the view that the government should regulate the competitive behaviour of Apple. [8 marks]

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

Growth lifts business mood to record high

- ❶ Confidence in the South African economy climbed last month. There is general optimism about the country's growth prospects. However, analysts warn that South Africa's large **current account deficit** remained a risk to the positive outlook.
- ❷ The business confidence index of the South African Chamber of Business rose to a record high of 103.5, while the Reuters Econometer, a measure of economic confidence, climbed to its highest level since May last year (2006), at 263.74.
- ❸ Analysts said that the outlook for economic growth remained positive although growth was expected to slow slightly this year (2007). But next year would see higher levels of growth, with the **multiplier** effect of increased infrastructure spending in preparation for the 2010 Soccer World Cup. A leading economist observed, "what is going to make a significant impact is the 410 billion rand (the South African currency) increase in capital expenditure". Economists forecast growth of 4.33% for this year and 4.62% next year.
- ❹ On the negative side, the current account deficit rose to above 6% of GDP last year – a record high. This remains a threat, and could have serious implications for the rand if the deficit is not brought back to more comfortable levels of around 3% of GDP.
- ❺ The central bank has increased interest rates four times in an attempt to slow down strong consumer spending. However, consumption is showing only small signs of responding. As monetary policy operates with a lag, the effect of tightened interest rates is only likely to be felt in coming months. Analysts remain divided on whether rates will be raised again when the monetary policy committee meets next month.
- ❻ Lower oil prices are a positive sign for the inflation outlook, and analysts have predicted an average of 5.26% this year and 4.80% next year.

[Source: adapted from *Business Day (Johannesburg)*, Ayanda Shezi, 12 January 2007]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) current account deficit (*paragraph 1*) *[2 marks]*
 - (ii) multiplier (*paragraph 3*). *[2 marks]*
- (b) Using an AD/AS diagram, explain why “lower oil prices are a positive sign for the inflation outlook” (*paragraph 6*). *[4 marks]*
- (c) Using an appropriate diagram, explain why the rising current account deficit “could have serious implications for the rand” (*paragraph 4*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the likely effects of the “tightened interest rates” (*paragraph 5*). *[8 marks]*

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

Chinese fruit might cause EU battle

- ❶ European fruit and vegetable farmers, who already benefit from heavy **subsidies**, are looking for even more protection from Chinese competition.
- ❷ Damaged by low-cost competition from China, Poland’s strawberry producers filed a complaint with the European Union (EU) last year, leading to the EU’s first agricultural import tariff of 34.2% on imports of frozen strawberries from China.
- ❸ Poland’s strawberry growers aren’t alone. EU trade officials, under pressure from Spanish farmers, set quotas in 2004 on Chinese mandarins and other Chinese citrus fruits. Lobbyists representing industries such as Spanish furniture makers and Belgian apple farmers could pursue dumping complaints against the Chinese. The EU recently imposed anti-dumping duties on Chinese and Vietnamese shoes following complaints from Italian shoemakers.
- ❹ European regulators are being influenced by two views. Some producers fear Asian competition. However, European jam, yogurt and ice-cream producers, who need cheap fruit to cut their costs, do not support the call for increased protection.
- ❺ The EU thinks it has much to gain by finding the right trade balance. “Agriculture will be an area of tremendous growth,” says the EU trade commissioner. China can sell bulk products in the EU, saving EU consumers money, he claims, while the EU can benefit from China’s growing middle classes by selling products for which people in China have high **income elasticity of demand**, such as wine and cheese.
- ❻ The value of Chinese agricultural exports to Europe is growing. For example, Chinese frozen strawberry exports to the EU rose to \$26.4 million last year from \$6.2 million in 2002, an increase in market share to 20% from 3.5%.
- ❼ Chinese agriculture exporters are actively pursuing sales to Europe. At a trade fair last month in Chengdu, agriculture was the most prominent sector represented – ahead of high-tech and heavy-machinery firms.
- ❽ Poland is the world’s sixth-largest grower of strawberries. It joined the EU in 2004 and has an unemployment rate near 15%. Lobbyists pushing for strawberry tariffs said that without them, the country could lose more than 2500 jobs.

[Source: adapted from http://www.chinadaily.com.cn/world/2006-12/26/content_767919.htm, 20 January 2007]

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(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) subsidies (*paragraph 1*) *[2 marks]*
 - (ii) income elasticity of demand (*paragraph 5*). *[2 marks]*
- (b) Using an appropriate diagram, explain the effect of the EU tariff on frozen strawberries on the European market for frozen strawberries. *[4 marks]*
- (c) Using an appropriate diagram, explain the type of unemployment that Poland might experience without the strawberry tariff. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate a decision to increase protection in the EU strawberry industry. *[8 marks]*

4.

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

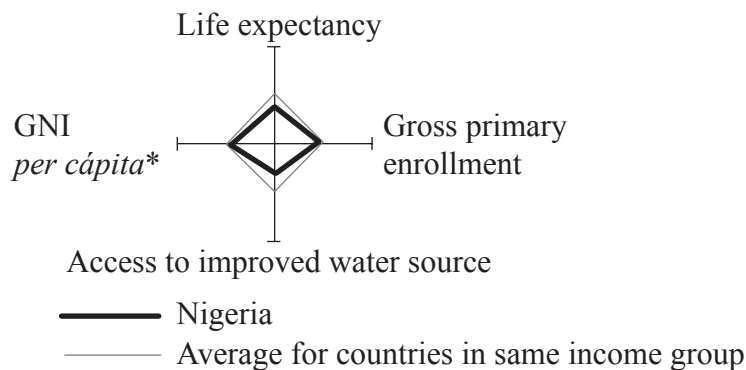
Nigeria

- ❶ Nigeria’s economy depends heavily on the oil sector, which contributes 95% of export revenues, 76% of government revenues, and about a third of gross domestic product (GDP). Oil prices rose considerably in 2005. With its large reserves of human and natural resources, Nigeria has the potential to build a prosperous economy, reduce poverty significantly, and provide the health, education, and **infrastructure** services its population needs.
- ❷ GDP *per capita* is about US\$400. Despite the country’s relative oil wealth, poverty is widespread – about 37% of the population lives in extreme poverty.
- ❸ Government efforts in the fight against corruption are improving the country’s international image. The government is also trying to ensure that public money can only be used for approved **investment** projects.

Table 1: Selected economic indicators for Nigeria – 2004 and 2005

	2004	2005
Average annual growth (%)		
GDP	6.0	6.9
GDP <i>per capita</i>	3.7	4.7
Economic indicators		
Consumer prices (% change)	19.4	13.5
Terms of trade index (base year = 2000)	104	143
Current account balance (US\$ millions)	3251	12 447

Figure 1: Development diamond for Nigeria 2005



[Source: adapted from *The World Bank Group, Country Brief, April 2006* and *Nigeria at a glance, September 2006*]

* GNI *per capita* is similar to GNP *per capita* but measured with a special method used by the World Bank

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(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) infrastructure (*paragraph 1*) *[2 marks]*
 - (ii) investment (*paragraph 3*). *[2 marks]*
- (b) Using information from paragraph **1** and table 1, explain why there is evidence that the demand for oil was price inelastic in 2005. *[4 marks]*
- (c) Using an AD/AS diagram, explain the effect that the changing current account balance is likely to have on inflation. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate possible measures that the Nigerian government might employ to promote economic development. *[8 marks]*
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