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International Baccalaureate®
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ECONOMICS
STANDARD 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.

Japan in first trade gap since 1963

- ❶ Japan's current account surplus fell 85.5% in November 2011 from a year earlier to 138.5 billion Japanese yen (Japan's currency) (\$1.80 billion), the Ministry of Finance said. In 2011, Japan recorded its first deficit in its balance of trade in goods since 1963.
- ❷ The appreciation of the Japanese yen against the dollar has reduced Japan's current account surplus. The Japanese yen gained 8.5% against the dollar in the 12 months since January 2011. The currency has acquired a new and unusual status as a safe haven, reinforced by the eurozone debt crisis since international investors are concerned about the single European currency.
- ❸ It is estimated that a 1% gain in the Japanese yen could reduce the export volumes by 0.34%, slowing down growth for a country that has relied on overseas demand to maintain its recovery from March 2011's earthquake. To stop the trade in goods deficit from getting worse, the world economy would have to grow by 4% and the value of the Japanese yen would have to fall by 5%. It is unlikely that this will happen.
- ❹ With their rapidly aging and decreasing population, Japanese firms face severe challenges and have little choice but to look abroad for growth. The Japanese yen's appreciation to record highs against the euro and relative strength against the US dollar has led to a boom in outward **foreign direct investment (FDI)**. Exporters are transferring their operations from Japan to other economies, where parts and labour costs are lower.
- ❺ Japan's current account surplus could move into a deficit sooner than 2015 if more companies shift production abroad to combat losses from a strong Japanese yen. In 2011 Japanese firms purchased a record number of firms across the rest of Asia. Worldwide the number of Japanese purchases reached 455, only just short of its record of 463 in 1990.
- ❻ Japanese firms are also acquiring shares in natural resource companies. Mitsubishi spent more than \$5 billion buying a quarter of mining giant Anglo-American's Chilean copper unit, and trading group Itochu bought a \$1 billion stake in a US oil and gas firm.
- ❼ The Japanese Prime Minister has encouraged the trend. "We will take advantage of the appreciating Japanese yen to support Japanese companies in purchasing foreign companies and acquiring resource interests," he said.
- ❽ However, Japanese authorities have signalled there are concerns about a further appreciation of the Japanese yen. The central bank said last month that it plans to increase the funds available for currency intervention.

[Source: adapted from www.bloomberg.com, 5 January 2012; www.chinadaily.com.cn, 12 January 2012 and www.channelnewsasia.com]

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(Question 1 continued)

- (a) (i) Define the term *foreign direct investment (FDI)* indicated in bold in the text (*paragraph ④*). [2 marks]
- (ii) Describe **two** responsibilities of a country's central bank (*paragraph ⑧*). [2 marks]
- (b) With reference to the text, explain how Japan's current account can be in surplus while it has a trade in goods deficit (*paragraph ①*). [4 marks]
- (c) Using an exchange rate diagram, explain how Japanese authorities might intervene in the currency market as a result of their concern about the value of the Japanese yen (*paragraph ⑧*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the possible consequences of the appreciation of the Japanese yen (*paragraph ②*). [8 marks]

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

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[Source: <http://www.theage.com.au/national/car-makers-plead-for-help-20111207-1ojc3.html>]

(This question continues on the following page)

(Question 2 continued)

- (a) (i) Define the term *currency appreciation* indicated in bold in the text (*paragraph ①*). [2 marks]
- (ii) Define the term *subsidies* indicated in bold in the text (*paragraph ③*). [2 marks]
- (b) Using a demand and supply diagram, explain the impact of the “recent currency appreciation” on Australia’s domestic car market (*paragraph ①*). [4 marks]
- (c) Using a demand and supply diagram, explain the impact on Australia’s car market resulting from the government’s policy to implement a carbon tax (*paragraph ⑤*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss the effects of “global economic uncertainty” (*paragraph ①*), “low trade barriers” (*paragraph ②*) and a “carbon tax” (*paragraph ⑤*) on Australia’s car industry. [8 marks]

SECTION B

Answer one question from this section.

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

Haiti

- ① Haiti remains the poorest country in the Americas and one of the poorest in the world, with a gross domestic product (GDP) per capita of US\$670 and significant needs in basic services. It is also one of the most unequal, with a Gini coefficient of 0.59. Over half of its population of 10 million lives in **absolute poverty**, as 78% live on less than US\$2 per day. In 2010, an earthquake killed over 200 000 Haitians.
- ② Before the earthquake, the country's social indicators were well below regional averages and the country had suffered from repeated external and political shocks. In 2008, rising food and fuel prices led to riots and the fall of the government. Tropical storms and hurricanes that same year caused losses estimated at US\$900 million (15% of GDP). Despite this, Haiti experienced modest but stable growth in the 2000s, with an average real growth of 2.2% per year between 2004 and 2009. In 2011, Haiti ranked 158th out of 187 in the Human Development Index (HDI).
- ③ In October 1996, Haiti agreed to implement a wide range of market-oriented reforms outlined in the IMF's US\$1.2 billion Emergency Economic Recovery Plan (EERP). The recovery package aimed to create a capital-friendly macroeconomic environment for the export-manufacturing sector over a five-year period. Requirements of the recovery package include reducing tariffs and selling off state-owned enterprises, as well as keeping wages from rising.
- ④ In just 33 years, Haiti has gone from being self-sufficient in rice, sugar, poultry and pork, to being the largest importer of US foodstuffs in the Caribbean.
- ⑤ The Haitian economy is recovering from the earthquake. After a contraction of 5.4% in 2009–10, GDP grew 5.1% in 2010–2011. In 2011–12, it was projected to grow by 7%, mainly driven by agriculture, textiles and construction. The macroeconomic situation is improving with domestic tax revenues rising to 13% of GDP in 2011 due to increasing imports and recovery efforts.

[Source: adapted from <http://newint.org/features/2012/01/01/haiti-earthquake-relief-reconstruction/> and www.historycommons.org/]

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(Question 3 continued)

- (a) (i) Define the term *absolute poverty* indicated in bold in the text (*paragraph ①*). [2 marks]
- (ii) List **two** components of the Human Development Index (HDI) (*paragraph ②*). [2 marks]
- (b) Using a Lorenz curve diagram, explain the meaning of “a Gini coefficient of 0.59” (*paragraph ①*). [4 marks]
- (c) Using a production possibilities curve (PPC) diagram, comment on the likely effect of the earthquake in 2010 on Haiti’s economy (*paragraph ①*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, discuss strategies that the Haitian government might use to achieve economic growth and development. [8 marks]

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

African Development Bank (AfDB) promotes improved access to water, sanitation and health services in rural and urban Uganda

- ① The AfDB and the Government of Uganda signed two agreements recently to finance projects to improve health services and access to water and sanitation, in urban and rural areas of Uganda. The projects will cost US\$155.8 million and are expected to boost the country's efforts to meet the 2015 Millennium Development Goals for health, water and sanitation.
- ② Uganda's National Development Plan identifies the provision of improved health services as well as adequate water supply and improved sanitation as key priority areas. "Investing in human development is crucial to **economic growth** and reducing poverty" said a government official. "So is the provision of adequate quantity and quality of water for all social and economic needs, for current and future generations."
- ③ Up to 2.4 million people in rural areas and small towns across Uganda should have improved access to water supply and sanitation by 2016 following the AfDB's approval of US\$67 million. This supports Uganda's national goal to increase access to water supply and sanitation services to 100% coverage by 2035.
- ④ Furthermore, access to quality and affordable health care services for the Kampala and metropolitan area will be improved. Immediate project beneficiaries are estimated at 3 million people, the majority being women and children under 15 years of age.
- ⑤ The AfDB Vice-President said: "The AfDB and Uganda have been partners in several development areas and the AfDB will continue to work with the Government of Uganda in its efforts to improve the economic and social wellbeing of the people of Uganda."

[Source: <http://www.afdb.org/en/news-and-events/article/afdb-promotes-improved-access-to-water-sanitation-and-health-services-in-rural-and-urban-uganda-8771/>]

(This question continues on the following page)

(Question 4 continued)

- (a) (i) List **two** of the Millennium Development Goals (MDGs) (*paragraph ①*). [2 marks]
- (ii) Define the term *economic growth* indicated in bold in the text (*paragraph ②*). [2 marks]
- (b) Using a demand and supply diagram, explain how the AfDB projects will lead to more “affordable health care services” (*paragraph ④*). [4 marks]
- (c) With reference to a poverty trap (poverty cycle), explain how “investing in human development is crucial to ... reducing poverty” (*paragraph ②*). [4 marks]
- (d) Using information from the text/data and your knowledge of economics, evaluate the likely effectiveness of the AfDB and Ugandan government projects in promoting economic development (*paragraph ①*). [8 marks]
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