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ECONOMICS
HIGHER LEVEL
PAPER 2

Tuesday 5 November 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 and data below and answer the questions that follow.*

Bolivia reacts to global economic change

❶ During the twentieth century, Bolivia experienced deteriorating terms of trade due to declines in prices of commodity exports on which the economy was highly dependent. Bolivia diversified its exports, but has remained highly dependent on commodity exports. These include natural gas, which accounts for nearly 40 % of export earnings and also silver and zinc.

❷ Bolivia succeeded in avoiding **recession** during the global economic downturn in 2009, though its rate of growth was affected by lower demand for natural gas from Brazil and lower prices for its key export products. Growth began again in 2010 due to the recovery of commodity prices and the global economy *(Figure 1)*.

❸ Strong inflationary pressures have appeared with the recovery, partly due to the removal of fuel subsidies. A key government policy objective is to hold down inflation and imported input costs. About 80 % of Bolivia's imports are used by the manufacturing sector in various industries. Since late 2010 the government has adopted a managed float to achieve appreciation of the Bolivian Boliviano (the Bolivian currency).

❹ Bolivia's **current account** surplus reached a maximum in 2008–2009 *(Figure 2)* due to the recovery of commodity prices, which led to an improvement in its terms of trade *(Figure 3)*. The resulting decrease in the surplus is due to a more rapid rise in imports than in exports. The current account surpluses have led to large increases in international reserves (reserve assets).

[Source: Adapted from "Gradual revaluation on higher inflation", *Business Monitor International*, 11 February 2011; "About Bolivia Economic Outlook", *Amcham Bolivia*, 2010]

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(Question 1 continued)

Figure 1

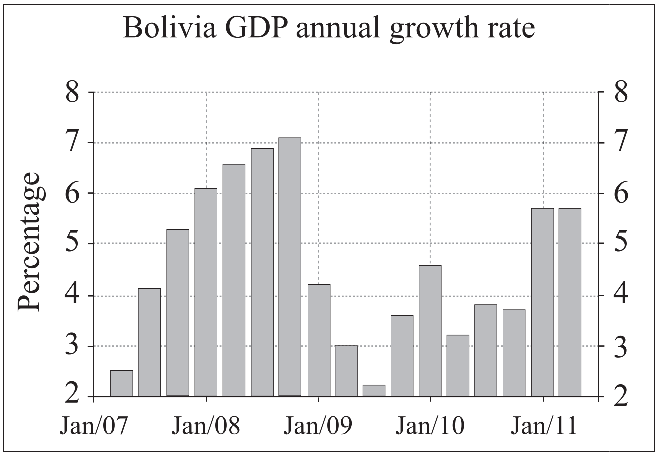


Figure 2

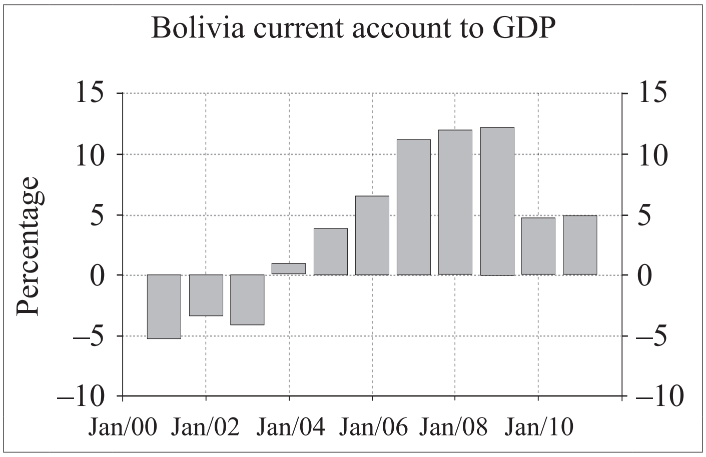


Figure 3

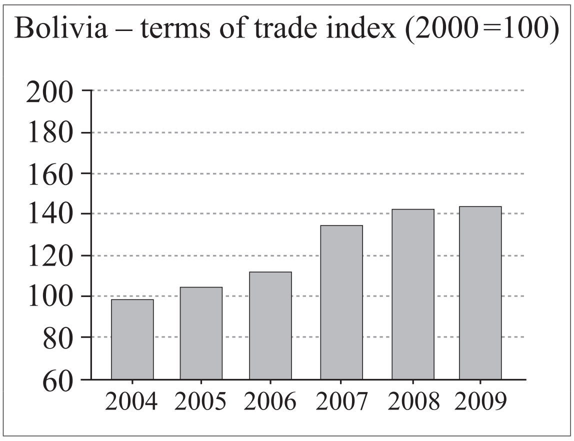
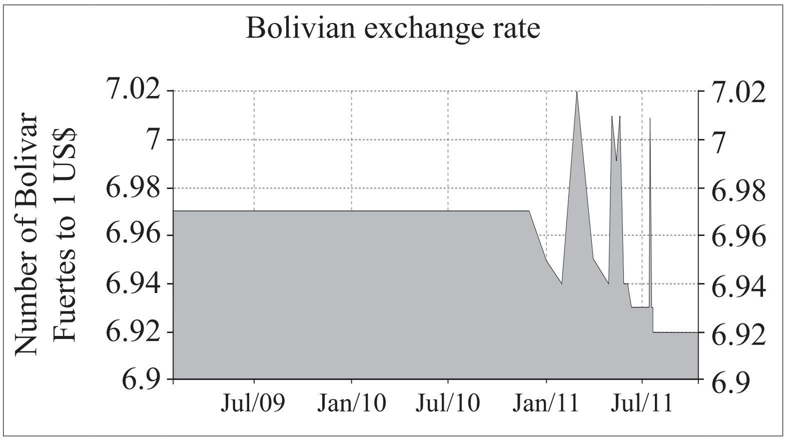


Figure 4



[Source: adapted from www.tradingeconomics.com, accessed 2011]

(a) (i) Define the term *recession* indicated in bold in text *(paragraph ❷)*. *[2 marks]*

(ii) Define the term *current account* indicated in bold in the text *(paragraph ❹)*. *[2 marks]*

(b) Using an appropriate diagram, explain the reason for the improvement in Bolivia's terms of trade *(paragraph ❹)*. *[4 marks]*

(c) Explain what is likely to have happened to any of the components of Bolivia's financial account as a result of its current account surplus from 2004–2010 (assuming no change in the capital account). *[4 marks]*

(d) Using information from the text/data and your knowledge of economics, evaluate the change in Bolivia's exchange rate policy in moving from a fixed exchange rate to a managed float in late 2010 *(paragraph ❸)*. *[8 marks]*

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

Japan fights recession

❶ Following statements by the Japanese Finance Minister that the yen was "strongly overvalued", Japan intervened in the yen market by buying US dollars, one day after the Swiss central bank cut interest rates to lower the value of the Swiss franc. These moves risked criticism that Japan and Switzerland may be initiating currency wars, involving competitive depreciations.

❷ The Japanese intervention was the third in a year. The first intervention, nine months earlier, aimed to improve **business confidence**. It was criticized by United States officials, who argued that Japan was seeking to gain unfair trade advantages by undervaluing the yen. In the past, Japan has been accused of using other forms of trade protection to gain an advantage in international markets.

❸ The Japanese economy has been suffering a long-lasting recession, deepened by an earthquake, tsunami and nuclear crisis in spring 2011. It faces **deflation** which is currently –0.9 %, yet there is little room for action by the central bank as interest rates have fallen to zero.

❹ Japan has a current account surplus, which has increased pressure for the yen to rise. The rising yen was unwelcome because Japan is strongly export-oriented. Large exporters like Toyota, Honda and Nissan have complained about lower export earnings, which already had been negatively affected by the global recession and a rise in trade protection in their export markets. A strong yen also works to increase the downward pressure on the general price level.

❺ In view of Japan's excessive dependence on exports, some analysts note that the economy must restructure to depend more on domestic consumption.

[Source: adapted from "Japan's yen intervention shows welcome activism", *Reuters BreakingViews*, 15 September 2010; "Top US lawmaker: Japan yen intervention deeply disturbing", *Agence France-Presse*, 15 September 2010; "The domino that never falls", *The Economist*, 21 July 2011; "Finance Minister say yen is strongly overvalued", *Japan Today*, 2 August 2011 and "Japan buys dollars to weaken the surging yen", *New York Times*, 3 August 2011]

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(Question 2 continued)

(a) (i) Describe the term *business confidence* identified in bold in the text *(paragraph ❷)*. *[2 marks]*

(ii) Define the term *deflation* indicated in bold in the text *(paragraph ❸)*. *[2 marks]*

(b) Using an appropriate diagram, explain a possible effect of the overvalued yen on the Japanese economy. *[4 marks]*

(c) Using an appropriate diagram, explain the impact of the Japanese current account surplus on the value of the yen *(paragraph ❹)*. *[4 marks]*

(d) Using information from the text/data and your knowledge of economics, discuss the likely consequences of intervention in the yen market. *[8 marks]*

SECTION B

*Answer **one** question from this section.*

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

Chinese and Indian foreign direct investment (FDI) in Africa

❶ The high growth experienced by many African countries has made them attractive to multinational corporations (MNCs), originating in China and India, which seek to expand and diversify their sources of energy and raw materials. In recent years, MNCs have begun to rapidly diversify into other sectors beyond oil and minerals.

❷ Chinese and Indian MNCs differ in their approaches. Most Chinese MNCs are large government-owned firms. They usually enter new markets by building their own new facilities, and buy most of their inputs or sell their output through their own branches. They buy a large portion of their inputs from China, and usually do not hire local managers and workers. Most sales in Africa are made to government bodies. Chinese MNCs tend to be focused on resource extraction.

❸ Indian MNCs are of varying size, and are mostly privately-owned. They usually enter markets by buying local, established businesses, and they buy far fewer of their inputs in Indian markets, preferring increasingly to buy them in other international markets. They often hire and train local managers and staff. Most sales in Africa are made to private firms rather than government bodies. Indian MNCs are expanding into telecommunication technologies, information technologies, education and health services and are encouraging **diversification**.

❹ Rapid **economic growth** in China, India and Africa, together with Chinese and Indian foreign direct investment (FDI), have strongly encouraged trade links between them. Africa's bilateral trade with India increased from $1 billion in 2001 to $46 billion in 2010. Africa's bilateral trade with China was $120 billion in 2010.

❺ Yet there are worries. Both Chinese and Indian MNCs have been accused of ignoring human rights violations and corruption by the government in countries they operate in. In some cases they have not been required to follow environmental laws.

[Source: adapted from "What are the Chinese firms doing in Africa?", *International Trade Forum*, 2010; "Foreign investment: lessons learnt at home foster success in Africa", *Financial Times,* 19 May 2011 and "India must tread carefully in Africa", *Financial Times,* 29 May 2011]

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(Question 3 continued)

(a) (i) Define the term *diversification* identified in bold in the text *(paragraph ❸)*. *[2 marks]*

(ii) Define the term *economic growth* identified in bold in the text *(paragraph ❹)*. *[2 marks]*

(b) Explain **two** reasons why multinational corporations (MNCs) expand into economically less developed countries. *[4 marks]*

(c) Explain **one** reason why over-specialization on a narrow range of products may be a barrier to development for economically less developed countries. *[4 marks]*

(d) Using information from the text/data and your knowledge of economics, discuss the likely effects of Chinese and Indian foreign direct investment (FDI) in Africa on the development of countries in Africa. *[8 marks]*

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

Economic growth and poverty in India

❶ Although India has one of the fastest growing economies in the world, it is unlikely that the Millennium Development Goal of halving the rate of poverty by 2015 will be achieved. An important factor is growing income inequality. Calculations of Gini coefficients show that inequality increased by about 14% between 2001 and 2011.

❷ India has about one third of the world's population living in extreme poverty (living on less than $1.25 a day). Three quarters of its population live in moderate poverty (less than $2 a day). It is estimated that nearly half the Indian population suffers from malnutrition. Part of India's poverty problem is a result of poor governance and failure to address the underlying causes of poverty.

❸ Growth averaged 8.6% per year in the years 2005–2011 compared with the 10% needed over 20 years to lift the poor out of their poverty. The central bank governor says that the lack of steps to improve the supply-side of the economy will make it difficult for India to maintain its high growth rates.

❹ The Indian Nobel Prize winner Amartya Sen argues that **economic growth** should not be "our ultimate objective, but a very useful means to achieve … a better quality of life".

[Source: adapted from "Growth and other concerns", *The Hindu,* 14 February 2011;
"Poverty reduction in India briefing", uk.oneworld.net, May 2011
and "Addressing income distribution", *The Financial Express,* 15 January 2011]

Table 1

	India	**Moldova**
GNI (GNP) per capita (PPP $) (2007)	2840	2980
GDP per capita (PPP $)(2007)	2753	2551
Human Development Index (HDI) (2007)	0.612	0.720

[Source: adapted from "World Development Indicators", *The World Bank*, accessed 2011 and
"Human Development Reports", *United Nations Development Programme*, accessed 2011]

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(Question 4 continued)

Table 2

	India	Bangladesh
GNI (GNP) per capita (PPP $) (2007)	2840	1350
Average annual growth rate (%) (1990–2007)	4.5	3.1
Improved sanitation facilities (% of population with access) (2008)	31	53
Life expectancy at birth (years) (2009)	64	67
Malnutrition rate (% of population that is malnourished) (2006)	47.9	47.0
Infant mortality rate (per 1000 live births) (2009)	50	41

[Source: adapted from "World Development Indicators", *The World Bank*, accessed 2011. World Bank]

(a) (i) Define the term *economic growth* indicated in bold in the text *(paragraph ❹)*. *[2 marks]*

(ii) State why the GNI (GNP) per capita for Moldova and India is higher than their GDP per capita *(Table 1)*. *[2 marks]*

(b) Referring to Table 1, explain **two** possible reasons why India and Moldova have different Human Development Index (HDI) values from each other. *[4 marks]*

(c) Using a Lorenz curve diagram showing India's changing income distribution, explain how India's Gini coefficient will have changed *(paragraph ❶)*. *[4 marks]*

(d) Using information from the text/data in Table 2 and your knowledge of economics, examine Amartya Sen's argument that economic growth should not be "our ultimate objective, but a very useful means to achieve … a better quality of life" *(paragraph ❹)*. *[8 marks]*