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**ECONOMICS
STANDARD LEVEL
PAPER 2**

Tuesday 15 November 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 and data below and answer the questions that follow.

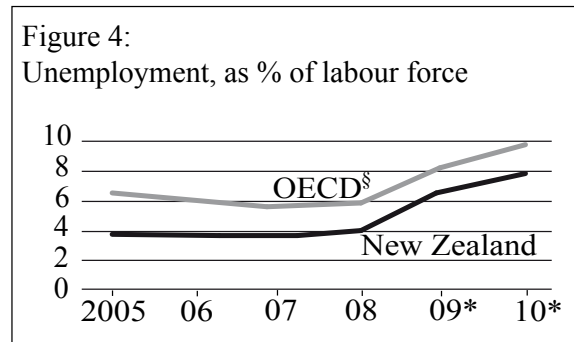
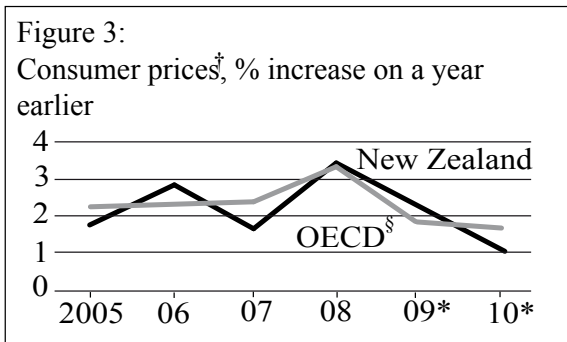
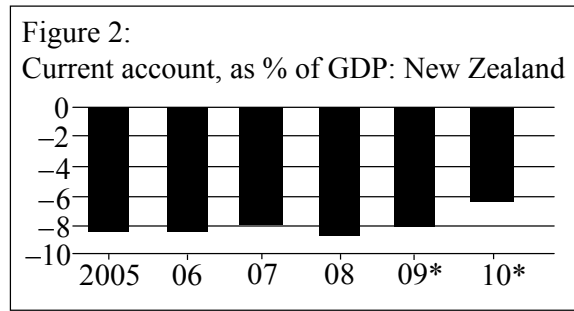
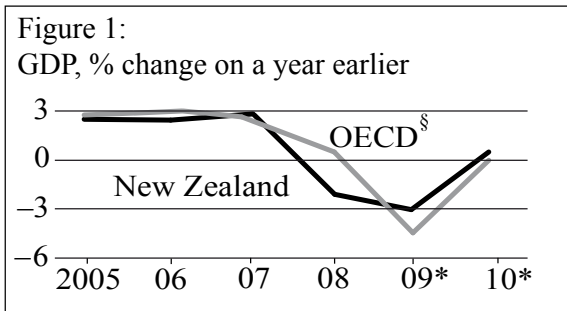
New Zealand's economy

- ❶ In April 2009, New Zealand reduced its interest rates to 2.5 %.
- ❷ The central bank governor said developments point to lower inflation than previously projected. The main factors behind this are weaker global **economic growth** and a stronger **exchange rate** than expected.
- ❸ The world economy deteriorated more than expected in the first quarter of 2009 and the New Zealand economy remains weak. In addition, business sentiment is low, investment has fallen and unemployment has increased.
- ❹ We expect the large decline in the official interest rate over the past year together with the fiscal stimulus to support the New Zealand economy. However, it is likely to be some time before economic activity returns to healthy levels.

[Source: adapted from <http://www.rbnz.govt.nz/news/2009/3621204.html>, 31 May 2011]

(This question continues on the following page)

(Question 1 continued)



Key:

* Forecast

† Private consumption deflator

§ 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.

[Source: adapted from http://www.economist.com/markets/indicators/displaystory.cfm?story_id=13496338, 18 April 2009]

© The Economist Newspaper Limited, London (16 April 2009)

- (a) Define the following terms indicated in bold in the text:
- (i) economic growth (*paragraph 2*) [2 marks]
 - (ii) exchange rate (*paragraph 2*). [2 marks]
- (b) Using an appropriate diagram, explain the type of unemployment that a “weak” economy and reduced investment are expected to create (*paragraph 3*). [4 marks]
- (c) Using an appropriate diagram, explain how a stronger than expected exchange rate might affect aggregate demand in New Zealand (*paragraph 2*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the likely effects of “the large decline in the official interest rate” together with the fiscal stimulus on the New Zealand economy (*paragraph 4*). [8 marks]

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

Toxic dump near Asopos River investigated

- ① An Athens prosecutor has ordered an investigation into allegations that an illegal dump near the industrial zone in Viotia, is being used by a number of manufacturing firms to dispose of toxic waste, severely contaminating nearby Asopos River.
- ② Researchers from Athens University have confirmed that river water has a concentration of 148 micrograms (mcg) of depleted chromium per kilogram (kg), and that local water is not suitable for irrigation or drinking.
- ③ High traces of toxins in river water have contaminated agricultural produce on sale in the shops and street markets of the area. Tests on carrots, for example, revealed concentrations of 663 mcg of nickel per kg, nearly six times higher than the international maximum level. Local residents also claim the **negative externalities** these manufacturers have imposed have caused an increase in cancer-related deaths.
- ④ The European Environment Commissioner has criticized the government for failing to introduce necessary policies to deal with the problems caused by the toxins in the river. The government responded by announcing that **indirect taxes**, direct regulation and new legislation are being considered to solve the problem. Indirect taxes could force polluting manufacturers to take all costs into consideration, but estimating the size of the necessary tax is complicated. A proposal that the government issues pollution permits allowing firms to trade them to achieve the optimal level of pollution has many theoretical advantages. However, these may be administratively complicated as there are many firms involved and they are small in size.

[Source: adapted from <http://www.ekathimerini.com>, 17 February 2009 and 7 March 2009]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) negative externalities (*paragraph 3*) [2 marks]
 - (ii) indirect taxes (*paragraph 4*). [2 marks]
- (b) Using an appropriate diagram, explain why illegal dumping of toxic waste by these manufacturing firms is an example of a market failure (*paragraph 1*). [4 marks]
- (c) Using an appropriate diagram, explain the expected effect on the local carrot market resulting from the contamination of the river (*paragraph 3*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the solutions that the government could employ to reduce the negative externalities caused by river pollution in Viotia. [8 marks]

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

As trade slows, China rethinks its growth strategy

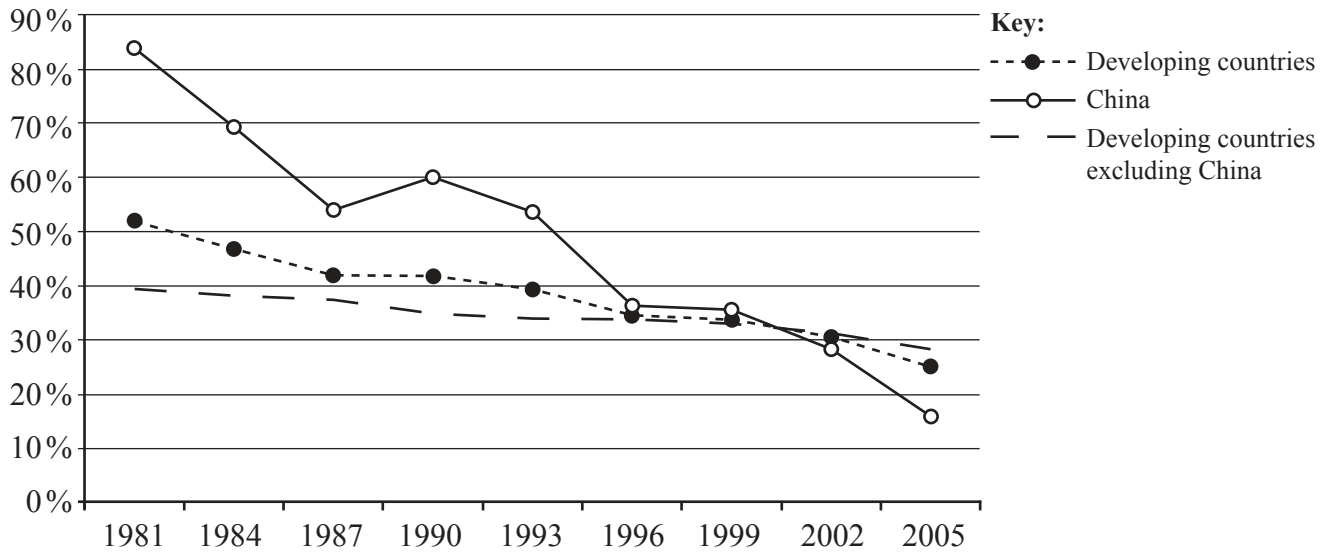
- ❶ Ships are leaving Chinese ports half empty. In the Guangdong province, many factories are shutting down without paying employees.
- ❷ This is the effect of millions of Americans cutting down on their spending. Chinese exports decreased by 9.6% in one month. A drastic decrease in export revenues is a major problem in a country that has relied for many years on exports to pursue its growth and **economic development** goals.
- ❸ For the Chinese economy to rely more on domestic demand instead of export demand is not easy. Chinese families are forced to save a lot and do not spend much on consumer goods and services. They need to save a lot to be able to meet any medical emergencies and to help them in retirement as the government does not currently provide the general population with health care insurance and pensions.
- ❹ To prevent a further increase in unemployment the Chinese government is forced to help increase the exports of low-skill, labour-intensive industries such as textiles. “China will resort to export **subsidies** to help the export of labour-intensive industries,” the minister of industry and information technology said. Increased subsidies by China have the potential to create trade difficulties with the United States (US), particularly regarding textiles, only weeks before American quotas on the import of Chinese clothing are about to expire.

[Source: adapted from “As trade slows China rethinks its growth strategy”, *New York Times*, 1 January 2009]

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(Question 3 continued)

Figure 1: Percentage of population living in households with consumption or income per person below the absolute poverty line (US\$1.25 per day in 2005 purchasing power parity (PPP))



[Source: The World Bank]

Figure 2: China: Human Development Index (HDI) selected years 1975–2007

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- (a) Define the following terms indicated in bold in the text:
 - (i) economic development (*paragraph 2*) [2 marks]
 - (ii) subsidies (*paragraph 4*). [2 marks]
- (b) Using an appropriate diagram, explain the effect on America’s clothing market resulting from removing quotas on Chinese clothing (*paragraph 4*). [4 marks]
- (c) Using an appropriate diagram, explain the effect on China’s aggregate demand of a decision by the Chinese government to provide the general population with health care insurance and pensions (*paragraph 3*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate China’s export-oriented growth and development strategy. [8 marks]

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

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(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) unemployment rate (*paragraph 4*) [2 marks]
 - (ii) inflation (*paragraph 5*). [2 marks]
- (b) Using an appropriate diagram, explain the effect of a rise in indirect taxes on the market for petrol (gasoline) (*paragraph 1*). [4 marks]
- (c) Using an appropriate diagram, explain why higher wage costs, “could endanger the country’s economic gains” (*paragraph 5*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the policies the government might use to reduce income inequality in South Africa. [8 marks]

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

Nigeria's oil economy

- ❶ Nigeria is dependent on oil for more than 90% of its exports and foreign exchange, with more than 80% of the government's revenues coming from the oil sector. The Nigerian economy is highly dependent on imports for both consumption and production.
- ❷ While Nigeria has exported billions of dollars worth of oil, poverty has worsened. The Niger Delta, where oil is concentrated, lacks basic services including clean water, electricity, health care clinics and schools. In addition, the oil companies are responsible for environmental pollution due to gas firing, oil spills, and groundwater contamination. The oil industry employs 35 000 Nigerians, of a total population of 149 million, and could at most add 5000 new jobs per year. With an annual population growth of 2.4%, there is a need for three million new jobs each year.
- ❸ The global recession that began in 2008 led to a decrease in the price of oil. The **terms of trade** have been also affected by a large **depreciation** of the naira (the Nigerian currency), which was made even greater by currency speculation.
- ❹ Given the economy's high dependence on imports, deteriorating terms of trade will have serious consequences for consumption and production. As oil prices fall, the government will see the need to diversify into non-oil areas of production. Nigeria should invest in social services, roads and transportation, and should diversify into a broader range of petrochemicals¹. It should also diversify into agriculture and agro-industry².
- ❺ One of the ironies of reliance on oil has been that whereas Nigeria has large areas of fertile farmland, it is a major importer of food staples, such as rice, wheat, sugar, and powdered milk. If Nigeria were making better use of its agricultural potential, it could produce enough of these food products for its own needs, and could also become a net exporter. The government has taken a first step in this direction with its Commercial Agricultural Development Programme, intended to support small farmers, which is expected to increase agricultural output and create three million jobs in three years.

¹ petrochemicals: chemical products produced by the oil industry

² agro-industry: agriculture undertaken on an industrial scale

[Source: adapted from "In Nigeria, oil wealth delivers grief", *Yale Global*, 10 June 2008;
"Meltdown will strengthen economy, says don", *Vanguard*, 2 March 2009 and
"FG to create three million jobs in three years", *Vanguard*, 13 March 2009]

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(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) terms of trade (*paragraph 3*) *[2 marks]*
 - (ii) depreciation (*paragraph 3*). *[2 marks]*
- (b) Using an appropriate diagram, explain how “the global recession that began in 2008 led to a decrease in the price of oil” (*paragraph 3*). *[4 marks]*
- (c) Using an appropriate diagram, explain how currency speculation contributed to the depreciation of the naira (the Nigerian currency) (*paragraph 3*). *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the impact of a falling oil price on Nigeria’s economy. *[8 marks]*
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