



22055105

**ECONOMICS
STANDARD LEVEL
PAPER 2**

Thursday 19 May 2005 (morning)

2 hours

INSTRUCTIONS TO 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 extracts below and answer the questions that follow.

Extract 1

**ASIAN AIRLINES SUFFERED A SHARP DECLINE
IN PASSENGERS IN APRIL 2003**

	<i>Passengers carried</i>	<i>% Change (over April 2002)</i>
Cathay Pacific Airways	340 691	-66
Hong Kong Dragon Airlines	71 283	-76
Singapore Airlines	619 000	-50.5
China Southern Airlines	1 265 880	-36.5
China Eastern Airlines	744 010	-31
Korean Airlines	n/a	-7
Vietnam Airlines	200 000	-388

Extract 2

- ① In just two months, the Severe Acute Respiratory Syndrome, or SARS (a serious respiratory disease) resulted in deaths among airline passengers and caused a major demand side shock for the airline industry which is especially vulnerable to changes in **demand**.
- ② Before the SARS outbreak, aircraft manufacturers had been forecasting 8 % annual growth over the next decade for China’s airlines. Now badly hit by SARS, several airlines have been devastated.
- ③ SARS has also affected the aircraft manufacturers. Companies have seen many orders put on hold. “This industry is a highly competitive **oligopoly** right now and it’s a buyer’s market,” said a spokesman.
- ④ Any recovery assumes that people will be quick to get back on flights once their fear of the disease has subsided. There is almost certainly a demand, especially among business travellers, many of whom have postponed meetings with clients and associates. Other businesses that have managed without travelling in the region during the SARS crisis may have discovered that travelling is a luxury they can do without.
- ⑤ Not all the news is bad. As the fear of SARS diminishes, major airlines may not be in a position to win back some market share from their regional and international rivals. “The foreign carriers that pulled out will be much slower to come back in, and that could mean opportunities for regional carriers that are quick to move in and take the advantage.”

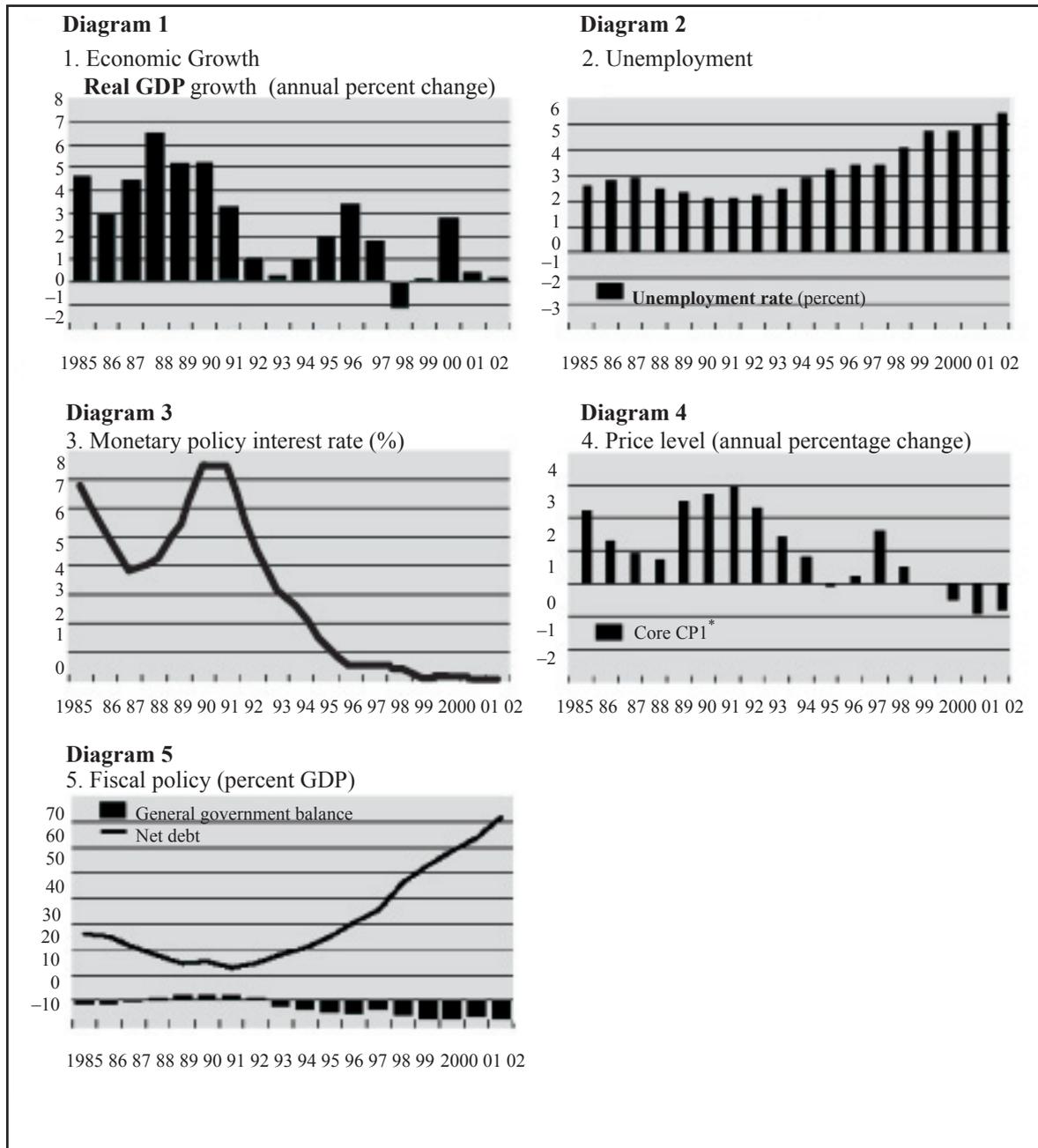
[Source: adapted from *Far Eastern Economic Review* 5 June 2003]

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) demand (*paragraph 1*) *[2 marks]*
 - (ii) oligopoly (*paragraph 3*). *[2 marks]*
- (b) Using an appropriate demand and supply diagram, explain the impact of the SARS virus on the airline industry in the Asia-Pacific region. *[4 marks]*
- (c) Using appropriate diagram(s), explain why the price elasticity of demand for travel by business travellers is likely to differ from that of tourists. *[4 marks]*
- (d) Using information from the text and supply and demand analysis, evaluate the likely future movements in ticket prices. *[8 marks]*

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

Japan A tale of stubborn deflation and weak growth



* Excludes fresh food and energy.

[Source: adapted from www.imf.org/external/pubs/ft/fandd/2003/06/pdf/country.pdf]

(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) real GDP (*Diagram 1*) *[2 marks]*
 - (ii) unemployment rate (*Diagram 2*). *[2 marks]*
- (b) Explain using appropriate economic terms, what occurred to the level of prices in the two time periods, 1991 to 1994 and 1999 to 2002. *[4 marks]*
- (c) Using an appropriate diagram, explain how monetary policy may be used to reduce unemployment. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the effectiveness of the policy tools available to the Japanese government in managing the economy. *[8 marks]*

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

Extract 1

The Thai Farmers Research Center (TFRC) predicts that Thailand's **economic growth** for 2003 will be at 4.3 percent, and that in 2004 the revival of the tourism sector, export expansion, and growth in private sector investment will continue to expand the economy, pushing up economic growth in 2004 to 5.3 percent.

Extract 2

Thailand will become a net creditor sometime between the end of 2003 and mid-2004 according to Olarn Chaiprawat, adviser to the Finance Ministry's Fiscal Policy Research Institute.

Olarn said yesterday that Thailand's current account surplus would increase its foreign assets while there would be a decline in foreign debt.

Olarn said that the country's foreign assets and liabilities would soon even out.

International reserves will total US dollars (\$) 40 billion and the foreign assets of all commercial banks will amount to US (\$) 15 billion, he said. In terms of liabilities, government debt will total US (\$) 20 billion and private debts will settle at US (\$) 35 billion.

Olarn said Thailand's current account will achieve a surplus of US (\$) 7 billion in 2003 and US (\$) 5 billion in 2004. Over the next three years, the total surplus would be between US (\$) 15 billion and US (\$) 20 billion. This surplus is creating upward pressure on the Thai currency, the baht.

Extract 3

Thai exporters have called on the government to help stabilize the baht, fearing that the **currency appreciation** would push export growth below target, the official Thai News Agency reported on Tuesday.

A recent report from the Thai Chamber of Commerce shows that some 69.5 percent of Thai exporters were worried that the current strength of the baht would deal a heavy blow to exporters in all sectors and to the whole Thai economy.

[Source: adapted from *WorldSource Inc* 23 May 2003, *WorldSource Inc* 24 June 2003
and from *WorldSource Inc* 10 June 2003]

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(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) economic growth (*Extract 1*) *[2 marks]*
 - (ii) currency appreciation (*Extract 3*). *[2 marks]*
- (b) Explain using an appropriate diagram, why “the revival of the tourism sector, export expansion, and growth in private sector investment” is expected to push up economic growth (*Extract 1*). *[4 marks]*
- (c) Using an appropriate diagram, explain how the current account surplus may be creating upward pressure on the baht (*Extract 2*). *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the concern of Thai exporters that the “strength of the baht would deal a heavy blow to exporters in all sectors and to the whole Thai economy” (*Extract 3*). *[8 marks]*

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

Extract 1

Open economy hurt, but it was good for Australia

- ① Australia's real average national income is up by more than half since the economy was opened up to international trade 20 years ago. Since 1983 Australia opened its economy to the world by **floating the exchange rate** and cutting tariffs.
- ② An Australian government report also showed that developed economies that had gone global enjoyed much faster growth over the last two decades than those which maintained protective barriers such as tariffs and subsidies.
- ③ Western Europe, the USA and Japan together spend about US dollars (\$) 1 billion a day manipulating world farm trade in their interests, against those of the developing world. Support for agriculture in OECD (Organisation for Economic Co-operation and Development) countries* cost taxpayers and consumers US (\$) 327 billion in 2000, more than five times what they spend on **official aid**.
- ④ US (\$) 2 per day in subsidies are spent on the average European Union (EU) dairy cow, which is more than the income of half the world's population. "Such policies severely damage developing countries' export industries because these industries face major difficulties competing in developed country markets," the report said.
- ⑤ Lower farm trade barriers are necessary to allow developing nations to trade their way out of poverty, and enjoy the gains from globalization.
- ⑥ Gains from globalization in east Asian countries have been significant, with high growth and the creation of employment opportunities. These gains in some cases have been unequally distributed between countries, with significant challenges remaining before globalization can be considered an advantage for the regions citizens.

* OECD countries: An international organization of industrial countries.

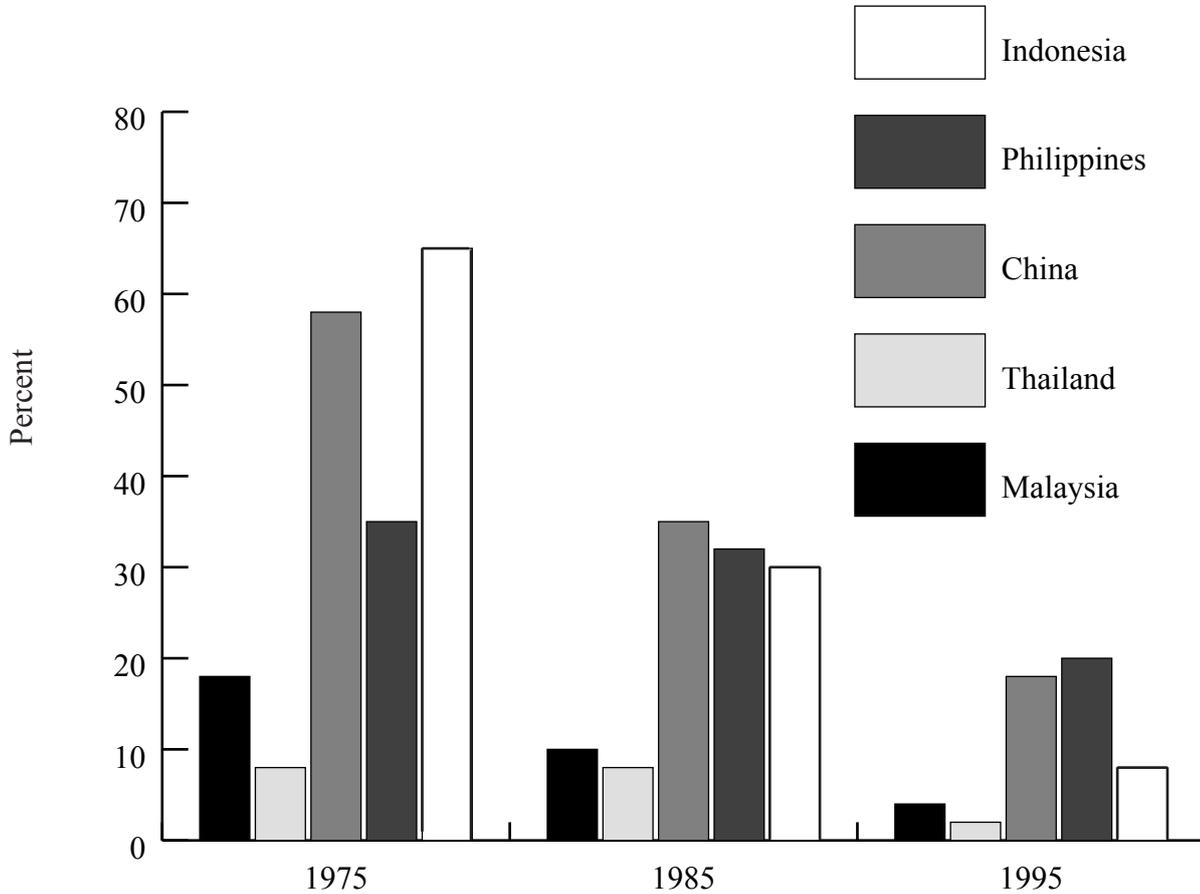
[Source: adapted from *The Australian* 27 May, 2003 and *Globalisation-Keeping the Gains*, a report released by the Australian Department of Foreign Affairs and Trade in May 2003]

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(Question 4 continued)

Diagram 1

Poverty Falling Rapidly – Share of the population living in poverty, selected East Asian economies, selected years, per cent.



- (a) Define the following terms indicated in bold in the text:
 - (i) floating the exchange rate (*paragraph 1*) [2 marks]
 - (ii) official aid (*paragraph 3*). [2 marks]
- (b) Using an appropriate diagram, explain how a subsidy will impact on the price of EU dairy products. [4 marks]
- (c) Using a demand and supply diagram, explain the effects of Australia imposing lower tariffs on imported cars. [4 marks]
- (d) Using information from the text and your knowledge of economics, evaluate the arguments for increased globalization. [8 marks]

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

Trade not Aid

- ① The benefits of government aid or Official Development Assistance (ODA) have been questioned by successive Australian governments. The UN target for ODA is 0.7 % of GNP and Australia has budgeted US dollars (\$) 1 billion in 2002-03 which represent 0.25 % of Australia's GNP. In October 2002 the Minister for Foreign Affairs, Alexander Downer, argued that trade was the main factor and that "aid can only help to a small extent".
- ② The "trade not aid" policy is strangely out of touch with what the poorest countries need for both economic development and trade expansion. Most simply do not have the necessary resources. The United Nations Commission on Trade and Development says that in the 49 poorest Least Developed Countries (LDCs), between 1995 and 1999, the average *per capita* income was US (\$) 0.72 and the average *per capita* consumption, was US (\$) 0.57 a day... This would leave an average US (\$) 0.15 per person per day to spend on private capital formation, public investment in **infrastructure** and the running of vital public services, including health, education, administration and law and order.
- ③ It is often claimed that trade brings much larger benefits to the poor than aid does. The problem with this claim is that the economic models used for trade policy analysis assume that poorer countries already have well-functioning markets for goods and services, a sound banking system, well-defined property rights, a skilled and healthy workforce, well-functioning legal and tax system and good infrastructure. But for many of the poorest countries these institutions are either not effective or non-existent, the human capital base is poor and the infrastructure is sadly deficient. Aid has a critical role in strengthening all these vital capacities.
- ④ Aid is essential to improve levels of education, sanitation and health to help the poorest countries escape from the **poverty cycle** and to build the skilled workforces needed to enable them to prosper. Without adequate investment in education, especially for women, countries risk becoming caught in a trap of low skills and low-quality products. Aid does work and it makes a huge difference to the lives of poor people. But aside from its obvious humanitarian benefits, aid should be considered an investment in our future, not a cost.

[Source: adapted from *Action News*, a World Vision publication, Autumn 2003]

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Question 5 continued

- (a) Define the following terms indicated in bold in the text:
- (i) infrastructure (*paragraph 2*) *[2 marks]*
 - (ii) poverty cycle (*paragraph 4*). *[2 marks]*
- (b) Using an appropriate diagram(s), explain the difference between economic growth and development. *[4 marks]*
- (c) Explain **two** reasons why increased investment in education is essential for development in developing economies. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the view that increased trade is more important than increased aid for less developed economies. *[8 marks]*
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