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

ECONOMICS
STANDARD LEVEL
PAPER 2

Tuesday 5 November 2002 (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.*

Question 1

Study the extract below and answer the questions which follow.

A GOLDEN ERA OF COFFEE DRINKING MAY BE COMING TO AN END

1 After fifteen years of cheap and plentiful coffee, prices could soon rise to levels unseen since the 1970s.

2 Coffee prices have fallen since the early 1980s, from a peak of nearly 240 cents per pound to well below 100 cents. By 1992, the price touched a low of 50 cents, and consumers enjoyed the lowest **real prices** in a generation.

3 To support the price, the Association of Coffee Producing Countries (ACPC) last month agreed to withhold from the market 20 % of production. The organisation's members are using a basket of prices to calculate a reference point of 95 cents per pound as the "floor" and 105 cents as the "ceiling". Last week the price was about 95 cents.

4 The countries which produce three-quarters of the world's coffee have signed the price support agreement. After the success of the oil cartel OPEC last year, when prices were effectively doubled, the coffee producers' deal may lead to a significant rise in commodity producer power. This may upset calculations in Western finance ministries about "sustainable, inflation-free growth".

5 "Even though people have totally lost faith in the ability of **commodity agreements** to work, I can't see any other way that you can help the development of the world's poorest countries," said Andrew Simms, head of the global economy programme at the New Economics Foundation.

6 Despite rumours in the market that the ACPC package is coming apart already, the key producer – Brazil – is solid. Of the 105 million 60 kilogram bags produced globally each year, Brazil accounts for between 30 and 40 million bags.

7 Smallest sub-Saharan countries suffer the most from fluctuations in coffee prices. Although their contribution to world exports is tiny many are almost one-crop economies. Coffee accounts for more than two-thirds of Uganda's export earnings and over half of Rwanda's. A fall in prices can have a devastating effect on these economies. When world prices dropped in 1998, Uganda's foreign exchange earnings slumped. This year a bad harvest forced Uganda to revise its growth forecast downwards by 1.5 %.

[Source: adapted from the *Guardian Weekly*, June 8–14, 2000]

(a) Define briefly the following terms highlighted in bold in the text.

(i) real prices (paragraph 2) *[2 marks]*

(ii) commodity agreements (paragraph 5) *[2 marks]*

(b) Explain how a rise in commodity prices might damage "sustainable, inflation-free growth" in Western economies (paragraph 4, last line). *[5 marks]*

(c) Using supply and demand analysis, show and explain how the ACPC price support system is expected to work. *[5 marks]*

(d) Suggest **two** problems which could threaten the success of the ACPC plan. *[4 marks]*

(e) If it is successful, how can the strategy proposed by the ACPC contribute to economic growth and development in the countries referred to in the text? *[7 marks]*

Question 2

Table 1 Average Income in US Dollars and US Dollars using Purchasing Power Parity Exchange Rates (PPP), selected countries, 1997/98

Country	GNP *per capita* in US Dollars	GNP *per capita* in US Dollars at PPP
Niger	200	920
Costa Rica	2640	6410
Brazil	4720	6240
Austria	27980	21980
Denmark	32500	22740

[Source: World Bank/OUP, *The World Development Report*, 1998/99, Table 1, page 190]

Table 2 Growth Rates and Income Distribution, selected countries 1996/97

Country	Average Annual Growth Rate, GNP 1997	Average Annual Growth Rate, GNP *per capita* 1997	Percentage share of income: poorest 20 %	Percentage share of income: richest 20 %
Niger	3.6	0.1	7.5	44.1
Costa Rica	2.6	0.7	8.8	51.8
Brazil	2.4	1.1	5.7	64.2
Austria	2.1	1.9	10.4	33.3
Denmark	3.4	3.1	14.9	34.5

[Source: World Bank/OUP, *The World Development Report*, 1998/99, Table 1 and Table 5, pages 190 and 198]

(a) Define the following measurements used in Table 1.

(i) GNP *per capita* *[2 marks]*

(ii) purchasing power parity exchange rates *[3 marks]*

(b) Using the data in Table 1, explain

(i) the difference between the two columns of measurements of GNP *per capita*. *[2 marks]*

(ii) what factors might account for these differences. *[6 marks]*

(c) Using the data shown in the first two columns of Table 2, account for the differences in annual growth rates of the selected countries. *[5 marks]*

(d) From your own knowledge of economic theory and the data in Table 2, discuss the influence of income distribution on rates of growth and development. *[7 marks]*

SECTION B

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

Question 3

(a) What are positive externalities and how do they arise? Illustrate your answer with examples. *[10 marks]*

(b) To what extent should governments attempt to influence markets where positive externalities exist? *[15 marks]*

Question 4

(a) Explain the factors which influence price elasticity of supply. Illustrate your answer with reference to the market for a commodity or raw material. *[13 marks]*

(b) Discuss the importance of price elasticity of supply and price elasticity of demand for producers of primary commodities in less developed countries. *[12 marks]*

Question 5

(a) What macroeconomic polices would a government adopt if it wished to reduce aggregate demand in an economy? *[12 marks]*

(b) Should a government attempt to manage the level of aggregate demand to influence unemployment and inflation rates? *[13 marks]*

Question 6

(a) Why do countries practise protectionism? *[12 marks]*

(b) Discuss the likely problems associated with such a policy. *[13 marks]*