

**ECONOMICS
STANDARD LEVEL
PAPER 2**

Wednesday 7 May 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.

Question 1

Read the following article and answer the questions which follow.

Falling world coffee prices create winners and losers

- ❶ Two years ago, coffee beans traded at almost \$2 US a kilogram, but today traders are buying at less than \$1 US per kilo – and prices are still falling.
- ❷ Price data cannot present the scale of the human tragedy unfolding across the developing world. An estimated 20 million households depend on income from coffee to pay for food, clothing and education. The livelihoods of these households are collapsing, with devastating consequences for poverty and the environment.
- ❸ In the Mexican state of Chiapas, thousands of indigenous farmers are migrating to find work picking fruit. And women farmers in the Dominican Republic report that they are unable to meet the cost of treating childhood sickness.
- ❹ The collapse of the coffee economy threatens whole environmental and agricultural systems. No other crop is so well suited for cultivation on the steep hillside of Chiapas and Kilimanjaro, where its deep roots bind the soil and prevent erosion. In both areas local communities have developed complex inter-cropping systems, where coffee is grown as a **cash crop** along with **food crops** such as maize, bananas and beans. Take away coffee, and the entire system collapses.
- ❺ **Not everyone involved in the coffee trade is losing out**, however; for the **transnational companies** that dominate the global coffee economy, the slump in coffee prices is generating windfall gains. Starbucks, the American coffee-shop chain, posted a 40 % increase in profits, while Nestlé, the world's largest coffee roaster, had profits exceeding \$1 billion last year.
- ❻ The underlying problem is simple. World production of coffee is increasing twice as fast as consumption, leaving massive oversupply and accumulation of stocks. Rising productivity and the emergence of East Asia as a major exporter have compounded the problem.
- ❼ Coffee exporting countries have not helped their own cause. Instead of working together to restrict supply and boost prices, they have attempted to compensate for falling prices by exporting more. **The result: they collectively export more for less revenue.**

[Source: Adapted from an article and letter published in the *Guardian Weekly*, 31 May and 21 June, 2001]

- (a) (i) Explain the difference between a cash crop and a food crop (paragraph 4). *[2 marks]*
- (ii) Define the term transnational company (paragraph 5). *[2 marks]*
- (b) Use a supply and demand diagram to explain the main reason behind the collapse in coffee prices on world markets. *[4 marks]*
- (c) “The result: they collectively export more for less revenue” (paragraph 7).
- (i) State what this tells us about the elasticity of demand for coffee beans. *[1 mark]*
- (ii) Use a supply and demand diagram to explain how more is exported but less revenue is earned. *[3 marks]*
- (d) (i) “Not everyone involved in the coffee trade is losing out” (paragraph 5). Explain why this is the case. *[3 marks]*
- (ii) Explain **one** possible way in which coffee producers could protect themselves against falling prices. *[3 marks]*
- (e) Discuss the development problems associated with free trade and globalization which are raised in this extract. *[7 marks]*

Question 2

Study the following items and answer the questions which follow.

Item 1 – Fighting the Slowdown in Chile

A reduction in inflationary pressures because of slow growth of international demand, and a deceleration of the world economy, has allowed the Central Bank of Chile to cut interest rates to their lowest level for 14 years. The low interest rates have in turn contributed towards the peso (the Chilean currency) hitting a record low; and the depreciating peso is raising import prices.

The Chilean government would like to see foreign trade add to growth, and is planning to eliminate its remaining controls on capital flows to stop the decline in foreign direct investment, and to provide funds for businesses.

A **bilateral free trade agreement** with the USA will help in the long run, but Chile’s economy could use a boost now, which may leave **expansionary monetary policy** as the main instrument available.

[Source: Adapted from *Business Week*]

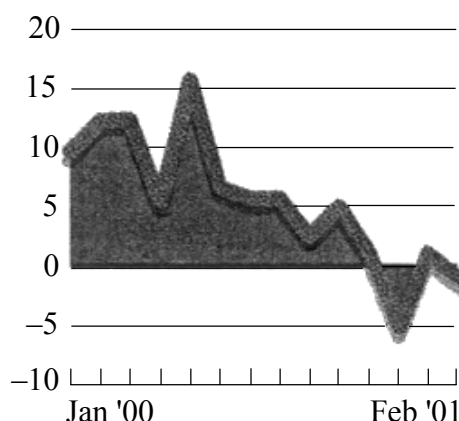
Item 2

Chile’s Real GDP and Current Account Balance

Real GDP (annual % change)			Current Account Balance (% of GDP)		
2000	2001	2002	2000	2001	2002
5.4	4.0	3.3	- 1.4	- 2.2	- 2.6

Item 3

**Chilean Industrial Output
(percentage change from a year ago)**



[Source: Standard & Poor’s DRI]

- (a) With reference to Item 1, explain the following terms which are in bold in the passage.
- (i) bilateral free trade agreement *[2 marks]*
 - (ii) expansionary monetary policy *[2 marks]*
- (b) Explain how low interest rates may have “contributed towards the peso hitting a record low” (Item 1, Paragraph 1). *[4 marks]*
- (c) (i) With reference to Item 2, briefly describe what has happened to the current account balance since 2000. *[2 marks]*
- (ii) Using any of the data provided, give **one** possible reason for this change. *[2 marks]*
- (d) Using Items 2 and 3,
- (i) describe the possible relationship between GDP and industrial output. *[2 marks]*
 - (ii) explain this relationship. *[4 marks]*
- (e) Use the data and your knowledge of economics to assess the likely impact on the Chilean economy of the government’s plans to “eliminate its remaining controls on capital flows”. *[7 marks]*

SECTION B

Answer **one** question from this section.

Question 3

- (a) Describe **three** strategies which governments may use to increase their economic growth rates. *[12 marks]*
- (b) Should increasing the rate of economic growth be the major policy objective of governments? *[13 marks]*

Question 4

Evaluate the view that the market should have no role whatsoever in the provision of health care and education. *[25 marks]*

Question 5

- (a) Explain why a country's balance of payments on current account may at times be in deficit and at other times be in surplus. *[12 marks]*
- (b) To what extent does the existence of a current account deficit represent an economic problem? *[13 marks]*

Question 6

- (a) Outline the different types of foreign aid. *[10 marks]*
 - (b) Discuss the view that foreign aid benefits the donor more than the recipient. *[15 marks]*
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