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**ECONOMICS
STANDARD LEVEL
PAPER 2**

Monday 9 November 2009 (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 extracts below and answer the questions that follow.

Rising grain prices are felt throughout the world

Text 1

The European Union (EU) agrees on a plan to increase wheat production

EU agriculture ministers approved plans to increase production of wheat and other grains across the 27-nation union in response to growing shortages on the world **market**. The decision means European grain farmers can ignore a 1992 EU set-aside policy that prevents the European nations from planting on 10% of their total land. The set-aside policy was designed to prevent overproduction and preserve the natural habitats of wildlife.

EU officials said the increase in land use is needed urgently to address the problems caused by poor harvests in Europe, Australia and elsewhere this year. Droughts combined with existing restrictions on how many crops could be grown have led to unstable market prices. Consumers around the world have seen prices rise sharply for bread, pasta and meat products in recent weeks because of the increased cost of wheat and other grains.

The removal of the set-aside policy has been welcomed. As the world's population increases, so too does the demand for food. Producers should be allowed to meet demand without being stopped by governments. The set-aside policy has favoured inefficient and underproductive producers at the expense of efficient and productive producers. Market forces should be allowed to prevail.

[Source: adapted from *Associate Press in Business week*, Constant Brand, 26 September 2007 and telegraph.co.uk, 27 September 2007]

Text 2

Bakers in Israel demand the removal of price ceilings

Following the sharp increase in flour prices this year, due to the international shortages of wheat, bakeries across Israel are threatening to stop the supply of bread to consumers unless the government removes the ceiling price on bread.

[Source: adapted from *Israel Money*, Navit Zomer, 20 September 2007]

Text 3

A call for the reduction of tariffs in Swaziland

An increase in the price of bread is certain in response to the rising price of wheat. Wheat suppliers said they would be increasing the price of wheat by 35% as a result of the world shortage of wheat. The Bakers Association Chairman of Swaziland said "one way of handling the problem would be to reduce the existing 8.5% tariff on wheat". While this would certainly help consumers, domestic producers would face increased competition from imports. As well, government spending on infrastructure, which is part of **fiscal policy**, could be threatened.

[Source: adapted from *The Swazi Observer*, 20 September 2007]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) market (*Text 1*) *[2 marks]*
 - (ii) fiscal policy (*Text 3*). *[2 marks]*
- (b) Using an appropriate diagram, explain why bakeries across Israel want the ceiling price on bread removed (*Text 2*). *[4 marks]*
- (c) Using a tariff diagram, explain why a reduction in the tariff on wheat in Swaziland “would certainly help consumers” (*Text 3*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the removal of the set-aside policy in the European Union and the reduction of tariffs in Swaziland as responses to the shortage of wheat. *[8 marks]*

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

Chinese inflation hits 6.5 %, the highest rate in nearly 11 years

- ❶ Rapidly rising food prices caused the Chinese **inflation** rate to rise to its highest point in nearly 11 years. Consumer prices rose 6.5 % in August from a year earlier. The central bank and economists fear that rising prices for food, particularly pork, will lead to higher prices throughout the economy.
- ❷ The Chinese statistics office said inflation had been driven by an 18.2% increase in the cost of food, which accounts for a third of the consumer price basket of goods and services. Meat prices rose 49% in August from a year earlier reflecting the shortage of pork, the staple meat in China. This was caused by a 10% drop in the Chinese pig population because of blue-ear disease and rapidly rising feed grain costs.
- ❸ While most economists accept that the central bank can do little about supply-side shocks like a shortage of pigs, many economists say that the central bank may need to raise borrowing costs again to limit inflation and reduce growth. Inflation has now exceeded the central bank's annual target of 3% for four consecutive months. To prevent excessive growth in real GDP, the central bank has already raised **interest rates** four times this year.
- ❹ There is also concern that the trade and current account surpluses are creating more inflationary pressure. The surpluses may be the result of the low value of the yuan against foreign currencies. The World Bank advises that, "policy measures should continue to focus on reducing the current account surplus while also paying attention to overall demand growth. Encouraging imports or reducing exports would achieve this, and both can be achieved with a stronger exchange rate".
- ❺ The rising cost of everyday goods has people complaining and this worries the leaders of China. Inflation was one factor in the unrest that led to the 1989 Tiananmen Square protests, which were crushed by troops. However, people may be equally upset now if interest rates are raised again in order to reduce the inflationary pressures.

[Source: adapted from *International Herald Tribune*, *Bloomberg News*, *Reuters*, 11 September 2007 and *Sydney Morning Herald*, John Garnaut, *Asia Economics Corresponding in Beijing*, 13 September 2007]

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(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) inflation (*paragraph 1*) *[2 marks]*
 - (ii) interest rates (*paragraph 3*). *[2 marks]*
- (b) Using an appropriate diagram, explain the impact of blue-ear disease on the market for pigs in China (*paragraph 2*). *[4 marks]*
- (c) Using an appropriate diagram, explain how the “low value of the yuan” may create inflationary pressure (*paragraph 4*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the likely consequences of China’s policy of raising interest rates to “prevent excessive growth in real GDP” (*paragraph 3*). *[8 marks]*

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

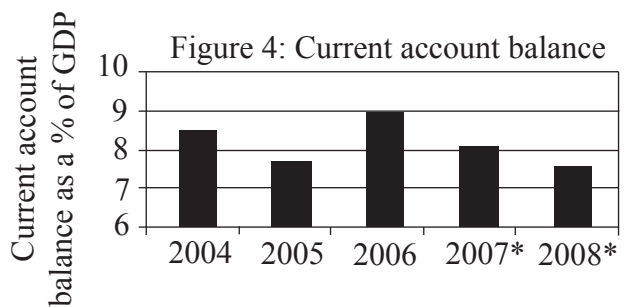
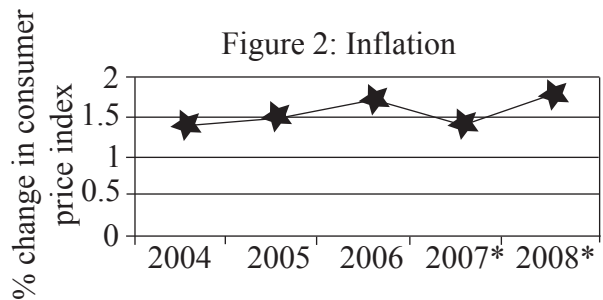
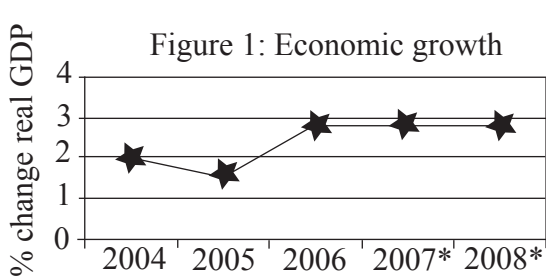
The Dutch economy

Table 1

Expenditure by sector	Current prices 2003 (€ billion)
Consumption	238
Government spending	117
Investment	93
Exports of goods and services	300
Imports of goods and services	270

Text A

The economy grew well in 2006. Economic growth was almost 3%. Exports benefited from faster demand in the Euro area, but export growth may slow down as a result of the strength of the Euro. Consumption was increased by higher real wages and a decrease in unemployment. If economic growth is higher than expected, it will result in an inflationary gap and the risk of an overheating economy. If this happens a tighter fiscal policy should be put in place to reduce demand pressures. As well, the government needs to implement policies to increase labour market participation and the number of hours worked.



[Source: adapted from *The OECD Economic Outlook 81 Database*, June 2007]

* Forecast values

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(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) consumption (*Table 1*) *[2 marks]*
 - (ii) unemployment rate (*Figure 3*). *[2 marks]*
- (b) Using the data in Table 1, calculate the value of GDP. Explain your calculation. *[4 marks]*
- (c) Identify **one** positive statement and **one** normative statement from Text A. Explain your reasoning. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the role of demand-side policies and supply-side policies in maintaining the growth of the Dutch economy. *[8 marks]*

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

Uranium mining creates controversy

- ❶ Malawi will soon have its first modern mining project if plans by the Australian multinational company Paladin are successful. The Malawi government granted the company a 15-year licence, with the possibility to extend the licence for another 10 years. Paladin will get a corporation tax reduction from 30% to 27.5% and will also not have to pay a 10% resource rental tax.
- ❷ The mining company has promised that the project will generate an annual income of over US\$100 million, about 5% of Malawi's annual **gross domestic product** (GDP). The project promises to create jobs for 800 people during the construction phase and 280 people during the operational phase. It also promises to indirectly support more than 1000 additional jobs, build a primary school, a secondary school, and a health facility near the project area.
- ❸ However, there have been fears from the public that the mining poses serious health dangers. A group of six **NGOs** in Malawi claimed that the company has not complied with international uranium mining standards. They say that uranium is radioactive and that with open-pit mining, the soil may drain into the rivers, contaminate the water, and cause fatal diseases.
- ❹ Malawi is one of the poorest countries in the world. The vast majority of the population of 12 million live in rural communities, with only 16% living in urban areas. This, coupled with rapid population growth and soil erosion due to deforestation, is applying severe pressure on the agricultural sector, which accounts for more than 90% of Malawi's export earnings and 45% of GDP.
- ❺ An estimated 57% of the rural population have access to safe water in comparison to 90% of the urban population. Access to sanitation is considerably lower with only 15% to 30% of the rural population having access to a latrine (toilet).
- ❻ As a result, water-related diseases, including cholera and typhoid, are common; a problem made worse by the rapid spread of HIV/AIDS which has affected 15% of the rural population and 30% of those in urban areas. Almost half of the population is under 15 years old.

[Source: adapted from *allAfrica.com Inter Press Service* and *Malawi at a Glance Engineers Without Borders Canada*, 17 July 2007]

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(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) gross domestic product (*paragraph 2*) *[2 marks]*
 - (ii) NGOs (*paragraph 3*). *[2 marks]*
- (b) Using a poverty cycle diagram, explain **one** of Malawi's obstacles to development. *[4 marks]*
- (c) Using an appropriate diagram, explain why the activities of the mining company might create negative externalities. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the possible effects of the mining project on economic development in Malawi. *[8 marks]*

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

Growers hurt by the low price of tea

- ❶ The world produces so much tea that British people are paying far less for their favourite drink than they did 30 years ago.
- ❷ Global overproduction, supermarket price wars and a weak dollar mean that the price is less than a penny a cup. The **real price** of a cup of tea is actually a quarter of what it was in 1977, industry research has revealed.
- ❸ The figures are good news for the world’s second-biggest *per capita* tea-drinking nation, but bad news for the 36 tea-growing countries, which last year produced 3.5 million tonnes of tea, of which 160 000 tonnes were shipped to Britain.
- ❹ Tea is grown in some of the poorest countries in the world and is often a primary source of income; for Uganda, for example, it is the third-largest export earner. For many growers and pickers it is their only source of income.
- ❺ A tea consultant said: “continuing low prices and deteriorating terms of trade mean that planned investment in infrastructure has to be postponed or cancelled and this is likely to result in a less than expected rate of economic growth. This impacts on the individual small farmers and puts more pressure on their day-to-day existence”.
- ❻ British tea importers argue that many countries, led by Bangladesh and Vietnam, are planting and growing far more tea bushes than the world needs, under pressure from poor local farmers desperate to make a living.
- ❼ The chairman of the UK Tea Council, said: “there is too much being grown in some countries, and producers need to balance **supply** with demand”.
- ❽ Some in the industry believe that Britain is not paying enough for the 165 million cups it drinks every day, and that a slightly higher price would benefit farmers without hurting consumers.
- ❾ Cafédirect, Britain’s largest ethical tea and coffee wholesaler (distributor) which deals only in fair trade products, said: “we are the only major brand to guarantee a minimum price for tea, and this year announced an increase of 8 %”.

[Source: adapted from *The Times*, 25 July 2007]

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(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) real price (*paragraph 2*) *[2 marks]*
 - (ii) supply (*paragraph 7*). *[2 marks]*
- (b) Using an appropriate diagram, explain the main reason for the change in the real price of tea since 1977 (*paragraph 2*). *[4 marks]*
- (c) Using a production possibility curve (PPC) diagram, explain why the reduced levels of planned investment are likely to result in a less than expected rate of economic growth (*paragraph 5*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate **two** possible measures which might be used to improve the standard of living of tea farmers. *[8 marks]*
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