



**ECONOMICS  
STANDARD LEVEL  
PAPER 2**

Tuesday 15 November 2005 (morning)

2 hours

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**INSTRUCTIONSTO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- **Answer** three questions.
- Use fully labelled diagrams and real-world examples where appropriate.

Answer **three** questions. Each question is worth [20 marks].

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

**Tanzania**

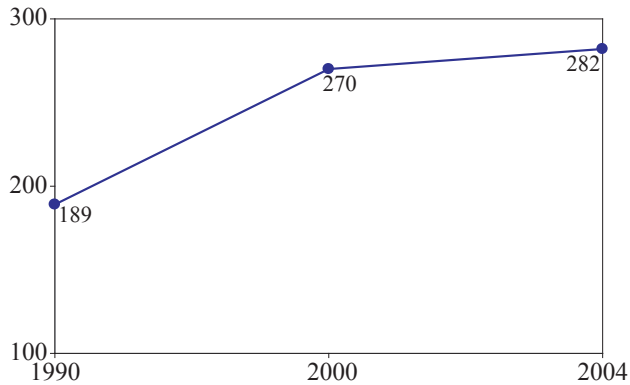
- ❶ Tanzania is one of the poorest countries in the world. In spite of progress in certain areas, *per capita* income in 2004 is estimated to be at about US \$282. Tanzania's economy is strongly dominated by agriculture, accounting for 45 % of GDP and 85 % of exports. This dependence has resulted in deteriorating terms of trade.
- ❷ One of the key challenges in achieving sustainable improvements comes from rising numbers of HIV infections. Along with other worrying signs for **economic development** (see Figure 3), this is likely to have negative consequences for the productive labour force and hence growth.
- ❸ Other key problems include inefficient land and labour markets, slow progress in the privatization of the gas, water and electricity industries, corruption in the administration and judicial system, and limited human and physical capacity.
- ❹ The World Bank's board approved a Country Assistance Strategy (CAS) for Tanzania in June 2000. The focus of World Bank lending is on higher growth, poverty reduction, and institutional reforms to improve the quality of government. The strategy supports the priorities of the Tanzanian government in its commitment to macroeconomic stability, renewed emphasis on rural development, greater openness in government, and increased private sector participation.

[Source: adapted from *Human Development Report*, 2002 and *The World Development report*, 2003]

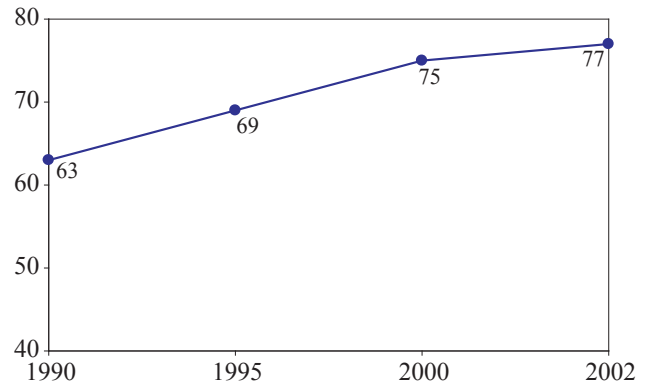
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(Question 1 continued)

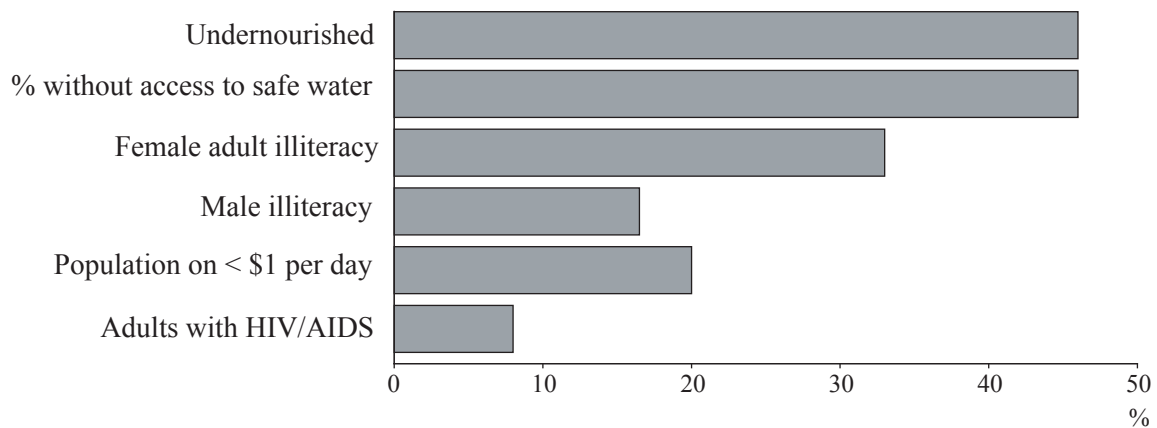
**Figure 1**  
**Gross Domestic Product**  
(US\$ per capita)



**Figure 2**  
**Literacy rate**  
(percentage of adults)



**Figure 3**  
**Poverty percentages**



- (a) Define the following terms indicated in bold in the text:
- (i) economic development (*paragraph 2*) [2 marks]
  - (ii) Gross Domestic Product (*figure 1*). [2 marks]
- (b) Using an appropriate diagram, explain the effect of the improvement in the literacy rate on economic growth, as shown in the data. [4 marks]
- (c) Explain why the importance of agriculture in Tanzania may result in the change in the terms of trade suggested in the text. [4 marks]
- (d) Using the data and your knowledge of economics, evaluate measures that could be taken to achieve development in Tanzania. [8 marks]

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

**Demand for chicken up after price cut**

- ❶ There has been a fall in the demand for chicken following the avian flu<sup>1</sup> scare which led to people being afraid to eat chicken for fear of becoming ill. In response to this, chicken farmers reduced the selling price.
- ❷ Yesterday, there was a 10 per cent increase in the sales of both processed chickens and live chickens, with some 800 000 birds sold in the market nationwide. The price cuts were agreed upon at a meeting of the Federation of Livestock Farmers' Association, Malaysia (FLFAM). The FLFAM is a cartel, which sets prices for livestock sales in Malaysia. It controls 80 % of the suppliers in the country. Processed chicken now costs only RM<sup>2</sup> 3.20 per kg and live chicken RM 2.80 per kg. Previously, the prices were RM 4.00 and RM 3.50 respectively.
- ❸ “The response is good and we hope that consumers now realise that chicken sold in Malaysia is safe to eat,” said a FLFAM spokesperson, adding that the industry was worried when chicken sales dropped by 300 000 a day following the avian flu outbreak in neighbouring countries. Some 1.1 million chickens are available daily to meet consumer demand.
- ❹ The spokesperson said that the drop in prices was to overcome the excess supply of chicken in the market, adding that poultry farmers in the country were holding an “Eat Chicken” campaign and were considering other marketing schemes. “We will continue with the current production of chicken,” he said, “we have decided not to reduce the supply as planned earlier when sales dropped.”
- ❺ It was feared that, if the supply were reduced, then the **maximum price** of chicken that had been fixed by the Agriculture Ministry, would have to be increased. The FLFAM was considering getting their baby chick supply for production from abroad, especially from Australia and the European Union countries. These would take the place of supplies from neighbouring countries, although the prices of the new imports would be higher.
- ❻ Cattle farmers were initially hoping that the misfortune of the chicken farmers might lead to a bonus for them. However, a positive **cross elasticity of demand** and a fall in the price of chicken is now likely to hurt suppliers of beef and lamb if the demand for chicken continues to rise.

[Source: adapted from *The New Straits Times*, Malaysia, February 2004]

<sup>1</sup> avian flu – disease humans contract from eating chicken.

<sup>2</sup> RM – Malaysian Ringit

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*(Question 2 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) maximum price (*paragraph 5*) [2 marks]
  - (ii) cross elasticity of demand (*paragraph 6*). [2 marks]
- (b) Using a supply and demand diagram, explain why there was an “excess supply of chicken in the market” (*paragraph 4*). [4 marks]
- (c) Using an appropriate diagram, explain the likely effect of importing higher priced baby chicks from Australia and the EU, on the market for chickens. [4 marks]
- (d) Using information from the text and your knowledge of economics, especially elasticity of demand, evaluate the economic situation facing the chicken farmers and consumers of chicken. [8 marks]

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

**Austria**

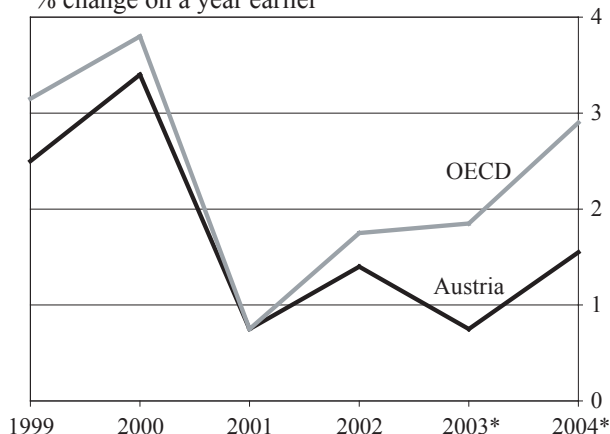
It has long been one of the richest countries in Europe, but Austria's performance has fallen below the OECD\* average in recent years. GDP grew by 1.4 % in 2002 and is forecast to grow by only 0.8 % in 2003 and 1.6 % in 2004, according to the OECD's latest country study. The **unemployment rate** (5.6 % in 2003) is still low by OECD standards, but it is high by Austrian standards. With a high ratio of old people relative to the working-age population, Austria faces big challenges. To boost its potential growth, the OECD believes that Austria needs to raise labour-force participation, especially among older workers. It also needs to strengthen public finances and boost productivity growth by opening up protected areas of the economy, especially services, to competition. Productivity growth in Austria's service sector has been particularly weak over the past decade.

\* OECD is the Organization for Economic Cooperation and Development (formed 1961). The members are the EU countries, USA, Canada, Japan, New Zealand, Australia, Mexico and Turkey.

**Figure 1**

GDP

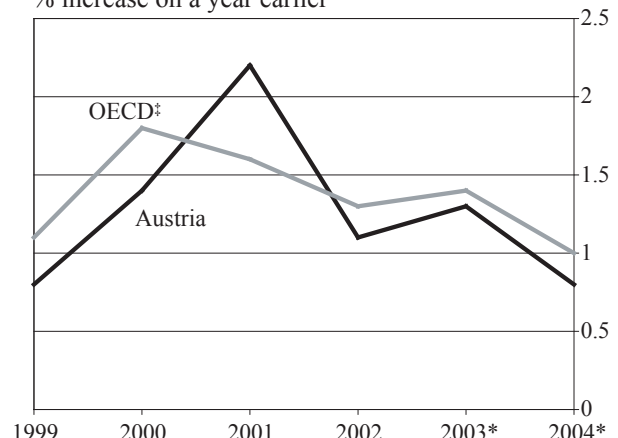
% change on a year earlier



**Figure 2**

Consumer prices†

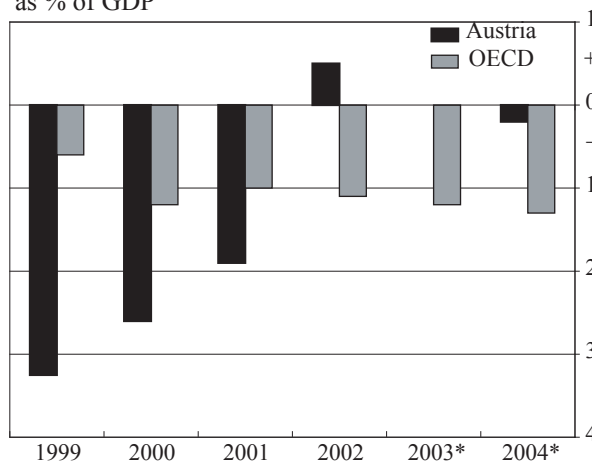
% increase on a year earlier



**Figure 3**

Current account balance

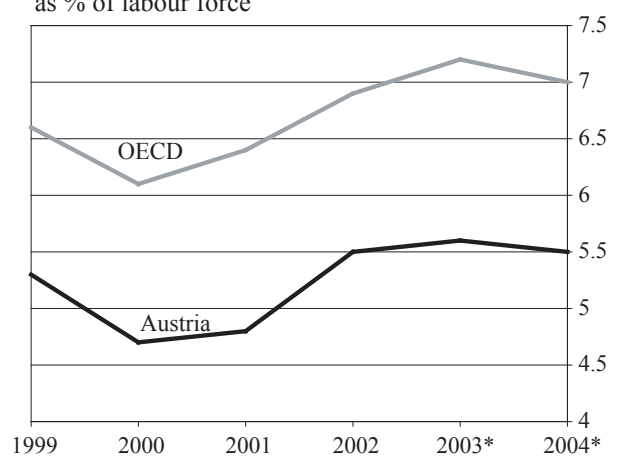
as % of GDP



**Figure 4**

Unemployment

as % of labour force



\* Forecast † Private-consumption deflator ‡ Excluding Hungary, Mexico, Poland and Turkey

[Source: adapted from *The Economist*, November 2003]

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*(Question 3 continued)*

- (a) Define the following terms indicated in bold in the text and data:
- (i) unemployment rate *[2 marks]*
  - (ii) current account. *[2 marks]*
- (b) Using a production possibility curve, explain how Austria might “boost its potential growth”. *[4 marks]*
- (c) Using an appropriate diagram, explain the relationship between consumer prices and unemployment in Austria from 2001 to 2002. *[4 marks]*
- (d) Using information from the text, the diagrams, and your knowledge of economics, evaluate the performance of the Austrian economy. *[8 marks]*

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

**Brazil takes front seat with a hit export**

- ❶ Thanks to a new style wooden chair, a small family-owned factory in Santo Cristo, Brazil, has found itself leading a rapid change in Brazil's furniture industry. The firm, named Schuster, agreed to build a chair for an Italian designer. The chair is made from bits of leftover timber, nailed together apparently at random, and named Favela, after Brazil's equally randomly built shantytowns. Favela is a hit, now sells for \$1800, and orders are coming in from around the world. Exports, almost non-existent last year, now account for 10 % of the firm's revenue this year. Today, 10 000 of Brazil's 13 500 furniture manufacturers are small, family-owned firms, like Schuster. The market is said to be a good example of **monopolistic competition**.
- ❷ With domestic **recession** and a weak local currency, more and more Brazilian furniture makers are aiming at the North American market. Many are concentrating on cheap furniture, copied from American models, as their Chinese rivals do. A few are aiming at the high quality designer-furniture end of the market. This has traditionally been dominated by Italy and Spain, but these countries are losing out in the United States these days because of the strengthening Euro.
- ❸ Last year, Americans bought \$262 million worth of Brazilian furniture, according to US government data. Although that was only a quarter of what Italy shipped to the United States and less than 5 % of the \$5.7 billion sold in the USA by China, it was still up 35 % for the year. That gain came on top of a 34 % increase in 2001. Total imports of furniture in the US last year were \$14.2 billion. The increased interest in Brazilian furniture might lead to higher prices in the future.
- ❹ American manufacturers are already hurt by cheap Chinese imports. More than 47 000 furniture workers have lost their jobs since 2000, according to the American Furniture Manufacturers Association. The Association is calling for tariff barriers to be placed upon furniture imports.
- ❺ Brazilian exporters say that they would be happy just to catch up with Italy. They say that they also use high-quality wood, but they can offer prices that are 40 % lower. Although it has traditionally exported more timber than tables, Brazil is the world's 10th largest furniture manufacturer. However, of its \$3.5 billion in sales last year, only \$500 million dollars came from exports.

[Source: adapted from *The International Herald Tribune*, November 2003]

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*(Question 4 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) monopolistic competition (*paragraph ❶*) *[2 marks]*
  - (ii) recession (*paragraph ❷*). *[2 marks]*
- (b) Using a supply and demand diagram, explain why the price of Brazilian furniture might be expected to rise in the future (*paragraph ❸*). *[4 marks]*
- (c) Using an appropriate diagram, explain what type of unemployment is occurring in the US furniture industry (*paragraph ❹*). *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the view of the American Furniture Makers Association that tariff barriers should be placed upon furniture imports. *[8 marks]*

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

**Dollar falls to all-time low against euro**

- ❶ The dollar fell sharply everywhere yesterday, hitting an all-time low against the euro. The euro traded as high as \$1.2018 – above \$1.20 for the first time – as the dollar fell to new lows against the UK pound and the Canadian dollar and a six-month low against the Swiss franc.
- ❷ Yesterday's fall added to the massive selling of the US dollar, which has dropped by 14 per cent against the euro so far this year. The financial markets are growing increasingly concerned that the US will not be able to attract enough investment to finance its exploding current account deficit, which is at record levels.
- ❸ Lehman Brothers was the latest Wall Street bank to take a pessimistic view, warning its clients that the dollar remained “unattractive”, because the Federal Reserve (the Fed) has been keeping interest rates so low. “By insisting that rates remain at historic lows, the central bank has only added to the doubts about the US recovery. If on the other hand, the Fed begins hinting that rates will head higher than we think, it could prove an important turning point for market confidence in the US – maybe not enough to turn the **exchange rate** trend, but certainly enough to slow it down.”
- ❹ Yesterday the UK pound rose to a fresh five-year high of \$1.7238, its strongest since October 1998. The pound has risen 1.6 per cent against the dollar since the Bank of England raised interest rates. Most of the burden of the dollar's **depreciation** has fallen on the euro as the major Asian economies have defended their currencies against any appreciation. China's *renminbi* is pegged to the dollar and the Chinese administration has rejected suggestions from the White House that the Chinese allow the currency to rise.
- ❺ Japan, which is struggling with a decade-long downturn, has repeatedly intervened to prevent the yen from rising. Their fear is that a high-valued yen will further depress the Japanese economy. It has spent a record ¥17.8 trillion (£95.9 billion) so far this year on keeping the yen down.

[Source: adapted from *The Independent, England*, November 2003]

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*(Question 5 continued)*

- (a) Define the following terms indicated in bold in the text:
- (i) exchange rate (*paragraph 3*) [2 marks]
  - (ii) depreciation (*paragraph 4*). [2 marks]
- (b) With the help of an appropriate diagram, explain **one** reason for the fall in the value of the US dollar. [4 marks]
- (c) With the help of an AD/AS diagram, explain why Japan fears a “high-valued yen” (*paragraph 5*). [4 marks]
- (d) Evaluate **two** methods that the US government might use to correct its “exploding current account deficit” (*paragraph 2*). [8 marks]
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