



22125107



**ECONOMICS
HIGHER LEVEL
PAPER 3**

Wednesday 16 May 2012 (morning)

2 hours

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer three questions. Each question is worth *[20 marks]*.
- Use fully labelled diagrams and references to the text / data where appropriate.
- The maximum mark for this examination paper is *[60 marks]*.

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

EU court rules minimum price for cigarettes illegal

- ❶ The European Court of Justice has ruled that Ireland cannot impose a **minimum price** on cigarettes. It said that member countries would have to find other ways to combat smoking. This could be achieved by increasing indirect tax on tobacco, but imposing a minimum price would distort fair competition in the market. The ruling is designed to maintain the freedom of manufacturers and importers to benefit from lower costs and greater efficiency.
- ❷ The judgment said the aim of ensuring that tobacco prices are high can be “adequately” achieved by increasing tax, since any indirect tax rises are, sooner or later, reflected in an increased retail price, without removing the freedom of manufacturers to set prices.
- ❸ The Irish government had claimed that it needed to fix a high minimum price to discourage smoking. This followed government legislation to ban tobacco advertising and promotion in July 2009. According to a spokesperson from the anti-smoking group ASH (Action on Smoking and Health), this measure helped to prevent retail outlets from making young people feel attracted to buying cigarettes. “Close to 30% of our population still smoke and 7000 die from tobacco-related disease each year,” he said.
- ❹ It has been argued that increasing the price of cigarettes is one of the most effective ways of curbing harmful smoking and there is a need to make cigarettes less appealing, particularly to young people. The evidence is that banning advertising, introducing minimum pricing and increasing health warnings can all work.
- ❺ The head of a major retail organization has attacked the idea of minimum pricing for cigarettes. He argued that artificially fixing a minimum price would not be effective. Also, since the demand for tobacco is inelastic, raising the price would not work. Moreover, it was against the **free market** for a government to set prices for any product available to consumers, limiting their freedom to choose.

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) minimum price (*paragraph 1*) [2 marks]
 - (ii) free market (*paragraph 5*). [2 marks]
- (b) Using an appropriate diagram, explain the possible effect on the market for cigarettes of the ban on tobacco advertising in Ireland. [4 marks]
- (c) Using an appropriate diagram, explain why, if the demand for cigarettes is inelastic, raising the price may not be effective. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the economic effects of the imposition of a minimum price for cigarettes. [8 marks]

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

Content removed for copyright reasons.

(This question continues on the following page)

(Question 2 continued)

Content removed for copyright reasons.

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

A new age dawns for Greece

- ❶ In a proposed deal aimed at rescuing Greece from near bankruptcy, European Union (EU) and International Monetary Fund (IMF) loans of €120 billion should replace the need for Greece to borrow at extremely high interest rates. This would be the biggest rescue package for any EU country.
- ❷ In return, the Greek government has agreed to reduce its budget deficit from nearly 14% to 8.1% of gross domestic product (GDP) by imposing even steeper cuts in public sector wages, lower pensions and an additional 2% rise in VAT, the main **indirect tax**, to 23%. Other taxes are liable to rise. In one of the biggest changes of all, there will be a change in pensions policy. The average age of retirement in Greece is 53 and this could now move to 67.
- ❸ The change in circumstances in Greece has been rapid. Greece’s once booming economy was based on consumption. Joining the eurozone* in 2001 brought interest rates down, and people rushed to get cheap loans. Huge budget deficits and government debt have taken Greece into a deep crisis, shaking international markets and the euro. It ran up debts equal to 115% of GDP. In effect, it cannot easily borrow more money because investors fear that they may not be repaid. Analysts now think the country’s €240 billion economy is likely to contract in 2010 by more than last year’s 2%, as the spending cuts and rising unemployment take effect. The IMF said it expects Greece will take 10 years to overcome its financial crisis.
- ❹ Many economists warn that the medicine is so strong that it could kill the patient and push Greece into a deep economic depression. There have been demonstrations in the streets to protest at the measures. A spokesman for a trade union representing the interests of workers, said: “These measures are tough and unfair. They will lead workers into misery and the country deeper into recession”.

Economic indicators for 2009		
	Greece	eurozone
GDP growth	-1.96%	-4.09%
Inflation	1.35%	0.29%
Government net borrowing (% of GDP)	12.87%	6.28%
Current account balance (% of GDP)	-11.22%	-0.35%

* eurozone: the group of countries which use the euro as their common currency

[Source: Adapted from ‘Europe hopes Greek bailout will calm market’, The Independent, 3 May 2010; ‘Greece: A new age of austerity and anger dawns’, The Independent, 2 May 2010 <http://www.independent.co.uk/news/world/europe/greece-a-new-age-of-austerity-and-anger-dawns-1960388.html>; <http://www.economywatch.com/economic-statistics/country/Greece/year-2009/>, accessed 26 September 2011.]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) indirect tax (*paragraph 2*) *[2 marks]*
 - (ii) inflation (*table*). *[2 marks]*
- (b) Using an appropriate diagram, explain how an increase in VAT is likely to affect the market for consumer goods. *[4 marks]*
- (c) With the aid of an AD/AS diagram, explain the possible effect on the economic growth of Greece of the decision to reduce its budget deficit. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, evaluate the effects of the measures taken by the Greek government to address its debt problem. *[8 marks]*

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

Venezuela takes steps to end currency speculation

- ❶ Venezuela’s government has approved new legislation in order to curb speculation after its currency, the bolivar fuerte (VEF) fell further in the **informal market**. The reform would give the Central Bank of Venezuela (BCV) exclusive power to authorize the purchase and sale of foreign currencies.
- ❷ Venezuela has a two-tiered official **exchange rate** of VEF 4.3 per US\$, for most imports, and VEF 2.6 per US\$ for transactions identified as priorities such as food and medicine. However, in the informal market the bolivar fuerte is currently nearly twice as weak as the official rate, trading at VEF 8.5 per US\$.
- ❸ Venezuela’s economy contracted 3.3% in 2009, and fell into recession for the first time since 2003 after oil production and exports plunged. The economy will probably shrink for a second consecutive year in 2010. In Venezuela, monthly inflation has quickened to a seven-year high and the bolivar fuerte has reached a record low. Venezuelans turn to the informal market when they cannot get government approval to buy US dollars at the official rates of VEF 2.6 and 4.3 per US\$.
- ❹ The legislation is aimed at slowing the rapidly falling value of the bolivar fuerte against the US dollar in the informal market in hopes of curbing worsening inflation and reducing capital flight. “We cannot allow businessmen to take money out of the country and exchange it abroad for their own benefit,” said a congressman. The price of US dollars on the informal market heavily influences inflation. The BCV said consumer prices jumped 5.2% in April alone, driving the annual inflation rate to 30.4%.
- ❺ An economics professor said the law would not put an end to informal market trading and he warned that it could push inflation higher. “More and more control is going to make the situation worse,” he said.

[Source: Adapted from ‘Venezuela Takes Steps to “Smash” Currency Speculation’, by Kiraz Janicke in venezuelanalysis.com, 12 May 2010 <http://venezuelanalysis.com/news/5356>, and ‘Pro-Chavez lawmakers tighten currency controls’, Associated Press, 16 May 2010]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
 - (i) informal market (*paragraph 1*) [2 marks]
 - (ii) exchange rate (*paragraph 2*). [2 marks]
- (b) Explain why Venezuela operates a “two-tiered official exchange rate” (*paragraph 2*). [4 marks]
- (c) With the aid of an appropriate diagram, explain how the “rapidly falling value of the bolivar fuerte” (*paragraph 4*) is likely to influence inflation. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the policy of the Venezuelan government of maintaining a fixed exchange rate. [8 marks]

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

Reliance on unprocessed exports damages African development

- ❶ The poor performance of the textile industry in Africa is caused by its reliance on exports of raw cotton. “The heavy dependence on production and export of primary products and the weakness of regional markets are the two major causes of Africa’s high vulnerability to external shocks,” said an African economist.
- ❷ He said that the world economic crisis hit African economies badly, adding that export prices and earnings have fallen, resulting in declines in government revenue and national incomes as well as rising unemployment and poverty.
- ❸ The Kenyan Prime Minister has challenged African firms to focus on the African market before exporting the surplus in order to promote intra-African trade. He said the population in Africa offered a valuable market for local products but urged African nations to eliminate existing barriers to trade, such as tariffs and **quotas**, to allow trade between African nations. “It is a pity that we do not import African goods directly,” he said. “Instead, we export our goods to other continents and also purchase African goods from there, due to the high barriers to trade between African countries.”
- ❹ “African countries have generally purchased fabrics from Asia and designs from Europe and the United States. We must help change that to ensure that fabric, design and fashion (the entire value chain) stems directly from the African continent.” Africa currently produces 12% of the world’s cotton but 90% of this is sold to other countries for processing. The Prime Minister said that Africa, like some European and Asian countries, can use the textile industry to promote **economic development**.
- ❺ Opponents argue that the African economy has been very weak in recent years, discouraging trade between African nations. Moreover, political differences have led to the tariffs and quotas which restrict such trade. They have pointed out that Europe and the United States are wealthy, stable markets with demand for commodities increasing as the recession ends.

[Source: Used with permission from NewsTime Africa]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) quotas (*paragraph 3*) *[2 marks]*
 - (ii) economic development (*paragraph 4*). *[2 marks]*
- (b) Explain **one** reason why a dependence on exports of primary products may be considered a barrier to economic development. *[4 marks]*
- (c) With the aid of a diagram, explain how the reduction of tariffs is likely to affect the level of trade between African nations. *[4 marks]*
- (d) Using information from the text/data and your knowledge of economics, discuss the view that African countries should increase their focus on trade within Africa in order to increase economic development. *[8 marks]*
-