



**ECONOMICS
STANDARD LEVEL
PAPER 2**

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 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

- ① 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.
- ② 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.
- ③ 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.
- ④ 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.
- ⑤ 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.”
- ⑥ 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.
- ⑦ 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.

Indonesian central bank raises interest rates to slow down inflation

- ❶ On Tuesday, Indonesia’s central bank tightened **monetary policy** for the third time in five weeks, raising the country’s base interest rate to 11.0% as it struggles to keep control of inflation. The inflation rate is predicted to rise after a huge increase in fuel prices last month. The Bank of Indonesia Governor told reporters that the aim of the interest rate increase “is to cool down the temperature of the economy”. He indicated that further interest rate rises are possible.
- ❷ Since it was introduced on 5 July, the Indonesian base interest rate has been raised four times to follow the increase in the US Federal Reserve’s rate, to stop the continued fall in the value of the Indonesian currency, the rupiah.
- ❸ The State Minister for National Development Planning warned that inflation may grow to 12% from 9.06% year-on-year in September, the highest level in 33 months. As well as the fuel price rise, the **depreciation** of the rupiah against the US dollar has added to inflationary pressures.
- ❹ Prices of consumer goods and basic commodities have risen uncontrollably since the increase in fuel prices. Producers and dealers of motor vehicles, electronics and food have raised prices by significant amounts.
- ❺ Food prices and transportation fares are very likely to double before the Muslim fasting month that begins Wednesday this week.
- ❻ “I think that the central bank is being responsible, especially when it looks like the inflation rate is about to rise,” said a vice president of regional economics at CIMB-GK Research. He said “inflation could rise to 15% in October from a year ago. However, the interest rate increase will slow down economic growth. Now the best-case scenario is around 5% growth over the next 12 months.”

[Source: adapted from *The People’s Daily*, 4 October 2005]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) monetary policy (*paragraph 1*) *[2 marks]*
 - (ii) depreciation (*paragraph 3*). *[2 marks]*
- (b) Using an appropriate diagram, explain how Indonesia’s monetary policy on interest rates will prevent “the continued fall in the value of the Indonesian currency” (*paragraph 2*). *[4 marks]*
- (c) Using an appropriate diagram, explain how “the depreciation of the rupiah against the US dollar has added to inflationary pressures” (*paragraph 3*). *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the likely effects of higher interest rates on the Indonesian economy. *[8 marks]*

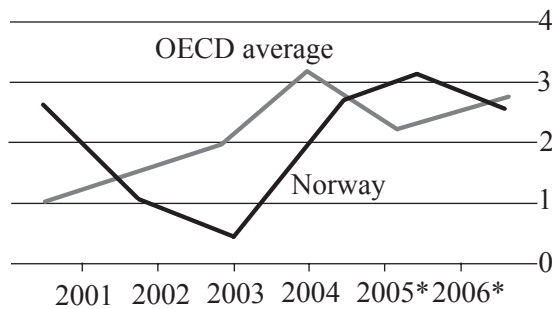
4. Study the extract and data below and answer the questions that follow.

Norwegian economy

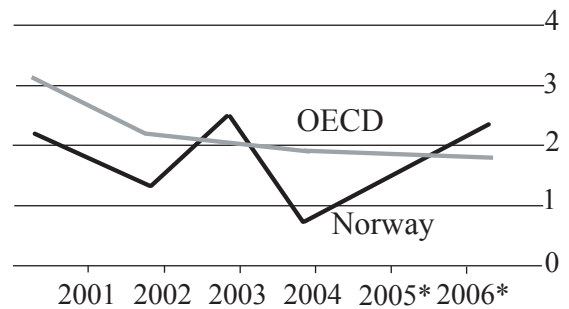
After a recent fall in growth, Norway is making a healthy recovery as the oil-rich economy prospers from rising oil prices. However, inflation is predicted to rise and the country still faces long-term **fiscal policy** problems as an aging population increases health and pension costs. Although the official **unemployment rate** is low, this may be misleading, as many Norwegians are on sick leave, are drawing disability pensions or have retired early. According to OECD* analysts, Norway's fiscal problems are worsened by the social security benefits that reduce incentives to work.

* 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.

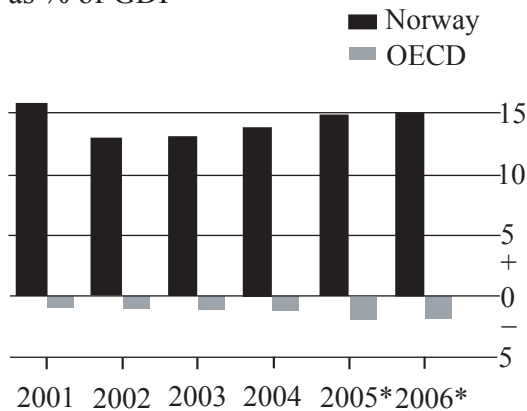
GDP
% change on a year earlier



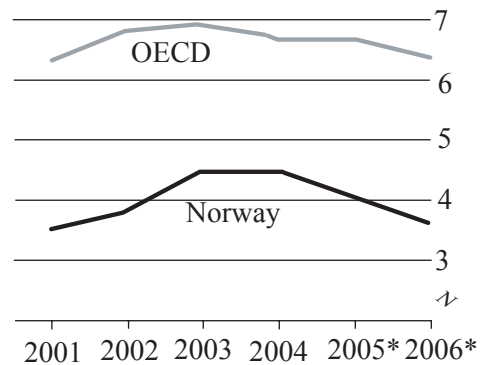
Consumer prices†
% increase on a year earlier



Current account balance
as % of GDP



Unemployment
as % of labour force



* Forecast † Private consumption deflator

[Source: adapted from *The Economist*, 20 August 2005]

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(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) **fiscal policy** *[2 marks]*
 - (ii) **unemployment rate.** *[2 marks]*
- (b) With reference to oil prices, explain the likely reason for the size of Norway's current account balance, compared with the OECD average. *[4 marks]*
- (c) Using an appropriate diagram, explain the possible relationship that may exist between the change in the current account balance and the change in GDP between 2003 and 2004 in Norway. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate policies that might be undertaken by the Norwegian government to increase the incentives to work, thus helping to solve "Norway's fiscal problems". *[8 marks]*

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

Deflating the case for bicycle tariffs

- ❶ Two Canadian bicycle manufacturers, Raleigh and Groupe Procycle, have started a campaign to increase tariffs on the import of foreign bicycles. As a result, the Canadian International Trade Tribunal (CITT) recommended last month that the federal government impose an “emergency” 30 per cent tariff on the import of foreign bicycles, to prevent the death of what is left of Canada’s bicycle manufacturing industry.
- ❷ The two factories, where the bicycles are built, are located in the Canadian province of Quebec and provide **wages** for approximately 600 workers. With an election in the near future, the federal government is keen to try to maintain popular support in the region. So there is considerable political pressure on the government to increase the tariff.
- ❸ The Canadian bicycle manufacturing industry is really an assembly industry – the parts are shipped in from China and elsewhere. The industry is already heavily protected by tariffs and **anti-dumping** measures. Nonetheless, Raleigh and Procycle can’t compete against the Chinese. In the past four years, the Canadian-made share of the domestic bicycle market has declined from 58 per cent to 30 per cent. The Chinese (and the Thais, Filipinos and Vietnamese) are now dominating the market.
- ❹ If the government were to increase the tariff, then the price of imported low-priced bicycles would increase sharply. Yet this is at the very time that governments are encouraging bicycle use as a cheap, healthy and environmentally friendly alternative to cars.
- ❺ There is also a concern that other Canadian manufacturers, who are also seeking more tariff protection, would demand the same protection as bicycle manufacturers.
- ❻ In addition, the Chinese may wonder about a country that claims it wants to expand trade with China, and then raises tariffs on one of China’s major exports.
- ❼ Senior government officials have been ordered to find alternatives, such as retraining for workers, which would help the domestic industry without penalizing imports.
- ❽ Interestingly, Canadian firms are respected internationally as designers and manufacturers of high-priced performance bicycles. The manufacturers of these “high-end” bicycles are not demanding increased tariff protection. Perhaps the message should be that successful firms don’t need tariffs and unsuccessful ones don’t deserve them.

[Source: adapted from John Ibbitson, *The Globe and Mail*, 4 October 2005]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) wages (*paragraph 2*) *[2 marks]*
 - (ii) anti-dumping (*paragraph 3*). *[2 marks]*
- (b) With the help of an appropriate diagram, show how the proposed tariff would affect the price and level of bicycle imports. *[4 marks]*
- (c) Describe the nature of the cross elasticity of demand between cars and bicycles suggested in paragraph 4. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the use of protectionism in the Canadian bicycle industry. *[8 marks]*
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