



22135113



**ECONOMICS
STANDARD LEVEL
PAPER 2**

Friday 3 May 2013 (morning)

1 hour 30 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is *[40 marks]*.

SECTION A

Answer **one** question from this section.

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

Boom or bust

- ❶ The freely floating Australian dollar has been appreciating, creating winners and losers. Australian tourists overseas are getting bargain hotel rooms while some local exporters are suffering huge falls in demand. The **appreciation** of the Australian dollar gives a good reason to foreign students not to study in Australia. But as the Australian dollar continues to gain strength it seems that the economy is coping with the appreciating currency better than many economists expected.
- ❷ Australia's exports are dominated by minerals, energy and agricultural products, and all are enjoying record prices. Continued strong demand means that the exporters of these products have not needed to look for other markets. For example, coal and iron ore prices have more than doubled in the last two years, these commodity prices rising even more quickly than the appreciating currency.
- ❸ The Australian dollar is only one factor affecting exporters, and at the moment the strong economic growth of the Asian economies is adding to the increasing demand for Australian commodities.
- ❹ However, not everyone in Australia is happy. Service industries have not enjoyed an increase in the price of their output, nor have they enjoyed booming foreign demand. The problems with the appreciating Australian dollar are most evident in the fact that fewer students and tourists are coming to Australia. Manufacturers have a similar problem and are suffering from the results of the rising Australian dollar and increased domestic interest rates.
- ❺ The higher Australian dollar has provided many indirect benefits. By making imported resources cheaper, it has reduced the inflationary pressures which were caused by the economic boom that gave consumers greater spending power. As a result, it allowed the Australian government to slow down the **interest rate** increases which it was imposing in order to tackle inflation.

[Source: adapted from The Age, 18 December 2010 'Boom or bust: the high dollar creates winners and losers.' By Clancy Yeates]

(This question continues on the following page)

(Question 1 continued)

- (a) (i) Define the term *appreciation* indicated in bold in the text (*paragraph 1*). [2 marks]
- (ii) Define the term *interest rate* indicated in bold in the text (*paragraph 5*). [2 marks]
- (b) Using an appropriate diagram, explain how the “increasing demand for Australian commodities” (*paragraph 3*) is likely to affect the value of the Australian dollar. [4 marks]
- (c) Using an AD/AS diagram, explain how the higher Australian dollar reduced inflationary pressure in the Australian economy (*paragraph 5*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the possible effects of the appreciating Australian dollar on the Australian economy. [8 marks]

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

Price of Chinese exports set to soar

- ❶ In December 2009, a Chinese trade official declared that China will continue to increase its share of world exports. While China's share of world trade fell in 2009 due to the world economic downturn, the share of other major exporters fell by even more. As a result China overtook Germany to become the world's largest exporter. Over the last 10 years China's exports grew by an average of 23%, more than twice as quickly as world trade. If this growth continues China could claim 25% of world trade by 2020.
- ❷ Chinese producers have become used to producing cheap goods and Chinese and overseas consumers have become used to buying these goods. The production of electronic toys and textiles in China is now suffering from increased production costs. Wages, raw materials and other manufacturing costs in China are rising, forcing up prices for producers and consumers.
- ❸ **Inflation** in China is also being affected by a huge increase in Chinese domestic demand as Chinese incomes increase. Chinese toy factories are being forced to give large wage increases to their workers who prefer to work in Japanese-owned electronics factories. Working conditions in a toy factory can be unpleasant and many workers leave resulting in labour shortages. It now takes longer to produce and deliver toys.
- ❹ These changes in the Chinese economy are beginning to have effects on other economies. Importers are warning of sharp price increases and stock shortages as Chinese factories struggle to meet demand. Prices have risen by 10% in the last eight months. Having built its reputation on low price manufactured goods, China now faces the problem of inflation and its effect on the export of these goods.
- ❺ China has also been criticized for maintaining a low and managed exchange rate to gain a competitive advantage and protect its domestic industry and employment and maintain a current account surplus. China's trading partners are becoming concerned and some are suggesting a need for protectionist measures in order to counteract the Chinese exchange rate policy.

[Source: Source: adapted from The Australian, 27–28 November 2010.]

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(Question 2 continued)

China's trade with the world					
	2006	2007	2008	2009	2010 (estimated)
Exports of goods and services (US\$ billion)	969.0	1220.5	1430.7	1201.7	1342.0
% change	27.2	26.0	17.2	-16.0	11.7
Imports of goods and services (US\$ billion)	791.5	956.1	1132.6	1005.6	1034.0
% change	19.9	20.8	18.5	-11.2	2.8
Current account balance (US\$ billion)	259.0	372.0	426.0	297.0	335.0

[Source: <http://www.uschina.org/statistics/tradetable.html>]

- (a) (i) Define the term ***inflation*** indicated in bold in the text (*paragraph 3*). [2 marks]
- (ii) List **three** components of the current account of the balance of payments. [2 marks]
- (b) Using an AD/AS diagram, explain how an increase in domestic wages might affect the output of the Chinese economy. [4 marks]
- (c) Explain how inflation in China might affect its current account balance. [4 marks]
- (d) Using information from the text/data and your own knowledge of economics, evaluate the possible effects on the Chinese economy of increased trade protection imposed by its trading partners. [8 marks]

SECTION B

Answer **one** question from this section.

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

Urban farms to feed Cuban cities

- ❶ The Cuban government has launched a project to surround its cities and towns with thousands of organic farms to make the growing of fruit, vegetables and the raising of livestock low cost and environmentally friendly.
- ❷ The government hopes this new approach to urban farming will make food cheaper and more abundant. It is also hoped that transport and fuel costs will be reduced and that urban dwellers will be encouraged to leave their city jobs and work in the farming sector. The farms are mostly privately-owned with some cooperatives, and more land has been leased to them. These private farmers and cooperatives own about 40% of Cuba's farmland and produce about 70% of food grown.
- ❸ In the past farmers had to purchase their subsidized resources from the government. However, they can now purchase their own seed, equipment and other materials directly from suppliers. They can choose what they want to grow. Farmers are also allowed to sell some of their produce to licensed government sellers or sell directly to consumers at roadside stands. Farmers can also vary the price of the products they sell. These changes allow for greater reliance on the price mechanism and for a more efficient **allocation of resources**.
- ❹ However, the Cuban government still plays a major role in production and support of the rest of the agricultural economy. It continues to hold a monopoly over essential foods such as rice, beans, pork and bananas by controlling the production, distribution and land use for these foods. Prices for these commodities are set by the government, which also provides **infrastructure**, schooling and overall direction to the economy. Nevertheless, poor planning and corruption continue to be obstacles to economic development.
- ❺ Not all urban farmers can see the long term benefits of this and are concerned about greater competition between producers and the possibility of rising input prices which may result if subsidies end. However, they are encouraged that the reforms allow them to make more decisions about what to produce and how to sell. They believe that more food will be available for sale and consumption. Foreign and local experts welcome the project and expect that as the market mechanism becomes more important, economic growth and economic development will be stimulated.

[Source: Source: adapted from The Guardian, 7 February 2010 'Cuba plans city farms to ease economy woes' by Marc Frank]

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(Question 3 continued)

- (a) (i) Define the term *allocation of resources* indicated in bold in the text (paragraph ③). [2 marks]
- (ii) Define the term *infrastructure* indicated in bold in the text (paragraph ④). [2 marks]
- (b) Explain why a “greater reliance on the price mechanism” might result in “a more efficient allocation of resources” (paragraph ⑤). [4 marks]
- (c) Explain the relationship between economic growth and economic development. [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the view that a balance between market-oriented policies and government intervention is needed in order to promote economic development in Cuba. [8 marks]

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

Cambodia encouraged to review international partnerships

- ❶ The United States (US) Secretary of State has urged Cambodians to pursue a variety of economic partnerships throughout Asia-Pacific and not become over-reliant on China. She said that Cambodia should look for partnerships that cut across regional geographic lines.
- ❷ Both China and the US are working to extend their influence in Cambodia. Nearly 400 Chinese companies have invested billions of dollars in Cambodia, including key infrastructure projects such as hydropower dams and coal-power plants. While acknowledging the attraction of Chinese **investment**, the Secretary of State said: “One of the challenges for Cambodia is the construction of dams on the Upper Mekong river”. China has been criticised by environmental groups over the building of a series of hydropower projects on the Mekong river. Concerns over the project include a possible loss of water quality and a loss of biodiversity.
- ❸ The Secretary of State also indicated that the US was willing to cooperate with Cambodia to resolve an outstanding debt of about US\$445 million that the country owes to the US.
- ❹ The Cambodian Foreign Minister had asked the Secretary of State at a meeting to help his country convert the debt into development aid. She said she was ready to explore creative ways Cambodia could be relieved of the debt, possibly by agreeing to preserve key environmental areas or investing in education. In this way, the debt repayment would be treated as development aid.

[Source: AFP 2010]

Human Development Report 2010 Statistics for Cambodia

	Life expectancy at birth	Expected years of schooling	Mean years of schooling	GNI per capita (Constant 2005 PPP US\$)	HDI value
1980	38.7	6.1	5.0	—	—
1985	52.6	6.1	5.2	—	—
1990	55.6	6.1	5.3	—	—
1995	56.2	6.5	5.5	793	0.407
2000	57.6	7.5	5.7	975	0.438
2005	60.1	9.7	5.7	1390	0.491
2010	62.7	9.8	5.8	1753	0.518

[Source: <http://hdrstats.undp.org/images/explanations/KHM/.pdf>
2011 Human Development Report, United Nations Development Programme.]

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(Question 4 continued)

- (a) (i) Define the term *investment* indicated in bold in the text (*paragraph 2*). [2 marks]
 - (ii) State **two** forms of development aid (*paragraph 4*). [2 marks]
 - (b) Using an appropriate diagram, explain why hydropower dam projects on the Mekong River might lead to market failure. [4 marks]
 - (c) Explain why life expectancy at birth (*see Table*) is one of the indicators used to measure economic development. [4 marks]
 - (d) Using information from the text/data and your knowledge of economics, discuss the possible effects on the economic development of Cambodia of investment from China and the United States (US). [8 marks]
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