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**ECONOMICS
HIGHER LEVEL
PAPER 2**

Tuesday 6 May 2014 (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.

Fast-growing Turkish economy showing signs of overheating

- ① The impressive economic growth that Turkey has enjoyed from 2010–2012 may soon come to an end, as the country’s economy shows signs of overheating. Although officials are still optimistic, economists are concerned about the **inflationary gap**, and note that the growing current account deficit makes Turkey vulnerable.
- ② At the crossroads of Europe and the Middle East, Turkey has benefitted from a boom in foreign investment and trade, and has been one of the engines of global growth from 2010–2012. The economy grew by 8.9% in 2010 – one of the highest in the world – and the Organisation for Economic Co-operation and Development (OECD) expects it to have grown by a further 7.4% in 2011.
- ③ However, analysts warn that the current growth rate is unlikely to last. “What GDP growth rates don’t reveal is that the Turkish economy is now showing signs of overheating,” said an economist at Capital Economics. The fast economic growth of 2010–2012 “was accompanied by a rapid widening of the current account deficit,” which has jumped to 10% of its GDP.
- ④ “What is more, from 2010–2012, the current account deficit has mostly been financed with short-term borrowing, which means Turkey is facing a heavy external debt service burden of \$135 billion (101 billion euros) in the period 2012–2013,” warned the chief economist at Finansbank.
- ⑤ Turkey’s current account deficit, which surged from just over 2% of GDP in 2009, is partially due to the rise in oil prices. Since Turkey is a large net oil importer, it is clearly worse off from higher oil prices. Turkey’s net energy imports were equivalent to around 6% of GDP in 2011 – accounting for over half of the total current account deficit of 10% of GDP.
- ⑥ There is more to Turkey’s current account shortfall than simply the high cost of energy imports. The deficit has also widened due to rapidly rising domestic demand, suggesting that a period of weaker domestic demand is needed to put the current account on a sustainable footing.
- ⑦ A financial services ratings agency warned recently that the high current account deficit makes Turkey vulnerable to sudden **financial account** outflows. There are concerns about the difficulty of attracting capital inflows to fund the current account deficit.

[Source: adapted from <http://www.dailystar.com.lb/Business/International/2012/Apr-02/168817-fast-growing-turkish-economy-showing-signs-of-overheating.ashx#axzz31EjcEmch>;

‘Fast-growing Turkish economy showing signs of overheating’; April 02, 2012; By Fulya Ozerkan]

(This question continues on the following page)

(Question 1 continued)

- (a) (i) Define the term ***inflationary gap*** indicated in bold in the text (*paragraph 1*). [2 marks]
- (ii) Define the term ***financial account*** indicated in bold in the text (*paragraph 7*). [2 marks]
- (b) With reference to the concept of price elasticity of demand, explain why rising oil prices have contributed to Turkey’s growing current account deficit (*paragraph 5*). [4 marks]
- (c) Explain **two** reasons why “rapidly rising domestic demand” may have contributed to Turkey’s current account deficit (*paragraph 6*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the possible policies that the Turkish authorities might use to reduce the current account deficit. [8 marks]

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

Freer trade in the Pacific Region?

Text A

In November 2011, leaders of the nine Trans-Pacific Partnership (TPP) countries – Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, United States, and Vietnam – announced the outlines of an agreement that is expected to increase trade and **investment** among the countries, promote innovation, economic growth and development, and support job creation.

[Source: adapted from <http://www.ustr.gov/tpp>, 12 November 2011]

Text B

- ❶ Japan’s Prime Minister said Japan would “start talks with other countries toward participating in TPP”, indicating Japan’s interest. The Prime Minister’s remark has caused more debate in Japan.
- ❷ Japanese exporters of industrial products – cars, electric appliances and high-tech machinery – are very keen to join. The strong appreciation of the Japanese yen (Japan’s currency) dramatically reduced the price competitiveness of their products last year.
- ❸ The toughest opposition to the TPP comes from farmers, most of them with small farms, protected for many years by government subsidies and high tariffs on imports. Japan imposes a tariff of 252% on imported wheat and 325% on imported sugar.

[Source: adapted from <http://www.nst.com.my/>, 9 January 2012]

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(Question 2 continued)

Text C

- ❶ Australian farmers are thrilled with the news that the Australian Prime Minister was pushing for the TPP. With a **comparative advantage** in many agricultural products, Australia has much to gain from a free trade agreement.
- ❷ Tariffs and other trade barriers in other countries are often disguised as farm subsidies, quotas and product standards to protect local producers. This restricts Australia’s ability to sell many foods freely into global markets. Beef, rice, wine, lamb and sugar exports are among those most affected.
- ❸ Only 40% of primary products grown in Australia are consumed domestically. Therefore, Australian producers need access to as many export markets as possible so that producers can gain from the potential economies of scale.
- ❹ Australia has relaxed most of its tariffs on imported food in recent years, and yet tariffs on Australian beef entering Japan, for example, remain as high as 38%. Many nations restrict the entry of Australian beef to protect their own cattle farmers. While Japan has officially opened its doors to Australian rice, Japanese producers remain heavily subsidized by its government, therefore limiting Australia’s access to the Japanese rice market.

[Source: adapted from <http://www.theaustralian.com.au/>, 14 November 2011]

- (a) (i) Define the term *investment* indicated in bold in the text (*Text A*). [2 marks]
- (ii) Define the term *comparative advantage* indicated in bold in the text (*Text C, paragraph ❶*). [2 marks]
- (b) Using a cost diagram, explain how access to foreign markets may allow Australian farmers to “gain from the potential economies of scale” (*Text C, paragraph ❸*). [4 marks]
- (c) Using an international trade diagram, explain how Japanese subsidies have been “limiting Australia’s access to the Japanese rice market” (*Text C, paragraph ❹*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the possible consequences for Australian and Japanese producers of moving towards freer trade. [8 marks]

SECTION B

Answer **one** question from this section.

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

Ivory Coast

Text A

- ❶ Ivory Coast is a developing economy located in West Africa. It depends heavily on agriculture and related activities, which are the source of income for approximately 70% of the population. Ivory Coast is among the world’s largest producers and exporters of cocoa beans, and a significant producer and exporter of coffee and palm oil. Consequently, the economy is highly sensitive to fluctuations in international prices for these products. Since 2006, petroleum oil and gas production have been rising and become an important source of growth. Cocoa, coffee and petroleum oil are the country’s top export revenue earners.
- ❷ Since the end of the civil war in 2003, political turmoil has continued to damage the economy, resulting in the loss of foreign direct investment (FDI) and harming economic growth. Per capita **gross domestic product (GDP)** has declined by 15% since 1999, but registered a slight improvement in 2009–2010. Power cuts caused by a turbine (generator) failure in early 2010 slowed economic activity. Ivory Coast’s long-term challenges include political instability and deteriorating infrastructure.

[Source: © International Baccalaureate Organization 2014]

Text B

- ❶ The International Monetary Fund (IMF) awarded a \$616 million loan to Ivory Coast to help revive its economy which was devastated by widespread political unrest and post-election violence. The IMF also supported \$8 million in aid for the country under the Heavily Indebted Poor Countries (HIPC) initiative. The money provides relief on debt service as the country moves through the HIPC process toward debt forgiveness.
- ❷ Ivory Coast “could qualify for debt relief on the vast majority of its external debts” through the HIPC and other initiatives in 2012 once it completes certain conditions, including “key structural and social reforms”.
- ❸ “Ivory Coast’s economy is recovering faster than anticipated, following a severe post-election crisis that caused a sharp decline in activity in the first four months of the year,” said the IMF deputy managing director.

[Source: adapted from <http://www.channelnewsasia.com>, 5 November 2011]

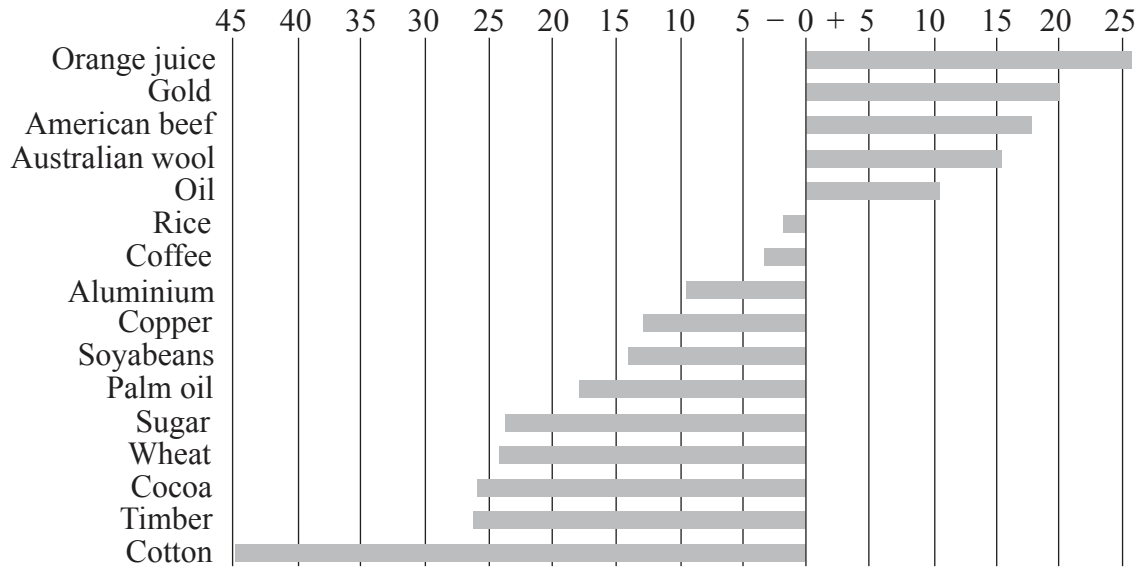
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(Question 3 continued)

Figure 1 – World Commodity Prices 2011

Many commodity prices fell last year as the euro crisis and slowing growth in emerging markets weakened demand.

Selected commodity prices, % change 28 December 2010 – 17 January 2012, \$ terms



[Source: Data sourced from Thomas Reuters and Bloomberg.]

- (a) (i) Define the term *gross domestic product (GDP)* indicated in bold in the text (Text A, paragraph 2). [2 marks]
- (ii) Outline the main function of the International Monetary Fund (IMF) (Text B, paragraph 1). [2 marks]
- (b) With reference to Text A **and** Figure 1, explain what is likely to have happened to Ivory Coast’s terms of trade in 2011. [4 marks]
- (c) Using an AD/AS diagram, explain how a loss of foreign direct investment (FDI) might have harmed economic growth in Ivory Coast (Text A). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the main challenges facing Ivory Coast as it seeks to achieve economic growth and economic development. [8 marks]

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

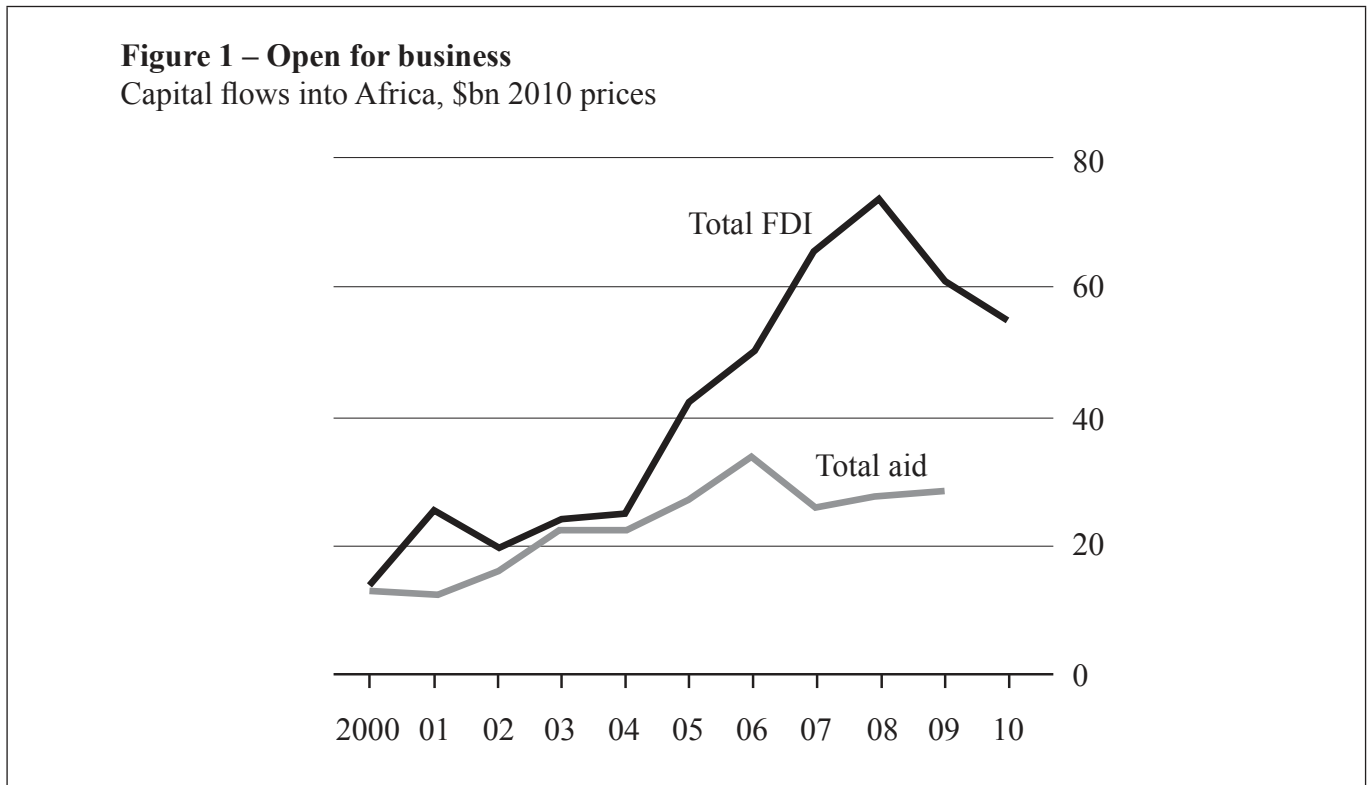
Africa's hopeful economies

- ❶ The majority of Africa's billion people live below the poverty line. Disease and hunger are still a big problem. Advances in technology are contributing to improved health care. For example, death rates due to malaria have fallen by 20% due to better bed nets, which protect people from mosquito bites. Labour productivity has been rising. It is now growing by an average of 2.7% a year. However, foreign investors in countries with high HIV-infection rates complain about expensively trained workers dying in their 30s and 40s. As a result, there is an ongoing shortage of skilled workers, which means that hiring qualified staff can be very expensive.
- ❷ Trade between Africa and the rest of the world has increased by 200% since 2000. **Inflation** in Africa fell from 22% in the 1990s to 8% in the period 2000–2010. Foreign debts declined by a quarter and budget deficits by two-thirds. The International Monetary Fund (IMF) expects sub-Saharan Africa's economies to expand by 5.75% in 2012. The World Bank said in a report in 2011 that "Africa could be about to experience an economic take-off". However, its officials think major poverty reduction will require higher economic growth.
- ❸ Various types of market-oriented policies have taken place in Africa. Reforms in regulations have partially liberated markets. A series of **privatizations** (more than 100 in Nigeria alone) has reduced the role of the state in many countries. Trade barriers have been reduced and despite the shortage of good roads, regional trade is picking up. Trade among African countries has increased from 6% to 13% of the total volume.
- ❹ Foreign investors are no longer just interested in oil wells and mines. They are now investing in consumer goods businesses. Africa's political and technological changes have increased interest from outside investors.
- ❺ African governments are encouraging entrepreneurship. According to the World Bank, 36 out of 46 African governments made things easier for business in 2011.
- ❻ Despite these reforms, there are still significant concerns. Extra mouths will need to be fed as Africa's population is growing. Africa is now a net food importer, yet it has 60% of the world's unused agricultural land. It produces less per person now than in 1960. Africa's land is often hard to farm, with annual variations in climate. Farmers lack access to capital for fertilizer and irrigation. More roads and storage facilities are also needed since much agricultural output rots before it gets to markets. Furthermore, land ownership often poses a problem.

[Source: © The Economist Newspaper Limited, London (2011)]

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(Question 4 continued)



[Source: © The Economist Newspaper Limited, London (2011)]

- (a) (i) Define the term *inflation* indicated in bold in the text (*paragraph 2*). [2 marks]
- (ii) Define the term *privatization* indicated in bold in the text (*paragraph 3*). [2 marks]
- (b) Using a production possibilities curve (PPC) diagram, explain how “better bed nets” (*paragraph 1*) may contribute to economic growth. [4 marks]
- (c) With reference to a poverty trap (poverty cycle), explain why “major poverty reduction will require higher economic growth” (*paragraph 2*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the strengths and weaknesses of market-oriented policies used by African governments to encourage economic growth. [8 marks]