

**ECONOMICS  
HIGHER LEVEL  
PAPER 3**

Wednesday 7 May 2003 (morning)

2 hours

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**INSTRUCTIONS TO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.  
Section B: answer one question.
- Use diagrams where appropriate.

## SECTION A

Answer **one** question from this section.

### Question 1

Read the following article and answer the questions which follow.

#### IMF's four steps to damnation

- 1 Robert Stiglitz, ex-chief economist of the World Bank, believes there are **four steps** which characterise structural assistance programmes:
- 2 **Step One** is **privatization**. Stiglitz points out that rather than objecting, some politicians happily sold their electricity and water companies. "You could see their eyes widen" at the possibility of commissions for shaving a few billion off the sale price.
- 3 US-backed power élites stripped Russia's industrial assets, with the effect that national output was cut nearly in half.
- 4 **Step Two** is capital market liberalisation. In theory this allows investment capital to flow in and out. Unfortunately, as in Indonesia and Brazil, the money often simply flows out.
- 5 And when that happens, to seduce speculators into returning a nation's own capital funds, the IMF demands these nations substantially raise their interest rates.
- 6 "The result was predictable," said Stiglitz. Higher interest rates demolish property values, savage industrial production and drain national treasuries.
- 7 **Step Three** is **market-based pricing** – essentially raising prices on food, water and cooking gas. This leads to Step-Three-and-a-Half: what Stiglitz calls "the IMF riot".
- 8 The IMF riot is painfully predictable, as when the IMF eliminated food and fuel subsidies for the poor in Indonesia in 1998, Indonesia exploded into riots.
- 9 The IMF riots cause new flights of capital and government bankruptcies. This economic arson has its bright side for foreigners, who can then pick off remaining assets at rock bottom prices.
- 10 A pattern emerges. There are lots of losers but the clear winners seem to be the western banks and US Treasury.
- 11 Now we arrive at **Step Four**: free trade. Europeans and Americans today are kicking down barriers to sales in Asia, Latin America and Africa while barricading their own markets against the Third World's agriculture.
- 12 Stiglitz has two concerns about IMF and World Bank strategy. Firstly, it undermines democracy as the plans are devised in secrecy. Secondly, it does not work: for example, under the guiding hand of structural "assistance", Africa's income dropped by 23 %.

[Source: Adapted from Gregory Palast, *Observer*, 29 April 2001]

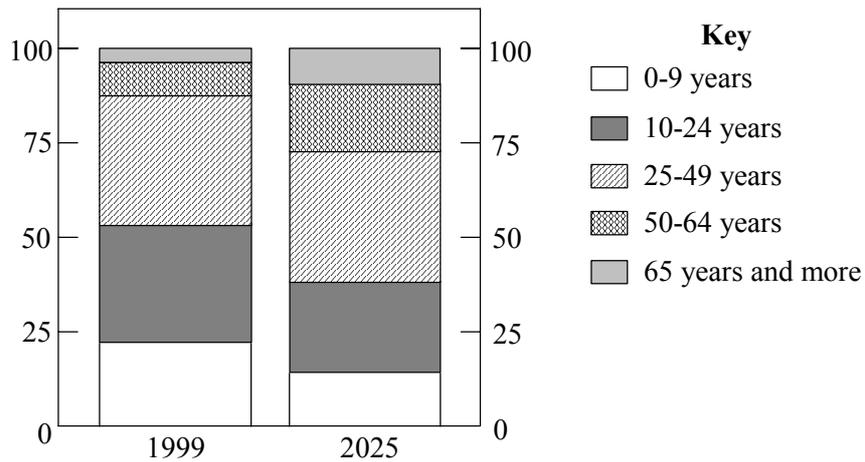
- (a) With reference to the article, define the following terms highlighted in bold.
- (i) privatization (paragraph 2) *[2 marks]*
  - (ii) market-based pricing (paragraph 7) *[2 marks]*
- (b) Use a supply and demand diagram to explain why market-based pricing (paragraphs 7 and 8) may result in higher prices. *[4 marks]*
- (c) Explain why the IMF and the World Bank demand that nations in need of capital funds raise their interest rates (paragraphs 4 and 5). *[4 marks]*
- (d) Discuss **one** consequence of the IMF and the World Bank policies regarding free trade for each of the following.
- (i) advanced industrialized countries *[3 marks]*
  - (ii) less developed agricultural countries *[3 marks]*
- (e) Use the text and your knowledge of economics to evaluate the view that the IMF and the World Bank policies are designed to further the interests of more developed countries at the expense of less developed countries. *[7 marks]*

**Question 2**

Study the following items and answer the questions which follow.

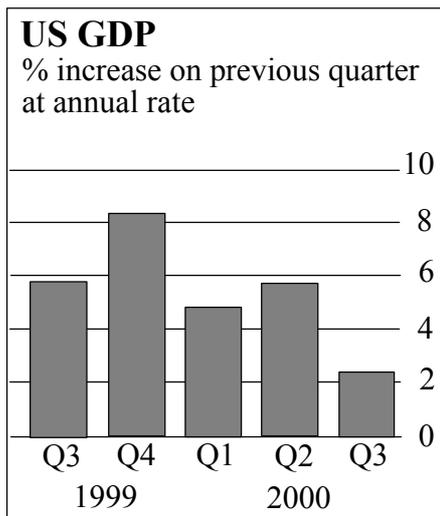
**Item 1**

**Estimated Mexican Population in 1999 and 2025**  
Age groups as a percentage of total population



[Source: OECD]

**Item 2**

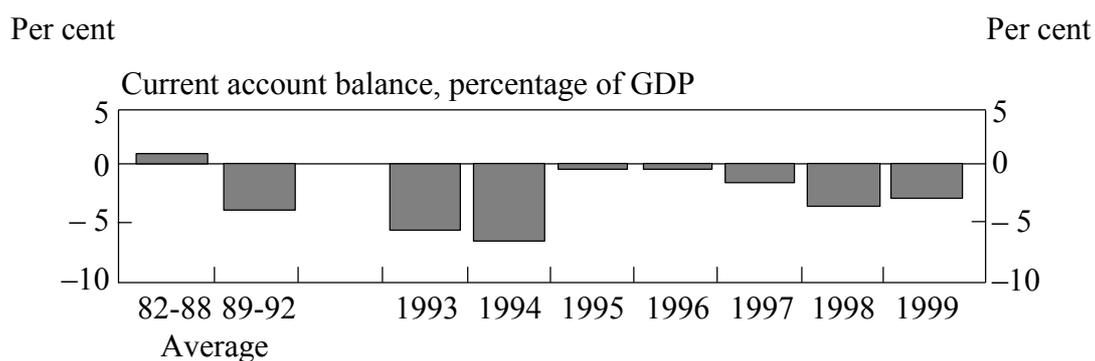
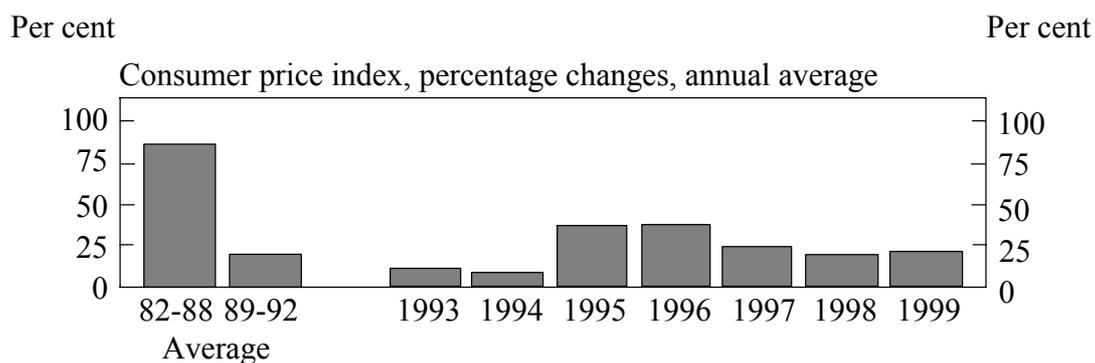
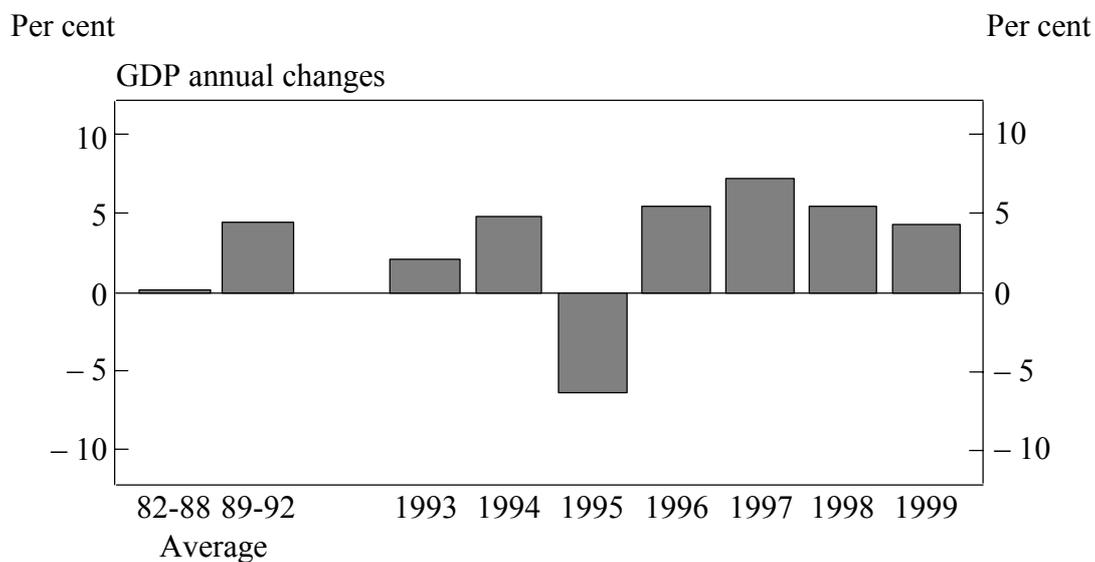


When the USA sneezes the rest of the world catches a cold. But who suffers the most when the US economy goes into decline? The easiest approach is to focus on the share of a country's GDP being exported to the USA. On this basis, Canada and Mexico, the USA's northern and southern neighbours respectively, face the biggest risks.

[Source: Bureau of Economic Analysis]

**Item 3**

**Mexico's Economic Performance**



[Source: Instituto Nacional de Estadística Geografía e Informática (INEGI); OECD, *National Accounts*]

- (a) With reference to Item 1, describe
- (i) the projected changes in Mexico's population structure between 1999 and 2025. *[2 marks]*
  - (ii) the likely impact of these changes on government spending and taxation in Mexico. *[3 marks]*
- (b) Using the data provided
- (i) explain the term current account balance, percentage of GDP (Item 3). *[2 marks]*
  - (ii) describe the changes shown in the GDP of the USA over the period shown (Item 2). *[2 marks]*
  - (iii) explain how the changes identified in (b)(ii) above are likely to affect Mexico's exports to the USA. *[4 marks]*
- (c) Explain **two** other ways in which the macroeconomy of Mexico may be affected by changes in GDP of the USA. *[5 marks]*
- (d) Using the data and your knowledge of economics, assess the performance of the Mexican economy during the 1990s. *[7 marks]*

## SECTION B

Answer **one** question from this section.

### Question 3

- (a) What role do prices play in the allocation of resources in free market economies? *[12 marks]*
- (b) Evaluate the options available to governments to overcome the failure of markets arising from the production and consumption of demerit goods. Illustrate your answer with examples where possible. *[13 marks]*

### Question 4

- (a) Outline the ways in which monopoly power might arise. *[10 marks]*
- (b) Should governments seek to control the growth of monopoly power? *[15 marks]*

### Question 5

Discuss the view that the achievement of price stability should be the major objective of government economic policy. *[25 marks]*

### Question 6

- (a) Describe the main barriers to economic development that countries may experience. *[12 marks]*
- (b) Evaluate the view that countries with a more equal distribution of income and wealth are more likely to experience higher levels of development. *[13 marks]*
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