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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

- ❶ 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**.
- ❷ 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.
- ❸ 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.
- ❹ 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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(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 1*). *[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]

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(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

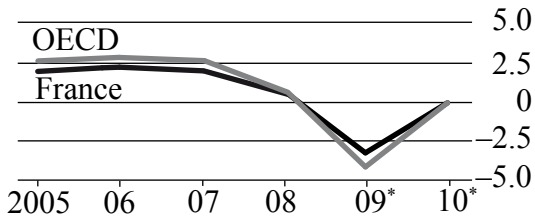


Figure 2:
Consumer prices, † % change on a year earlier

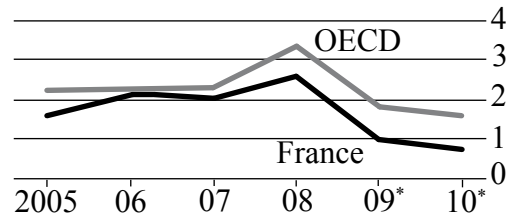


Figure 3:
Current account, as % of GDP: France

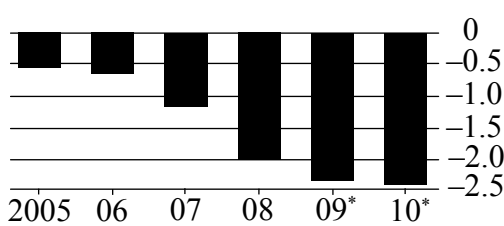
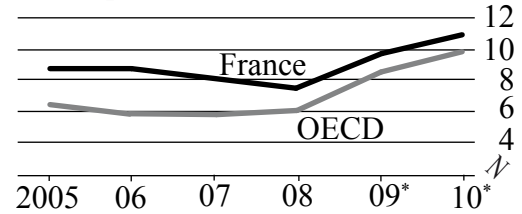


Figure 4:
Unemployment, as % of labour force



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>]

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(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]

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(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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