

Exam practice: paper 2 (SL and HL)

Introduction to paper 2

Paper 2 has the same structure for both standard and higher levels.

	Paper 2: SL and HL
Duration of paper 2	1 hour and 30 minutes
Focus and structure of paper 2	<p>Section A focuses on section 3 of the syllabus (international economics), though students may be required to draw on other parts of the syllabus. Students must answer one question from a choice of two.</p> <p>Section B focuses on section 4 of the syllabus (development economics), though students may be required to draw on other parts of the syllabus. Students must answer one question from a choice of two.</p>
Structure of questions and marks earned in paper 2	<p>Paper 2 consists of data response questions. Each question consists of four parts, (a), (b), (c) and (d), which are based on a text/data provided. Students must answer all parts.</p> <p>Part (a) is subdivided into two parts, (i) and (ii), each of which is worth 2 marks; therefore, part (a) is worth a maximum of 4 marks.</p> <p>Part (b) is worth a maximum of 4 marks.</p> <p>Part (c) is worth a maximum of 4 marks.</p> <p>Part (d) is worth a maximum of 8 marks.</p> <p>Therefore, each question earns a maximum of 20 marks.</p>
Assessment objectives in paper 2	<p>Part (a) of the questions examines assessment objective 1.</p> <p>Part (b) of the questions examines assessment objectives 1, 2 and 4.</p> <p>Part (c) of the questions examines assessment objectives 1, 2 and 4.</p> <p>Part (d) of the questions examines assessment objectives 1, 2 and 3.</p>
Maximum marks earned in paper 2, and percentage in total IB Economics grade	<p>Since the student must answer two questions, Paper 2 earns a maximum of 40 marks.</p> <p>Paper 2 accounts for 40% of the student's overall grade at standard level, and 30% of the student's overall grade at higher level.</p>

Organisation of paper 2 questions in the CD-ROM

Paper 2 questions are organised by section, i.e. section A on international economics followed by section B on development economics. Section A questions are further organised by chapter within the international economics section. Section B questions in some cases are based on more than one chapter (the relevant chapters are indicated).

Most (though not all) texts/data are used as the basis of both SL/HL core questions as well as HL questions. (An exception is text/data 12 which is HL only.) This is common IB practice, and is justified

by the fact that much of the section 3 material (international economics) and nearly all of the section 4 material (development economics) is common to both SL and HL. HL material is examined by HL question parts that are marked as 'higher level'. Each HL question part is accompanied by an alternative question part taken from SL/HL core topics, which is marked as 'core'. This way, all students, at both SL and HL, can have the benefit of completing full 20-mark paper 2 questions. Note that you will find markschemes to many of the paper 2 questions on the teacher support website at ibdiploma.cambridge.org.

Paper 2 section A: International economics

Chapter 13 International trade

Text/data 1

Removing quotas on United States textiles

- 1 Parkdale Mills in North Carolina (in the United States) is one of the largest textile manufacturers in the world. Its chief executive is worried that tough competition from China will get far worse after quotas on Chinese textiles (cotton trousers, golf shirts, baby socks and more than 30 more products) are removed under a World Trade Organization (WTO) agreement.
- 2 Some years earlier, when similar import barriers were temporarily removed, Chinese products had flooded the market, and imports of Chinese trousers alone increased by over 1500%. Prices of the imported products fell, and about 55 000 jobs in the United States were lost. At that time, to put an end to the job losses, the US government temporarily re-imposed the **quotas** that are now to be lifted. This time, WTO rules do not permit new quotas to be applied again.
- 3 Parkdale Mills was among those firms that survived the increased competition from the flood of imports, and still makes yarn and sewing thread used in Central American countries that produce clothing products sold to the United States. There are now fears that a flood of Chinese products that do not make use of US-produced yarns and threads will seriously affect the US and Central American industry.
- 4 US textile manufacturers say they have learned to compete against the products of low-wage countries

like China. However, they accuse China of **dumping** its textiles in international markets, claiming that **subsidies** granted by the Chinese government on textiles allow China to sell some finished products at lower prices than the cost of producing just the yarn and threads in the United States.

The US government has opened a case with the WTO, intended to stop what are claimed to be Chinese unfair trade practices. If the WTO determines that China is practising dumping, China could face penalties such as **anti-dumping tariffs**.

Yet an official of the US International Trade Administration claims that China is not even exporting all the products it is permitted to export to the United States under WTO rules. Even with reductions in US quotas, Chinese products still face an average tariff rate of 17%. Lifting the quotas is likely to result in lower prices for US consumers. He notes that Americans benefit from the trade relationship between the US and China. Just as American consumers want to buy Chinese products, so Chinese consumers want US products. China is a growing market for US exports.

Source: Adapted from 'Expiring quotas threaten textiles' in the Charlotte Observer, 29 December 2008.

Question A.1

- (a) (i) Define the term **dumping** identified in bold in the text (paragraph 4) [2 marks]
- (ii) Define the term **subsidies** identified in bold in the text (paragraph 4) [2 marks]
- (b) Draw a diagram and use it to explain how the removal of the US quotas on Chinese textiles will affect Chinese exports to the US. [4 marks]
- (c) Draw a diagram and use it to explain the effects of the remaining US tariffs on Chinese products on US producers, consumers and workers (paragraph 6). [4 marks]
- (d) Using information in the text and your knowledge of economics, discuss the benefits that might arise from free-trade between the United States and China. [8 marks]

Question A.2

- (a) (i) Define the term **quotas** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Define the term **anti-dumping tariffs** identified in bold in the text (paragraph 5). [2 marks]
- (b) Using an appropriate diagram, explain the effects of subsidies granted to Chinese textiles on Chinese producers and consumers (paragraph 4). [4 marks]
- (c) (higher level) Explain why the theory of comparative advantage is a more powerful explanation of the benefits of trade than the theory of absolute advantage. [4 marks]

HL

- (c) (core) Using an appropriate diagram, explain how US consumers and producers are likely to be affected once the import quotas on textiles are removed (paragraph 6). **[4 marks]**
- (d) Using information in the text and your knowledge of economics, discuss arguments for and against trade protection policies for the textile industry in the United States. **[8 marks]**

Question A.3

- (a) (i) and (ii) Outline two objectives or functions of the World Trade Organization (paragraph 5).

[2 marks + 2 marks]

- (b) Draw a diagram and use it to explain what type of unemployment increased in the United States by the loss of 55 000 jobs (paragraph 2). **[4 marks]**
- (c) Draw a demand and supply diagram and use it to explain the likely effects on Central American clothing products of the US removal of quotas on Chinese textiles. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, compare and contrast the effects of tariffs and quotas, considering their effects on stakeholders and the US and Chinese economies. **[8 marks]**

Text/data 2

Corporate fraud: free trade

1 Free trade is ruining America. You'd think economists would feel a duty to explain to our leaders what's gone wrong. Well, that's their job, but most economists these days work for industry, largely the same employers who benefit from cheap foreign or imported labour. They're surely not going to sound the alarm. Other economists work for universities, where they are still caught up in ancient ideology, including the buzzword 'comparative advantage'.

HL 2 (higher level^a) According to comparative advantage, Mexico should send avocados to Maine (a state in the United States) and get blueberries in return. That way everyone makes a profit. Such is the foolish logic that presidents have used to sell free trade agreements to the government, which the government buys too often. Unfortunately what is at stake – always – is greed. Manufacturers and marketers don't know avocados from blueberries. But they do seek out cheap labour anywhere they can find it. What's more, they pay big money to political campaigns to get it. After all, American workers aren't their responsibility.

3 Large agricultural producers also don't care about workers and poor farmers. They are heavily subsidised by the government, and love selling their low-cost products to countries where there is no such subsidy. That may drive local farmers out of business but the companies don't care.

4 Most nations have imposed tariffs or quotas to protect local industries against such cheap foreign competition. This healthy protection is what free trade agreements seek to eliminate. Expanded to the grand scale of world trade, these actions have led to uncontrolled unemployment, a depressed economy and a huge trade deficit.

5 So why not impose more tariffs to raise prices for specific foreign goods and services? This would save and possibly create jobs. We could also use the administrative barriers to prohibit entry of those products whose manufacturer destroys the environment or abuses workers.

6 If by any chance you would like to do your bit for the economy, you can urge your government representatives to oppose upcoming free trade agreements. They would only make unemployment worse. And don't pay attention to economists on trade issues. Too many have sold out. They warn of trade wars, but ignore the damage of the trade peace we're suffering today.

^aSL students can ignore this paragraph and answer the alternative questions below marked as 'core' based on the rest of the text.

Source: Adapted from William A. Collins, 'Corporate scam: free trade' in *The Union Daily Times*, 13 November 2010.

Question A.4

HL (a) (higher level) (i) and (ii) Describe two sources of comparative advantage, using examples. [2 marks + 2 marks]

(a) (core) (i) and (ii) Outline two benefits (gains) that can be expected to arise from international trade. [2 marks + 2 marks]

HL (b) (higher level) Assuming Mexico exports avocados and Maine exports blueberries, draw a diagram and use it to explain the theory of *comparative advantage*. [4 marks]

(b) (core) Using a supply and demand diagram, explain how the use of 'cheap labour' by manufacturers may lead to increased export competitiveness (paragraph 2).

(c) Draw an appropriate diagram and use it to explain how US subsidies on agricultural products result in 'low-cost products' sold to other countries (paragraph 3). [4 marks]

(d) Using information in the text and your knowledge of economics, to what extent do you support the author's perspective on the point that the United States should impose trade barriers to protect jobs and avoid recession in the United States? [8 marks]

Question A.5

(a) (i) and (ii) Describe two administrative barriers that can be used as a method of trade protection (paragraph 5). [2 marks + 2 marks]

(b) (higher level) Assuming Mexico exports avocados and Maine exports blueberries, draw a diagram and use it to explain the theory of *absolute advantage* (paragraph 2). [4 marks]

(b) (core) Draw a diagram illustrating a type of trade protection of your choice, and use it to explain the meaning of 'trade wars' (paragraph 6). [4 marks]

HL

- (c) Using an appropriate diagram, explain how removal of tariffs in the United States may lead to job losses. **[4 marks]**
- (d) (higher level) Using information in the text and your knowledge of economics, evaluate the author's perspective on the point that economists should advise the government to ignore the theory of comparative advantage. **[8 marks]**
- (d) (core) Using information in the text and your knowledge of economics, discuss the possible consequences of a US policy involving increased trade protection measures, as suggested by the author. **[8 marks]**

Chapter 14 Exchange rates and the balance of payments

Text/data 3

Vietnam tries to deal with trade deficit

- 1 Vietnam's currency, the dong, is pegged to the US dollar. Following two **devaluations** in the past six months, the dong's **exchange rate** has reached its lowest value in the last seven years. Recently, the central bank bought US\$1 billion by selling dong in order to maintain the value of the currency at the lower level. However, some economists claim that the dong is still **overvalued**.
- 2 Vietnam is having difficulties achieving macroeconomic stability. It has a persistent **current account deficit** (due to a trade deficit), which is very large and growing, and which is putting a downward pressure on the value of the dong. Vietnam is also threatened by **inflation**. The dong devaluations indicate that the government and central bank are attaching greater importance to tackling the problem of the current account deficit rather than the problem of inflation. 'The risk from the trade and **balance of payments** deficits remains,' said Hung, from one of Vietnam's larger brokerage firms. 'A weaker dong is needed to spur exports and to stabilise the foreign-currency market.' Analysts say the dong may be devalued again in order to bring Vietnam's trade deficit under control.
- 3 Vietnam also faces a large and growing foreign debt. Its payments for debt servicing (repayment of loans plus

interest) are expected to double in the next six years. An important reason behind the growing foreign debt burden is the need to finance the large trade deficit.

Economic policy makers are at the same time determined to maintain a high rate of growth, forecast to be 6.5% this year. To achieve this goal, they are pursuing expansionary **fiscal policy** and **monetary policy**. This increases the likelihood of inflation and also puts a downward pressure on the value of the dong.

The dong devaluations are likely to help boost exports, but they will also make imports more expensive. This means that prices of imports of machinery, equipment and other imported inputs will increase, hurting export competitiveness, and also increasing inflationary pressures. Much of Vietnam's growth is based on exports. Yet exports appear to be slowing down. A slowdown in export growth will create difficulties for policy-makers concerned about the widening trade deficit.

Source: 'Vietnam may weaken dong to support exports, SS I says' in *Bloomberg Businessweek*, 20 May 2010; 'Not all that it seems in the Vietnamese economy' in *The Nation* (Thailand), 19 August 2010; 'A cheap dong may prove costly for Vietnam' in *The Straits Times* (Singapore), 2 December 2009.

Question A.6

- (a) (i) Define the term **overvalued** (exchange rate) identified in bold in the text (paragraph 1). [2 marks]
- (ii) Define the term **monetary policy** identified in bold in the text (paragraph 4). [2 marks]
- (b) Using a foreign exchange diagram, explain the effects of the central bank's purchase of dollars (sale of dong) on the value of the dong (paragraph 1). [4 marks]
- (c) Using an AD-AS diagram, explain how a devaluation can affect the rate of inflation in Vietnam (paragraphs 2 and 5). [4 marks]
- HL (d) (higher level) Using information in the text and your knowledge of economics, evaluate the effectiveness of expenditure-reducing policies that the Vietnamese government and/or central bank could use to correct Vietnam's persistent current account deficit. [8 marks]

- (d) (core) Using information in the text and your knowledge of economics, discuss the effects of expansionary fiscal and monetary policies on Vietnam's trade deficit and the Vietnamese economy. [8 marks]

Question A.7

- (a) (i) Define the term **current account deficit** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Define the term **inflation** identified in bold in the text (paragraph 2). [2 marks]
- (b) Using an exchange rate diagram, explain how the pegged (fixed) dong is maintained relative to the dollar. [4 marks]
- (c) Explain why the devaluations suggest that the central bank is more interested in the size of the current account deficit than in controlling inflation (paragraph 2). [4 marks]

- HL** (d) (higher level) Using information in the text and your knowledge of economics, evaluate the effectiveness of expenditure-switching policies that the Vietnamese government and/or central bank could use to correct Vietnam's persistent current account deficit. **[8 marks]**
- (d) (core) Using information in the text and your knowledge of economics, discuss the possible effects of a new devaluation of the dong (paragraph 2). **[8 marks]**

Question A.8

- (a) (i) Outline the role of the balance of payments (paragraph 2). **[2 marks]**
- (ii) Define the term **exchange rate** identified in bold in the text (paragraph 1). **[2 marks]**
- (b) Using an exchange rate diagram, explain why expansionary monetary policy puts a downward pressure on the value of dong (paragraph 4). **[4 marks]**
- (c) Distinguish between a current account deficit and a current account surplus. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, discuss the possible effects of a hypothetical policy decision to move from a pegged (fixed) dong to a freely floating dong. **[8 marks]**

Question A.9

- (a) (i) Define the term **devaluation** identified in bold in the text (paragraph 1). **[2 marks]**
- (ii) Define the term **fiscal policy** identified in bold in the text (paragraph 4). **[2 marks]**
- (b) Explain two possible consequences of an overvalued dong (paragraph 1). **[4 marks]**
- (c) Explain why a deficit in the current account results in a downward pressure on the value of the dong (paragraph 2). **[4 marks]**
- (d) (higher level) Using information in the text and your knowledge of economics, discuss the possible consequences of Vietnam's persistent current account deficit on the Vietnamese economy. **[8 marks]**
- (d) (core) Using information in the text and your knowledge of economics, evaluate the policy of government intervention to influence the value of the dong. **[8 marks]**

HL

Text/data 4

China's trade surplus

- 1 Just before the global financial crisis, China was close to surpassing Germany in becoming the world's largest exporter. However the onset of the crisis caused a sharp drop in Chinese exports, leaving China as the world's second largest exporter after Germany. Still, China's persistent **current account surplus** (due to its trade surplus) increased to record levels. The reason was that Chinese imports dropped even more dramatically than its exports.
- 2 The drop in Chinese imports was partly due to falling oil and other commodity prices (causing a fall in the value of imports). Also, since a large share of China's imports (over 50%) consists of raw materials and other inputs used to produce exports, falling exports has meant a reduced need to import. Further, imports fell because of weakening domestic demand. Construction, which relies heavily on imported materials, has collapsed.
- 3 Due to the global economic crisis and **recession**, it is expected that Chinese exports will continue to fall. Imports, on the other hand, are forecast to increase, as a result of massive planned increases in the government's spending on infrastructure, which will require imports of raw materials and machinery. Therefore China's trade surplus is expected to fall.

4 The sharp drop in exports has led to serious job losses in southern China. Given the expectations of declining exports and rising imports, it is believed that the Chinese government or central bank may try to push down the value of the yuan (the Chinese currency). However, it is believed that the yuan, which is pegged to the US dollar, is already **undervalued**. The large current account surplus is causing an upward pressure on the value of the yuan. If its value is pushed even lower, this could give rise to retaliation by the United States. The United States is demanding that China revalues its currency.

5 The real problem in China is not low competitiveness, but weak foreign demand. China cannot rely on exports when global trade is falling due to recession. The best way to deal with this problem is to encourage increases in domestic demand. Falling domestic interest rates and reduction of government credit restrictions have resulted in an increase in bank loans of 19% in the past year, which is likely to support domestic spending.

Source: Adapted from 'Surplus to requirements' in *The Economist*, 17 January 2009; 'China: return of the dollar peg?' in *Forbes*, 31 March 2009.

Question A.10

- (a) (i) Define the term **current account surplus** identified in bold in the text (paragraph 1). [2 marks]
- (ii) Define the term **recession** identified in bold in the text (paragraph 3). [2 marks]
- (b) Explain two possible consequences of an undervalued yuan (paragraph 4). [4 marks]
- (c) Draw an exchange rate diagram and use it to explain one way that the Chinese government or central bank can use to 'push down the value of the yuan' (paragraph 4). [4 marks]
- HL (d) (higher level) Using information in the text and your knowledge of economics, discuss the possible consequences of China's persistent current account surplus (paragraph 4). [8 marks]
- (d) (core) Using information in the text and your knowledge of economics, to what extent do you support the view that China should revalue the yuan (paragraph 4)? [8 marks]

Question A.11

- (a) (i) Define the term **undervalued** (exchange rate) identified in bold in the text (paragraph 4). [2 marks]
- (ii) Referring to China's balance of payments, state one item that enters as a debit and one that enters as a credit in China's current account. [2 marks]
- (b) Explain why a surplus in the current account results in an upward pressure on the value of the yuan (paragraph 4). [4 marks]
- (c) Draw an AD-AS diagram and use it to explain why the global recession caused an increase in unemployment in southern China (paragraph 4). [4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate the policy option to lower the value of the yuan (paragraph 4). [8 marks]

Text/data 5

Sri Lanka's reserve assets fall to dangerously low levels

- 1 The **reserve assets** held by Sri Lanka's **central bank** fell to a level just enough to cover 1.3 months of imports. In addition, its private remittances from workers (income from abroad), have fallen by nearly 7%.
- 2 Imports are contracting sharply in the midst of a global recessionary environment and lower domestic demand. A lower demand for imports is partly due to lower worker remittances.
- 3 In spite of lower imports, Sri Lanka's falling exports are causing its huge trade deficit to grow even larger. Its textile exporters state that they are having a harder time than textile exporters in India or Bangladesh, because of a serious shortage of skilled labour, which is driving up labour costs and making textiles uncompetitive in foreign markets. Some textile factories have already closed down or are reducing their size. Unemployment is expected to rise as the textile industry is one of Sri Lanka's biggest employers.
- 4 Exporters argue that the rupee (the Sri Lankan currency) should be allowed to depreciate to allow exporting firms to regain competitiveness. However, the government is concerned that a large **depreciation** would push up inflation and import costs, as well as the value of foreign debt. Sri Lanka just recently succeeded in bringing down the rate of inflation from over 28% to single digits.

5 Sri Lanka used to peg the rupee to the US dollar. The peg was abandoned in favour of a managed float. As a result, the rupee depreciated, but the central bank intervenes to prevent it from falling to its freely floating exchange rate value. This is one reason why the central bank's reserve assets have fallen to very low levels. The central bank wants to allow the value of the rupee to depreciate gradually.

6 A textile industry representative argues that the central bank may not have enough reserves to keep supporting the rupee, and that if the central bank did not intervene in the foreign exchange market, the rupee would 'reach an acceptable level'. Domestic interest rates are falling, as the central bank is loosening its monetary policy, in view of rapidly falling rates of inflation. This is leading to net outflows of portfolio investments, which additionally may result from a more risk-averse attitude (avoidance of risk) on the part of foreign investors.

Source: Adapted from The Economist Intelligence Unit ViewsWire: News analysis, 'Sri Lanka economy: outlook – fall in exports to slowdown growth', 22 January 2009; 'Sri Lanka's apparel exporters say depreciation needed', in *Asia Pulse*, 21 January 2009; 'Sri Lanka's foreign reserves fall to US\$1.4 billion in Jan' in *Asia Pulse*, 18 March 2009.

Question A.12

- (a) (i) Using information in the text, state one item that enters as a credit and one item that enters as a debit, in Sri Lanka's balance of payments accounts. [2 marks]
- (ii) Define the term **reserve assets** identified in bold in the text (paragraph 1). [2 marks]
- (b) Using an exchange rate diagram, explain how the rupee would reach 'its freely floating exchange rate value' (paragraph 5). [4 marks]
- (c) Using a diagram, analyse the effects of the shortage of skilled workers on textile firms' export competitiveness (paragraph 3). [4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate the central bank's decision to avoid a rapid depreciation of the rupee (paragraph 5). [8 marks]

Question A.13

- (a) (i) Define the term **central bank** identified in bold in the text (paragraph 1). [2 marks]
- (ii) Define the term **depreciation** identified in bold in the text (paragraph 4). [2 marks]
- (b) Using an exchange rate diagram, explain the effect of outflows of portfolio investments on the value of the rupee (paragraph 6). [4 marks]
- (c) Explain how a managed float (managed exchange rate) operates (paragraph 5). [4 marks]
- (d) Using information in the text and your knowledge of economics, discuss the policy options available to the government and central bank of Sri Lanka to avoid a rapid depreciation of the rupee. [8 marks]

Text/data 6

Mauritius' policy dilemma

- 1** The Mauritius Finance Minister and Central Bank Governor are considering what to do with the rupee (the Mauritian currency): appreciate it to fight inflation, or depreciate it to increase export competitiveness. In fact, export competitiveness appears to be dominating in their minds. They appear to be thinking that rupee depreciation will work to increase exports and lower imports, whereas **appreciation** will do the opposite. Recent high inflation is due mainly to increases in prices of imported food and oil. The central bank recently lowered interest rates to prevent large inflows of financial capital, and to prevent an appreciation of the rupee.
- 2** In earlier years, a rupee depreciation did not work to improve Mauritius' current account on its balance of payments. Between 2003 and 2006, the rupee went from 1 pound sterling = Rs 47.30 to Rs 66.95. Yet the current account went from surplus in 2003 to deficit over the following years.
- 3** One possible explanation relates to price elasticity of demand for imports and exports. The demand for imports in Mauritius may be highly price-inelastic. The reason is that exports have a large import content. It is estimated that imports of raw materials and intermediate goods required for production of exports represent about

60% of the value of exports produced by export-oriented enterprises. Strong dependence of production of export goods on imports makes demand for these very price-inelastic.

Therefore, import expenditures may not fall much as a result of a rupee depreciation. In addition, depreciation may not lead to an increase in the volume of exports. Since depreciation increases the prices of imported inputs, the effect of higher costs of production may be so strong as to lead to a drop in export volumes.

By the same logic, exports need not fall as a result of currency appreciation, which might even cause export volumes to increase. Whereas the rupee appreciated strongly after 2007, exports were not negatively affected.

Export competitiveness can also be achieved through **productivity** increases, which can be pursued through improvements in human capital and physical capital including new technology development, as well as improvements in management practices.

Source: 'AAGM: coping with food inflation' in *L'Express*, 16 April, 2008; 'AAGM: the competitiveness mantra' in *L'Express*, 28 May 2008.

Question A.14

- (a) (i) Define the term **appreciation** identified in bold in the text (paragraph 1). **[2 marks]**
- (ii) Outline the meaning of **productivity** identified in bold in the text (paragraph 6). **[2 marks]**
- HL** (b) (higher level) Using the Marshall–Lerner condition, explain the effects of the rupee depreciation of 2003–6 on Mauritius' current account (paragraph 2). **[4 marks]**
- (b) (core) Use a supply and demand diagram to suggest a possible reason why the rupee appreciation after 2007 did not lead to a decrease in the volume of exports (paragraph 5). **[4 marks]**
- (c) (higher level) Explain the J-curve effect and why it does not appear to apply in the case of Mauritius (paragraph 3). **[4 marks]**
- (c) (core) Explain the kind of exchange rate system in use in Mauritius. **[4 marks]**
- (d) (higher level) Using information in the text and your knowledge of economics, compare and contrast the effectiveness of expenditure-reducing policies and supply-side policies to increase competitiveness that the Mauritius government and/or central bank could use to correct the current account deficit. **[8 marks]**
- HL** (d) (core) Using information in the text and your knowledge of economics, discuss the policy option to allow the value of the rupee to depreciate. **[8 marks]**

Text/data 7

Riverland's balance of payments problems

Riverland's economy faces several problems. It has a relatively high rate of inflation at 8%, which is expected to rise further due to cost factors, including increases in the price of its oil and other commodity imports. Unemployment is estimated to be 11%, though this is likely to be an underestimate because of the presence of extensive hidden unemployment. Its public debt is high (at 75% of GDP). Its rate of growth has been falling,

reaching an expected 0.7% for the current year (2010). It has a poverty rate of 25%. Further, it has a highly inflexible labour market.

Riverland has also been experiencing balance of payments difficulties over many years. The table below presents its balance of payments accounts for the year 2010.

Balance of payments accounts for Riverland, 2010 (billions of RvI)

1	Current account	
2	Balance of trade in goods	-230
3	Balance of trade in services	-25
4	Income	+55
5	Current transfers	+37
6	Balance on current account	-163
7	Capital account	
8	Capital transfers	+12
9	Transactions in non-produced, non-financial assets	+15
10	Balance on capital account	+27
11	Financial account	
12	Direct investment	+67
13	Portfolio investment	+12
14	Reserve assets	+40
15	Balance on financial account	+119
16	Errors and omissions	+17

Question A.15

- (a) (i) Outline the meaning of **balance of trade in goods** (row 2 in the table). [2 marks]
- (ii) Outline the meaning of **direct investment** (row 12 in the table). [2 marks]
- (b) Using the concepts of debits and credits, explain which of the three accounts has a surplus and which has a deficit. [4 marks]

- (c) Referring to item 4 (income) in Riverland's balance of payments accounts, explain what was likely to be larger in Riverland in 2010: GNI *per capita* or GDP *per capita*. [4 marks]
- (d) (higher level) Using information in the text and table, and your knowledge of economics, compare and contrast the use of demand-side policies and supply-side policies as methods to correct Riverland's balance of payments problems. [8 marks]

HL

- (d) (core) Using information in the text and table, and your knowledge of economics, evaluate possible economic consequences of depreciation/ devaluation of the Rvl. **[8 marks]**

Question A.16

- (a) (i) Outline the meaning of **balance of trade in services** (row 3 in the table). **[2 marks]**
 (ii) Outline the meaning of **capital transfers** (row 8 in the table). **[2 marks]**
- (b) Considering the entry for reserve assets (row 14 in the table), explain what type(s) of exchange rate system Riverland could have. **[4 marks]**
- (c) Explain what item in Riverland's balance of payments accounts is most likely to have led to its balance of payments difficulties. **[4 marks]**
- (d) Using information in the text and table, and your knowledge of economics, compare and contrast the likely effectiveness of alternative exchange rate systems in addressing Riverland's economic problems. **[8 marks]**

Question A.17

- (a) (i) Outline the meaning of **income** (row 4 in the table). **[2 marks]**
 (ii) Outline the meaning of **portfolio investment** (row 13 in the table). **[2 marks]**

- (b) Draw an exchange rate diagram and use it to show the effect of the change in reserve assets (row 14 in the table) on the value of the Rvl. **[4 marks]**
- (c) Explain what would likely happen to the value of the Rvl if Riverland switched to a freely floating exchange rate system. **[4 marks]**
- (d) Using information in the text and table, and your knowledge of economics, examine the possible consequences of an overvalued Rvl. **[8 marks]**

Question A.18

- (a) (i) Outline the meaning of **current transfers** (row 5 in the table). **[2 marks]**
 (ii) Outline the meaning of **transactions in non-produced, non-financial assets** (row 9 in the table). **[2 marks]**
- (b) Using the concepts of debits and credits and the information in the table, explain how the current account, capital account, financial account and errors and omissions are related to each other. **[4 marks]**
- (c) Using information in the table, explain why the Rvl might be overvalued. **[4 marks]**
- (d) Using information in the text and table, and your knowledge of economics, examine the interdependence of Riverland's current account and financial account. **[8 marks]**

Text/data 8

Dilemmas facing the Turkish economy

The Turkish economy went through a major currency and banking crisis in 2001, but with assistance from the International Monetary Fund (IMF) that imposed restrictive fiscal and monetary policies, it has made substantial progress toward achieving macroeconomic stability. It has a market-oriented economy which has experienced high rates of economic growth, above the OECD* average (see the diagrams below), it has diversified its exports and the rate of inflation has come down. However, it is still faced with problems that the government must address. It has a large current account deficit, and therefore relies heavily

on financial capital inflows. High interest rates have caused the lira (the Turkish currency) to appreciate, making exports less competitive. It has a high rate of unemployment. While the rate of inflation (measured by the **consumer price index**) fell dramatically in 2003–4, it still remains high compared to the OECD average. In addition, there is high inequality in income distribution. According to the OECD, Turkey should pursue fiscal restraint by avoiding large **budget deficits**, in view of its large **public debt**. Also, it should adopt supply-side policies to encourage competition, including **labour market reforms**.

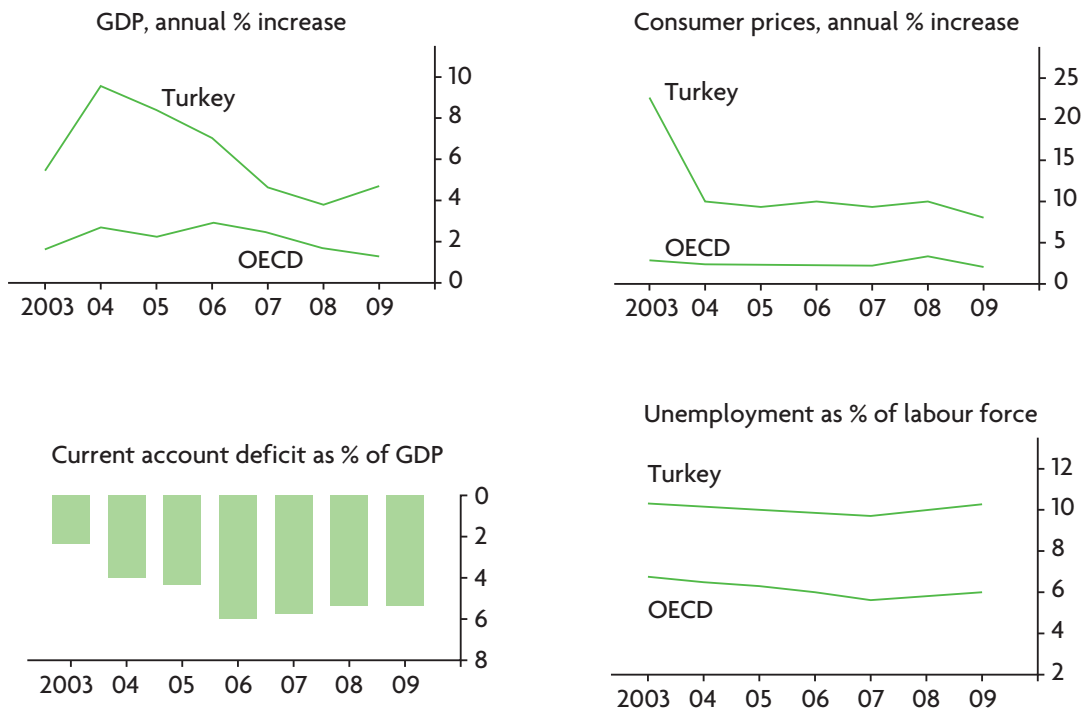


Figure cs.1 Turkey
Source: Data from OECD.

* The OECD is the Organisation for Economic Co-operation and Development, and consists of many of the countries of the European Union, plus Australia, Canada, Iceland, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey and the United States.

Source: Adapted from: *The Economist*, 17 July 2008; OECD, 'Economic Survey of Turkey 2008', 17 July 2008.

Question A.19

- (a) (i) Define the term **budget deficit** identified in bold in the text. **[2 marks]**
- (ii) Define the term **consumer price index** identified in bold in the text. **[2 marks]**
- (b) Explain why Turkey's large current account deficit makes it dependent on financial capital inflows. **[4 marks]**
- (c) Using an exchange rate diagram, analyse the likely impact of Turkey's relatively high rate of inflation on the value of the lira. **[4 marks]**
- (d) Using information in the text, the diagrams and your knowledge of economics, discuss the likely effects of lira appreciation on the Turkish economy. **[8 marks]**

Question A.20

- (a) (i) Outline the meaning of **public debt** identified in bold in the text. **[2 marks]**
- (ii) Outline the meaning of **labour market reforms** identified in bold in the text. **[2 marks]**
- (b) Using an *AD-AS* diagram, explain the likely effects of supply-side policies on Turkey's export competitiveness. **[4 marks]**
- (c) Using an exchange rate diagram, analyse the impact of Turkey's high interest rates on the value of the Turkish lira. **[4 marks]**
- (d) (higher level) Using information in the text, the diagrams and your knowledge of economics, justify two policies you would recommend to the Turkish government to reduce the current account deficit. **[8 marks]**
- (d) (core) Using information in the the text, the diagrams and your knowledge of economics, evaluate the OECD's policy recommendation that Turkey should pursue supply-side policies. **[8 marks]**

HL

Chapter 15 Economic integration and the terms of trade

Text/data 9

Asia free trade zone raises hopes and fears

- 1 At the stroke of midnight on the last day of 2009, China and ASEAN (a **trading bloc** of ten nations in southeast Asia*) launched the world's largest **free trade area** (FTA) in terms of population (1.9 billion people) and the third largest in terms of combined GDPs. The FTA is known as CAFTA (China-ASEAN Free Trade Area). The agreement will result in lower tariffs on 90% of traded goods.
- 2 CAFTA is expected to lead to large increases in trade between members. For ASEAN countries, increased access to the Chinese market of 1.3 billion people will produce benefits including more opportunities to achieve economies of scale, improved efficiency in production due to greater competition, lower prices and increased choices for consumers. Producers may benefit from greater choice and access to cheaper inputs and materials from China, as well as increased exports. For example, Malaysia could gain from increases in exports of palm oil, rubber and natural gas to China. China will benefit as manufacturers satisfy their growing demand for raw materials imports, while materials exporters similarly benefit from export growth.
- 3 However, the FTA also carries dangers. Some poorer ASEAN countries may not be ready to compete with more efficient and lower cost producers in China, and

may be flooded by cheaper Chinese imports, resulting in the closure of small domestic firms and higher **structural unemployment**. Cambodian textile producers are fearful of the Chinese garment industry. Vietnamese consumer goods production could also be damaged. In Indonesia, worries are focused on the textile and steel industries. On the other hand, it is also possible that Chinese farmers may be affected by increased agricultural product imports from Malaysia, Thailand and Vietnam.

Supporters of the FTA agree that while it is likely to bring about benefits, governments should pursue policies to ensure broad participation in the benefits of growth. The World Bank argues that the FTA is a gold mine for growth, but governments must make more investments in public goods and **merit goods**, and ensure that growth improves standards of living for all citizens.

* The countries of ASEAN (Association of Southeast Asian Nations), initially consisted of Brunei, Indonesia, Malaysia, Singapore, the Philippines, and Thailand, and were later joined by Cambodia, Laos, Myanmar and Vietnam.

Source: 'Asia free-trade zone raises hopes, and some fears about China' in *The New York Times*, 31 December 2009; ACFTA offers opportunities for Indonesia: WB' in *The Jakarta Post*, 9 April 2010.

Question A.21

- (a) (i) Define the term **trading bloc** identified in bold in the text (paragraph 1). [2 marks]
- (ii) Define the term **structural unemployment** identified in bold in the text (paragraph 3). [2 marks]
- (b) Using a tariff diagram, explain why Cambodian textile producers are fearful of the Chinese garment industry (paragraph 3). [4 marks]
- HL (c) (higher level) Draw a diagram illustrating economies of scale and use it to explain how countries forming a free trade area can gain from economies of scale (paragraph 2). [4 marks]
- (c) (core) Using a supply and demand diagram, explain how 'access to cheaper inputs and materials from China' will help producers' export competitiveness (paragraph 2). [4 marks]
- (d) Using information in the text and your knowledge of economics, to what extent would you support

the view that 'the FTA is a gold mine for growth' (paragraph 4)? [8 marks]

Question A.22

- (a) (i) Define the term **free trade area** identified in bold in the text (paragraph 1). [2 marks]
- (ii) Define the term **merit good** identified in bold in the text (paragraph 4). [2 marks]
- (b) Using a trade protection diagram of your choice, explain why formation of a free trade area increases competition among producers in the trading bloc (paragraph 2). [4 marks]
- (c) Using a tariff or quota diagram, explain why the FTA is likely to lead to lower prices for consumers (paragraph 2). [4 marks]
- (d) Using information in the text and your knowledge of economics, discuss the view that the costs of CAFTA membership may be greater than the benefits for CAFTA's poorer member countries. [8 marks]

Text/data 10

Africa's main trading bloc works on customs union

- 1 Leaders from Africa's largest trading bloc, the Common Market for Eastern and Southern Africa (COMESA*), met to discuss steps toward greater **economic integration** between its 19 member countries. The member countries of COMESA are home to 400 million people, representing half of Africa's population, with a total **GDP** of over US\$270 billion.
- 2 Founded in 1994, COMESA replaced a **preferential trade agreement** that was in place since 1981. Though called a 'common market' from the outset, economic integration began through the gradual formation of a free trade area, established in 2000 when nine of the member-states eliminated their tariffs on products originating within COMESA. COMESA plans to form a customs union in 2012, and to complete monetary union by 2018.
- 3 COMESA is actively working on issues of tariff alignment among the member countries. As noted by its secretary-general, 'Member-states are obliged to act collectively as any unilateral action by a member state would undermine the very essence of the Customs Union.'
- 4 COMESA is also working on improving transport and communications infrastructure and administration in order to facilitate the movement of goods, services and people between the member countries; creating a legal framework to encourage private sector growth; establishing a secure investment environment; and harmonising macroeconomic and monetary policies throughout the region.
- 5 The establishment of the customs union is expected to boost regional trade and investment among participating countries and promote their **economic growth**. However, several countries have not yet participated in the free trade area. There are broad differences among countries

in income levels, giving rise to concerns that some weaker economies could face deteriorating economic conditions due to increased competition, as well as due to loss of tariff revenues on which they are highly dependent.

(higher level^a) The evidence suggests that while COMESA has given rise to some trade creation effects, it has not led to much trade diversion.

There are hopes that monetary union will eventually include Africa's other two major trading blocs, the East African Community (EAC**) and the Southern Africa Development Community (SADC***). As of 2008, there has been agreement to harmonise trading arrangements among the three blocs, with a view to creating a free trade area that will include all the member states, with the goal of eventually establishing a single customs union.

^a SL students can ignore this paragraph and answer the questions below marked as 'core' based on the rest of the text.

* COMESA includes Burundi, Comoros, the Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe

** EAC includes Burundi, Kenya, Rwanda, Tanzania, Uganda.

*** SADC includes Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

Source: COMESA website (<http://about.comesa.int>); 'Historic first EAC-SADC-COMESA Tripartite Summit' in *The African Executive*, 5 November 2008; 'Comesa all set to usher in new era' in *Mmegi*, 25 September 2009; J. W. Musila (2005) 'The intensity of trade creation and trade diversion in COMESA, ECCAS and ECOWAS: a comparative analysis' in *Journal of African Economies*, Vol. 14(1).

6 HL

7

Question A.23

- (a) (i) Define the term **economic integration** identified in bold in the text (paragraph 1).
[2 marks]
- (ii) Define the term **GDP** identified in bold in the text (paragraph 1).
[2 marks]
- (b) Using an AD-AS diagram, explain how loss of revenues from tariffs may have serious negative effects on some COMESA economies (paragraph 5).
[4 marks]
- (c) (higher level) Using the concept of *trade creation*, explain how increased trade links between the member countries of COMESA could benefit their economies (paragraph 6).
[4 marks]

HL

- (c) (core) Distinguish between a customs union and a common market.
[4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate the desirability of monetary union for COMESA members.
[8 marks]

Question A.24

- (a) (i) Define the term **preferential trade agreement** identified in bold in the text (paragraph 2).
[2 marks]
- (ii) Define the term **economic growth** identified in bold in the text (paragraph 5).
[2 marks]

HL

- (b) Comment on the point that COMESA was called a 'common market' before it became a free trade area (paragraph 2). **[4 marks]**
- (c) (higher level) Explain the importance of the statement that COMESA 'has not led to much trade diversion' for COMESA members (paragraph 6). **[4 marks]**
- (c) (core) Distinguish between a free trade area and a customs union. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, compare and contrast different types of trading blocs. **[8 marks]**

Text/data 11

Mexico's membership in NAFTA

- 1 The Mexican economy is expected to experience its most serious contraction in real GDP since the Great Depression of the 1930s. **Consumer confidence** has fallen to very low levels.
- 2 While Mexico's central bank had avoided pursuing an expansionary monetary policy for fear of inflation, which had reached an eight-year high, fears of a major recession prompted the central bank to lower interest rates in the hope of stimulating the economy. This was supplemented by an injection of government spending, including investment in public goods and merit goods (roads, railways and oil wells, increased medical care) and **transfer payments**, as well as temporary jobs for unemployed workers and support for small businesses.
- 3 However, Mexican government officials do not believe that these policies will be enough to help the economy in its severe **deflationary gap** (recessionary gap). Mexico is highly dependent upon the United States for its exports, due to the North American Free Trade Agreement (NAFTA), a free trade area that includes Mexico, the United States and Canada. About 80% of Mexican exports are directed to the United States. As a result of a sharp downturn in the US, Mexican exports to the US fell sharply, leading to an increase in unemployment and lower incomes in Mexico.
- 4 Whereas Mexico has signed trade agreements with other countries as well, it has ignored these, focusing its attention on exports to the US. In addition, it has not made necessary investments in education and infrastructure, and has not pursued an **industrial policy**. Other Latin American countries (like Chile and Brazil), which are less dependent on the US for exports, have fared better than Mexico.

5 Under NAFTA, Mexican farmers are unable to compete with tariff-free imports of food from the United States. Many are forced to hold other jobs in addition to farming to make ends meet. Domestic industries were wiped out as multinational corporations (MNCs) began to import inputs rather than buy from local suppliers. Also, as lower-price Chinese goods flooded the US markets, Mexico lost much of its competitive advantage it had gained through NAFTA. Many millions of Mexicans who live and work in the United States are losing their jobs, and are sending less money home (worker remittances), causing consumption expenditure to fall further. A massive return of Mexican workers from the United States would additionally increase unemployment in Mexico.

6 Expectations of falling Mexican exports to the United States caused a huge depreciation of the peso (the Mexican currency) of 25%, leading to fears of cost-push inflation. To avoid a peso collapse, the central bank intervened heavily in the foreign exchange market, spending US dollar reserves to buy pesos. On the other hand, a lower peso could encourage American tourism in Mexico, and could help stop the downward trend in exports.

7 *Source:* Adapted from: 'Damage control: a Latin American country softens recession with counter-cyclical policies' in *The Economist*, 22 January 2009; 'The financial crisis world markets: Mexico moves to secure peso' in the *Houston Chronicle*, 11 October 2008; Reuters, 'Mexico recession shows downside of close US links' 4 August 2009; 'Nafta's promise unfulfilled' in the *New York Times*, 23 March 2009.

Question A.25

- (a) (i) Define the term **deflationary gap** identified in bold in the text (paragraph 3). [2 marks]
- (ii) Define the term **industrial policy** identified in bold in the text (paragraph 4). [2 marks]
- (b) Explain how a fall in Mexico's exports affects its balance of payments, and through what account. [4 marks]
- (c) Using an *AD-AS* diagram, explain the impact on Mexico's deflationary gap of an increase in US tourism in Mexico due to a lower value of the peso (paragraph 7). [4 marks]
- (d) Using information in the text and your knowledge of economics, discuss the role of Mexico's membership in NAFTA on Mexico's export performance and economy. [8 marks]

Question A.26

- (a) (i) Define the term **consumer confidence** identified in bold in the text (paragraph 1). [2 marks]
- (ii) Define the term **transfer payments** identified in bold in the text (paragraph 2). [2 marks]
- (b) Using an *AD-AS* diagram, explain how an economic downturn in the United States can cause a recession in Mexico (paragraph 4). [4 marks]
- (c) Using an exchange rate diagram, explain how a drop in worker remittances has affected the value of the peso (paragraph 5). [4 marks]
- (d) Using information in the text and your knowledge of economics, discuss the possible consequences on the Mexican economy of a collapsing peso (paragraph 6). [8 marks]

Non-oil commodity prices in developing countries

Higher level

- 1 Developing countries specialising in the export of non-oil **primary commodities** tend to experience long-term deteriorating terms of trade (extract 1) and short-term fluctuating terms of trade (extract 2).

Extract 1 Deteriorating terms of trade

- 2 Empirical evidence shows that many developing countries that specialise in the production and export of non-oil commodities have been experiencing a deterioration in their terms of trade over many decades. This suggests that countries should make efforts to diversify their production and exports to avoid further deterioration.

Extract 2 Commodity prices: 'boom and bust'

- 3 Commodity prices reached a 30-year peak in the middle of 2008. With the beginning of the global financial crisis in late 2008, prices dropped significantly. By the second half of 2009, prices had increased again, though they were much below their peaks of 2008. 'These dramatic price swings represented the latest 'boom and bust' cycle in commodity markets.' They also represent major short-term fluctuations in the terms of trade of commodity-exporting countries. Important factors leading to the rapid price increases until mid-2008 were:
- 4 Supply shocks, including crop failures in Australia and lower agricultural outputs in Europe.
- 5 Speculation. Speculators buy commodities on the expectation that prices will rise, so they can sell later at a profit. Speculators' buying actions work to increase commodity prices; later their selling actions work to reduce them. Excessive speculation greatly increased commodity price volatility.
- 6 Lack of investments in agriculture over the previous two decades. **Investment** in the agricultural sector of developing

countries is very low, resulting in low responsiveness of **supply** of agricultural products to increases in **demand**, thus increasing price volatility.

Growing use of food grains for ethanol production. It is estimated that 20–30% of the increase in commodity prices in the commodity boom was due to increasing demand for ethanol, a biofuel made of grains (corn and wheat) as well as other agricultural products.

During 2009, following the commodity price declines, the value of non-oil exports of least developed countries dropped by nearly 9%. At the same time, export volumes increased by nearly 6%, suggesting large drops in export prices. During 2009, the terms of trade of less developed countries declined against their major partners by 16–36%, relative to 2006. 'Overall, the findings support the observation that the post-crisis context for LDCs is one in which they are 'exporting "more for less".'

The World Trade Organization predicts that export levels will continue to increase. However, 'such an accomplishment is of limited value if those export earnings only buy a smaller quantity of imports.'

According to UNCTAD*, 'The recent commodities boom has demonstrated that rather than being an opportunity, the commodities boom has become the greatest obstacle to achieving [development goals] ...'

* United Nations Conference on Trade and Development, a United Nations agency specialising in trade and development issues.

Source (extract 1): Adapted from José Antonio Ocampo and María Angela Parra, 'The commodity terms of trade and their strategic importance for development' in *International Trade*, 3 March 2004. Source: (extract 2): UNCTAD, 'Report of the Multi-year Expert Meeting on Commodities and Development on its second session', Geneva, 24–25 March 2010; International Trade Centre, 'LDCs Terms of Trade During Crisis and Recovery', ITC Trade Map Factsheet #3, 1 June 2010.

Question A.27 (higher level)

- (a) (i) Define the term **investment** identified in bold in the text (paragraph 6). [2 marks]
- (ii) Outline the meaning of **primary commodities** identified in bold in the text (paragraph 1). [2 marks]
- (b) Explain the meaning of deteriorating terms of trade (paragraph 2). [4 marks]
- (c) Using the concept of price elasticity of demand, draw a diagram to explain why changes in supply (such as crop failures in Australia or lower agricultural outputs in Europe; paragraph 4) can contribute to short-term fluctuations in the terms of trade of a country exporting agricultural commodities. [4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate the view that countries that have a comparative advantage in the production of agricultural commodities should specialise in the production and export of these.^b [8 marks]

HL

Question A.28 (higher level)

- (a) (i) Outline one objective of the World Trade Organization (paragraph 9). **[2 marks]**
- (ii) Define the term **demand** identified in bold in the text (paragraph 6). **[2 marks]**
- (b) Using the concept of price elasticity of supply, draw a diagram to explain how changes in demand (such as growing use of food grains for ethanol production contribute; paragraph 7) can contribute to short-term fluctuations in the terms of trade of a country exporting agricultural commodities. **[4 marks]**
- (c) Distinguish between a deterioration and an improvement in the terms of trade. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, to what extent do you agree with the statement by UNCTAD that the recent commodity boom was more of an obstacle than an opportunity for developing countries to pursue development goals (paragraph 10)?^b **[8 marks]**

Question A.29 (higher level)

- (a) (i) Outline one reason why the terms of trade may change over the short term. **[2 marks]**
- (ii) Outline one reason why the terms of trade may change over the long term. **[2 marks]**
- (b) Using the concept of income elasticity of demand, explain why many developing countries experience deteriorating terms of trade over the long term (paragraph 2). **[4 marks]**
- (c) Explain how long-term changes in the terms of trade can result in a redistribution of income among trading partners. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, examine the likely effects of a

deterioration in a country's terms of trade on its current account, using the concepts of price elasticity of demand for exports and imports.

[8 marks]

HL

Question A.30 (higher level)

- (a) (i) State the equation for calculating the terms of trade. **[2 marks]**
- (ii) Define the term **supply** identified in bold in the text (paragraph 6). **[2 marks]**
- (b) According to paragraph 7 growing use of food grains (for use in ethanol production) contributed to the rapid increase in agricultural commodity prices, suggesting that exporters of these commodities experienced an improvement in their terms of trade. Using a diagram, show the likely impact of the terms of trade improvement on the current accounts of commodity exporters. **[4 marks]**
- (c) According to paragraph 4 supply shocks, including crop failures in Australia and lower agricultural outputs in Europe, also contributed to the rapid increases in agricultural commodity prices, suggesting a terms of trade improvement of the exporters of these commodities. Using a diagram, show the likely impact of the terms of trade improvement on the current accounts of commodity exporters. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, discuss the significance of deteriorating terms of trade for developing countries.^b **[8 marks]**

^b You should respond to these questions again after you have studied Chapter 17.

Paper 2 section B: Economic development

Chapter 16 Understanding economic development

Text/data 13

Comparing and contrasting economic and development indicators

Use the data in the table below to answer the question that follows.

	(1) GDP <i>per capita</i> (US\$) (2007)	(2) GNI <i>per capita</i> (US\$) (2007)	(3) GDP <i>per capita</i> (US\$ PPP) (2007)	(4) GNI <i>per capita</i> (US\$ PPP) (2007)	(5) HDI rank (2010)	(6) Human development index (2010)
UK	45 901	43 970	35 130	36 050	26	0.849
Japan	34 264	37 770	33 632	34 700	11	0.844
Brazil	7 185	6 100	9 567	9 600	73	0.699
Georgia	2 318	2 090	4 662	4 730	74	0.698

Source: World Bank, World Development Indicators; United Nations Development Programme, *Human Development Reports*.

Question B.1

- (a) Comparing columns **1** and **2** in the table, outline one factor that could be responsible for:
- lower GNI *per capita* than GDP *per capita* figures for the UK, Brazil and Georgia. **[2 marks]**
 - higher GNI *per capita* than GDP *per capita* for Japan. **[2 marks]**
- (b) Comparing columns **1** and **3** (or columns **2** and **4** for GNI), explain why GDP *per capita* in US\$ PPP is lower than GDP *per capita* in US\$ for the UK and Japan, and higher for Brazil and Georgia. **[4 marks]**
- (c) Considering the figures in columns **2** and **4**, explain why the difference between the highest-income and the lowest-income countries is smaller in column **4** than in column **2**. **[4 marks]**
- (d) Using information in the table and your knowledge of economics, evaluate the use of GDP *per capita* and GNI *per capita* as the basis for measuring economic development, and as the basis for making comparisons of standards of living across countries. **[8 marks]**

Chapter 16 Understanding economic development

Chapter 17 Topics in economic development

Text/data 14

Economic growth and development in Sri Lanka

- 1 In spite of nearly 30 years of civil war (which ended in 2009), Sri Lanka has been remarkably successful in its human development. According to the UNDP country director, Sri Lanka has been able to achieve high human development levels due to steady investments made in education and health over two decades.
- 2 Yet the last two decades have also seen growing income inequalities, and disparities in income distribution are high. The UNDP country director notes that there is room for improvement in this area. Speaking for Asia as a whole, the Asian Development Bank has noted that there is a need to limit 'the very real danger that concentrations of income and wealth pose for social cohesion and growth-promoting policies and institutions'.
- 3 According to the World Bank, Sri Lanka must make efforts to reduce regional disparities in living standards, health and education across provinces. In spite of the impressive achievements in health and education, there remain gaps in geographical regions and among vulnerable groups.

The deputy finance minister of Sri Lanka notes that the government wants to ensure more equitable growth to help poor people improve their standards of living, especially in rural areas. Much of the country's economy and growth are concentrated in the western province where Colombo (the capital) is located.

Micro-credit is one area being examined to deal with regional disparities. According to the deputy finance minister, the development of lagging, underdeveloped areas and markets requires financial institutions in rural areas, particularly to help the poorest of the poor. One million Sri Lankan workers live abroad, and are known for their hard work and enterprise. When they return home 'they are mentally ready. They need capital – they are a large reservoir of people who are already pre-disposed to efficient rural activity. So we must now find structures and policies that can generate growth through these people.'

The following table shows the HDI rank, human development index and several other indicators for Sri Lanka and other countries, in order of increasing HDI rank.

	HDI rank (2010)	Human development index (2010)	GNI per capita (PPP \$) (2009*)	Life expectancy at birth (2010)	Mean years of schooling (2010)	Expected years of schooling (2010)	% of population living below PPP \$1.25 a day (2000-08)	Gini coefficient (2000-10)
China	89	0.663	6890	73.5	7.5	11.4	15.9	41.5
El Salvador	90	0.659	6420	72.0	7.7	12.1	6.4	46.9
Sri Lanka	91	0.658	4720	74.4	8.2	12.0	14	41.1
Thailand	92	0.654	7640	69.3	6.6	13.5	<2	42.5
Gabon	93	0.648	12 450	61.3	7.5	12.7	4.8	41.5

Source: United Nations Development Programme, *Human Development Report 2010*.

* The World Bank, World Development Indicators (<http://data.worldbank.org/data-catalog/world-development-indicators>).

Source (extract): 'Lanka has made rapid progress despite conflict: UNDP' in the *Daily Mirror* (Colombo), 8 November 2010; The World Bank, 'Connecting people to prosperity and improving basic services are key to Sri Lanka's economic prosperity, says World Bank' press release, 9 August 2010; 'Inequality a danger for Asia: ADB' in *Business Daily Update*, 10 August 2007.

Question B.2

- (a) (i) Outline how we can tell which country of those appearing in the table is most advanced with respect to achieving human development objectives. **[2 marks]**
- (ii) Outline why economic development is a multi-dimensional process. **[2 marks]**
- (b) Explain which indicators account for Sri Lanka's HDI rank in relation to its relatively low GNI per capita. **[4 marks]**

- (c) Referring to the difference between GNI measured in \$ PPP and GNI converted into \$ by use of market exchange rates, explain why it is useful to use GNI *per capita* measured in PPP \$ in the table above. **[4 marks]**
- (d) Using information in the text and table, and your knowledge of economics, examine how a more equal distribution of income can make a positive impact on Sri Lanka's economic growth and development process. **[8 marks]**

Question B.3

- (a) (i) Using examples, identify one advantage of composite indicators over single indicators. **[2 marks]**
- (ii) Outline one Millennium Development Goal. **[2 marks]**
- (b) Explain what measures are used to construct the human development index. **[4 marks]**
- (c) Explain what accounts for Sri Lanka's achievement of an HDI rank comparable to the ranks of the other countries in the table, even though it has a much lower GNI *per capita*. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, evaluate the potential contributions of micro-credit to Sri Lanka's economic growth and development. **[8 marks]**

Text/data 15

Women in Cambodia

- 1 The United Nations Development Programme (UNDP) is expressing fears that severe recession in Cambodia will have serious negative effects on women, who make up the bulk of the labour force. According to the UN resident coordinator, 'We know that when women's incomes are lost, the whole family suffers, especially the children.'
- 2 Falling demand from United States and European Union markets led to major job losses in the clothing sector. Further job losses are expected due to reduced foreign direct investment and declines in the tourism industry. Migrant workers in neighbouring Korea, Malaysia and Thailand are expected to return back home to Cambodia due to rising unemployment in these countries as well, which could work to lower GNI per capita.
- 3 About one third of Cambodia's population live in **absolute poverty**, and the absence of a social protection system (including unemployment insurance, pensions, free health care and education, etc.) means that the economic crisis will push many more women and children into extreme poverty and hunger.
- 4 A large part of the rural population depends for their income on money sent to them by urban workers (mostly women). Yet many urban unemployed are returning to their villages where possibilities for work are very limited. Others are turning increasingly to the **urban informal**

sector, in spite of lower wages, risk of sexual exploitation and poorer conditions.

The UN fears that many families will resort to fewer, smaller and less nutritious meals, to cutting back on health care, much of which is paid for privately, to removing children from school in order to send them out to work, and to selling their property such as land.

Acute malnutrition is on the rise, and infant and maternal mortality are unacceptably high; five women per day die in childbirth. Poorer nutrition and lower access to health care due to lower incomes will increase these mortality rates further.

The government of Cambodia and the United Nations in Cambodia are designing a system of social protection that will protect Cambodia's most vulnerable groups. A UN spokesperson says 'Investment in women and children is the best way to ensure long-term prosperity.' Public provision of health care services, education, food and work 'can help break the **poverty cycle** and we must not lose sight of this focus.'

Source: Adapted from 'In Cambodia, women and children hit hardest by economic crisis', United Nations Development Programme Newsroom, 8 April 2009.

Question B.4

- (a) (i) State two consequences of poverty. [2 marks]
(ii) Define the term **poverty cycle** identified in bold in the text (paragraph 7). [2 marks]
- (b) Using a diagram, explain some positive consumption externalities that arise from the education of women. [4 marks]
- (c) Explain the difference between *GNI per capita* and *GDP per capita*. [4 marks]
- (d) Using information in the text and your knowledge of economics, examine the potential contributions of education and health to economic development. [8 marks]

Question B.5

- (a) (i) Define the term **urban informal sector** identified in bold in the text (paragraph 4). [2 marks]
(ii) Define the term **absolute poverty** identified in bold in the text (paragraph 3). [2 marks]
- (b) Explain how public provision of health care services and education might help Cambodia break out of the poverty cycle. [4 marks]
- (c) Explain why the return of migrant workers to Cambodia from neighbouring countries could work to reduce *GNI per capita*. [4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate the United Nation's argument that 'Investment in women and children is the best way to ensure long-term prosperity.' [8 marks]

Chapter 17 Topics in economic development

Text/data 16

Two views on trade liberalisation

Two very well-known US economists write about trade liberalisation and economic growth.

Part 1 Anne O. Krueger, 'Trade, jobs and growth: why you can't have one without the other'

1 History shows that free trade is an engine for growth. The General Agreement on Tariffs and Trade (GATT) that preceded the WTO was based on the principle of gradual liberalisation of trade. The results of the new trade framework exceeded expectations of economic prosperity, as the postwar period was a golden age for much of the world economy. While several factors played a role in accelerating economic growth, increased trade due to trade liberalisation was one of the most important. Most of the Asian economies grew at annual rates of more than 7% since the 1970s, while China has been growing at more than 10% a year. In growth terms, South Korea achieved in a decade what Britain had done in the whole of the 19th century.

2 One of the key benefits of free trade is that it leads to job gains, especially in export industries as these expand. However, it will result in some job losses, as some firms lose out from the greater competition. This is why social safety nets are important, to help the unemployed get financial assistance and job training.

3 In low-income countries, economic growth has a direct – and beneficial – impact on people's daily lives. We can see improvements in the quality of life around the world. Infant mortality rates have declined sharply; literacy rates have risen worldwide; and there has been a major increase in life expectancy. Poverty reduction can only be achieved and sustained over a long period by growth, and to maximise growth opportunities, trade liberalisation is vital.

Part 2 Joseph Stiglitz, 'Social justice and global trade'

4 The history of recent trade meetings shows that something is wrong with the global trading system. Tariff structures

are designed to make it more difficult for developing countries to move up the value-added chain. The prevailing mantra is 'trade liberalisation leads to economic growth'. The fact that so many have been hurt by trade liberalisation contradicts this claim.

Mexico's very poor performance under the **free trade area** NAFTA* does not help the case for trade liberalisation. While NAFTA opened up for Mexico the largest market in the world (the United States), growth in Mexico has been slower than before, while the poorest in the country, the corn farmers, have been especially hurt by US-subsidised corn.

6 There are some circumstances when trade liberalisation brings enormous benefits – when there is full employment and when an economy is mature. Full employment means that a worker who becomes unemployed can easily find another job; otherwise, s/he remains unemployed. Developing countries cannot compete in modern, industrial sectors without protection; therefore, when they liberalise they cannot industrialise and they are condemned to remain in low value-added, low-growth production. Thirty-five years ago, South Korea was told to stick with rice farming. But South Korea knew that even if it improved productivity in rice farming, it would remain a poor country. It had to industrialise.

7 We know which countries have grown the fastest. They were the countries of East Asia (including South Korea), which actively pursued **industrial policies** and strongly intervened in markets, and whose growth was based on **export promotion**, not liberalised trade and free markets. Trade liberalisation has brought enormous benefits to some countries, but not to all. Some have even been made worse off, because of an unfair global trade regime. The World Trade Organization (WTO) must be reformed to make trade fair.

* North American Free Trade Agreement.

8 Source: Adapted from Address by Anne O. Krueger, 'Trade, jobs and growth: why you can't have one without the other', International Monetary Fund, 15 June 2004; Joseph Stiglitz, 'Social justice and global trade' in *Economist's View*, 19 March 2006.

Question B.6

- (a) (i) Define the term **free trade area** identified in bold in the text (paragraph 5). [2 marks]
- (ii) Define the term **industrial policies** identified in bold in the text (paragraph 7). [2 marks]
- (b) Explain the difference between export promotion and import substitution as two different strategies for growth and development. [4 marks]
- (c) Using a diagram of your choice, explain why trade liberalisation leads to job losses. [4 marks]
- (d) Using information in the text and your knowledge of economics, discuss trade liberalisation as a strategy for growth and development. [8 marks]

Text/data 17

Coffee, trade and development

- 1 The Secretary-General of UNCTAD*, in a speech on coffee issues in developing countries, stated that low-income, coffee-exporting countries must respond to challenges and opportunities offered by the global coffee market.
- 2 Coffee is the most valuable tropical agricultural product, produced in over 50 countries in Africa, Asia and Latin America, contributing substantially to job creation, export earnings, and economic growth and development. Moreover, as coffee production is labour-intensive, it is especially important for creating jobs that contribute to poverty reduction.
- 3 Coffee offers opportunities for developing countries also because global consumption has been growing at an annual rate of 2.5%, and is expected to continue growing. Most consumption is concentrated in the developed countries of western Europe and North America, though the highest rates of growth in demand for coffee are in developing countries, including the producing countries themselves.
- 4 Yet in spite of this growth, coffee prices are very **volatile**. The most recent coffee crisis occurred in 2000–4, when many coffee producers could not cover their costs of production, and only continued to produce because they had no alternative. This resulted in losses of coffee-producing countries of over \$30 billion. In 2005, coffee prices began to recover and rose substantially, only to fall again by 20% just in the last six months of 2008 due to falling demand caused by the financial crisis.
- 5 Also, the price of coffee tends to fall over the longer term, resulting in deteriorating terms of trade, particularly for countries whose exports are dominated by coffee. One

factor in the downward pressure on coffee prices has been an increase in **productivity** and technological change in the coffee sector.

Some coffee-producing countries have achieved **diversification** of their production and exports; however, many remain highly dependent on coffee exports (e.g. Burundi 52%, Ethiopia 31%, Honduras 23%). For such countries, an additional problem involves tariff escalation on processed coffee (higher tariffs on processed goods), preventing full access of processed coffee exports to foreign markets.

UNCTAD and the International Coffee Organization (ICO) argue that the most urgent area that coffee-producing countries should address is the promotion of a sustainable coffee economy. Coffee production is likely to be increasingly affected by climate change, requiring the development of new technologies that adapt coffee production to new climatic conditions, while the demands of **sustainability** will require the development of environmentally friendly technologies.

Other areas that require attention include improvements in coffee quality and marketing systems, research and development (R&D) in new technologies, and diversification of production and exports.

* United Nations Conference on Trade and Development, a UN organisation that promotes the integration of developing countries into the world economy.

Source: Statements by Supachai Panitchpakdi, Secretary-General of UNCTAD, Office of the Secretary-General of UNCTAD, 8 April 2009. The figures quoted in the speech were accurate at the time of publication in April 2009.

Question B.7

- (a) (i) Define the term **volatile** (prices) identified in bold in the text (paragraph 4). [2 marks]
- (ii) Define the term **diversification** identified in bold in the text (paragraph 6). [2 marks]
- (b) Explain whether coffee production is likely to use technologies that are appropriate to the factor market conditions of low-income developing countries (paragraph 2). [4 marks]
- (c) (higher level) Explain why deteriorating terms of trade over the long term can be a barrier to economic growth and development (paragraph 5). [4 marks]

- (c) (core) Draw a diagram and use it to explain why the price of coffee has fallen over the longer term, even though the demand for coffee has been increasing (paragraphs 3 and 5). [4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate UNCTAD's and the ICO's statement that promotion of a sustainable coffee economy is the most urgent issue facing coffee-producing countries (paragraph 7). [8 marks]

Question B.8

- (a) (i) Define the term **productivity** identified in bold in the text (paragraph 5). [2 marks]
- (ii) Define the term **sustainability** identified in bold in the text (paragraph 7). [2 marks]

- (b) Using an *AD-AS* diagram, explain why limited access to international markets, caused by tariff escalation, works to reduce economic growth in coffee-exporting countries (paragraph 6). **[4 marks]**
- HL** (c) (higher level) Assuming a perfectly competitive market for coffee, draw a diagram and use it to explain why decreases in coffee prices lead to losses for coffee producers (paragraph 4). **[4 marks]**
- (c) (core) Using the concept of price elasticity of demand (*PED*) **or** price elasticity of supply (*PES*), draw a diagram and use it to explain why coffee prices are highly volatile (paragraph 4). **[4 marks]**
- (d) Using information in the text and your knowledge of economics, evaluate the desirability of diversification of production and exports of countries that specialise in coffee production. **[8 marks]**

Text/data 18

European Union bilateral trade agreements with Colombia and Peru

- 1 The European Union (EU) concluded controversial bilateral trade agreements with Colombia and Peru, amid opposition by NGOs (non-governmental organisations) that fear the agreements may not be in the interests of the two countries.
- 2 The agreements provide for complete **trade liberalisation** in manufactured products, agricultural goods, and services on both sides, as well as liberalisation of investment. They foresee initial tariff-free trade in 80% of industrial products with Peru and 65% with Colombia, with the remaining tariffs to be removed at a later time.
- 3 NGOs worry that producers in Peru and Colombia may be unable to compete with EU products following trade liberalisation.
- 4 In response to NGO concerns, the EU has agreed to provide Colombia and Peru with aid to help modernise their economies and take advantage of the trade agreements. In addition, the agreements include a clause requiring that environmental and human rights concerns are respected. However, NGOs are doubtful about its effectiveness.

NGO representatives argue that such agreements have a strategic importance for the EU, which aims to bypass the stalemate of the Doha Round of World Trade Organization's (WTO) **multilateral trade** negotiations. They point out that the EU had begun regional trade negotiations with the Andean Community (a regional trade block in Latin America), which failed because the EU was unwilling to compromise. The EU then switched to pursue bilateral agreements. Ecuador was a potential candidate for such an agreement, but it then withdrew because of concerns that liberalisation was going too far.

Peru and Colombia, for their part, are interested in the bilateral agreements because they expect better export opportunities and increased foreign direct investment.

Source: 'EU concludes trade agreements with Colombia and Peru' in D+C, Vol. 51(4), November 2010; 'EU completes trade talks with Peru and Colombia', euobserver.com, 2 March 2011.

Question B.9

- (a) (i) Define the term **trade liberalisation** identified in bold in the text (paragraph 2). **[2 marks]**
- (ii) Define the term **multilateral trade** identified in bold in the text (paragraph 5). **[2 marks]**
- (b) Using a diagram, explain why 'producers in Peru and Colombia may be unable to compete with EU products following trade liberalisation' (paragraph 3). **[4 marks]**
- (c) Using a diagram, explain the possible effects of increased exports to the EU on Peru's and Colombia's economic growth. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, evaluate Colombia's and Peru's bilateral trade agreements with the EU as an alternative to WTO trade liberalisation agreements. **[8 marks]**

Chapter 17 Topics in economic development

Chapter 18 Foreign sources of finance and foreign debt

Text/data 19

Banana trade wars

- 1 In a settlement overseen by the World Trade Organization (WTO), the European Union (EU) agreed to reduce tariffs on bananas from €176 per tonne to €114 over a seven-year period, ending a 17-year-long trade dispute between the EU, and the United States and Latin America.
- 2 Since 1993, according to a preferential trade agreement called the Lomé Convention, the EU granted preferential access to the banana exports of its former colonies in Africa, the Caribbean and Pacific region (ACP) through tariff-free entry of bananas and banana import **quotas** for ACP bananas, while imposing tariffs on non-ACP banana imports. Latin-American countries complained on the grounds that they produce bananas at a far lower cost than ACP countries, and that the EU was unfairly discriminating against them.
- 3 In its final ruling on the case, the WTO declared that the tariff-free entry of ACP bananas into the EU was violating WTO rules.
- 4 The United States is not a major banana exporter. However, it sided with Latin-American countries because several US **multinational corporations** (MNCs), including Chiquita, Dole and Del Monte, dominate banana plantations in countries like Colombia, Costa Rica and Panama. The United States therefore wanted to protect the global market share of US MNC subsidiaries.
- 5 Caribbean bananas are grown on small family farms, averaging about one hectare in size, with the result that they cannot be produced cheaply in large quantities. The

preferential treatment had allowed relatively inefficient producers to compete with huge MNCs in Latin America. Some ACP countries are so dependent on bananas for trade that a sudden decline in exports would cause a huge shock to their economy. The ACP countries are among the poorest in the world, many with high levels of unemployment and **underemployment**, extreme poverty and high levels of indebtedness. There are fears that increased competition with the US multinationals may endanger their growth and development objectives. To compensate them for the reduction of their preferential access to EU markets, the EU promised an additional 190 million of **development assistance** to help them restructure their economies.

Banana production methods followed by most MNCs are not consistent with environmental sustainability. Although there are international environmental standards, many banana-producing MNCs do not follow them. Workers on banana plantations are often forced to work 10–12-hour days, though they are paid for eight, doing very heavy and sometimes dangerous work due to exposure to chemicals. WTO rules do not permit importing countries to refuse imports based on producer violations of environmental standards or due to poor treatment of workers.

Source: 'Banana politics' in the *Financial Express* (India), 25 December 2009; Rebecca Cohen, 'Global issues for breakfast: the banana industry and its problems' in *The Science Creative Quarterly*, 2011.

Question B.10

- (a) (i) Define the term **multinational corporation** identified in bold in the text (paragraph 4).
[2 marks]
- (ii) Define the term **development assistance** identified in bold in the text (paragraph 5).
[2 marks]
- (b) Using a diagram, explain the effects on Latin-American banana producers that result from the EU's lower tariffs on banana imports (paragraph 1).
[4 marks]

- (c) (higher level) Using a diagram, explain why larger plantations can achieve lower average costs of production than smaller ones (paragraph 5).
[4 marks]
- (c) (core) Explain how overspecialisation in bananas may be a barrier to economic growth and development in ACP countries.
[4 marks]
- (d) Evaluate the roles of the WTO and the EU-ACP regional preferential trade agreement as strategies for economic growth and development.
[8 marks]

HL

Question B.11

- (a) (i) Define the term **quota** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Define the term **underemployment** identified in bold in the text (paragraph 5). [2 marks]
- (b) Explain why the tariff-free entry of ACP bananas into the EU was considered to be a violation of WTO rules. [4 marks]
- (c) (higher level) Explain why the EU's imposition of tariffs on banana imports from non-ACP countries may be a case of trade diversion. [4 marks]
- (c) (core) Using a diagram, explain the effects on EU consumers arising from the reduction of tariffs on bananas. [4 marks]
- (d) Discuss the possible effects of the EU's reduction of tariffs on banana imports from non-ACP countries on the economies of ACP countries. [8 marks]

Text/data 20

Appropriate technology in rural Africa

- 1 In rural areas in Africa, where the majority of the population lives, people still do not have access to simple appropriate technologies.
- 2 In Nyamapanda (Zimbabwe), a group of 15 women run a soap-making and oil-pressing enterprise, set up as a type of **project aid** provided by a Zimbabwean NGO (non-governmental organisation) called Edit Trust. The donation of an oil-pressing machine and provision of training have helped the women find practical solutions to important problems. They can now earn a living by selling soap, cooking oil and paraffin. This kind of rural project can help improve people's income-earning potential by increasing food production, diversifying income sources, creating employment, and developing **entrepreneurship**. With more training in commercial production, packaging, marketing and distribution, the women can produce for local markets and for export. When rural communities start their own businesses using simple technologies, this has ripple effects on the economy. These include greater economic growth and more possibilities for development.
- 3 The lack of appropriate technologies is contributing to Africa's lack of sustained economic growth and very slow **economic development**. This process involves wasted opportunities as well as resources. For example, most rural

communities in Zimbabwe grow tomatoes and fruits, but have no technologies to cane or dry these. They therefore throw away agricultural produce before it goes bad, thus losing valuable tomato and fruit output.

Reasons for the lack of appropriate rural technologies include the absence of institutions for technology diffusion, lack of funding, poor links between rural communities and scientific institutions, and weak science and technology policies.

In addition, the **dual economy** of the country poses challenges to the system of innovation, as there is a gap between research on simple technologies needed by disadvantaged people, and research on advanced technologies in line with international scientific centres.

Another major problem concerns the hardships faced by poor rural people in securing food and health. Without these, they cannot express an interest in appropriate technology. This is an important factor that contributes to excluding poor people from access to simple appropriate technologies.

Source: Sifelani Tsiko, 'Rural access to appropriate technologies vital', International Forum for Rural Transport and Development (IFRTD), 2009.

Question B.12

- (a) (i) Define the term **entrepreneurship** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Define the term **dual economy** identified in bold in the text (paragraph 5). [2 marks]
- (b) Explain **two** common characteristics that are often shared by economically less developed countries, and **two** factors that create diversity between them. [4 marks]
- (c) Explain which are the most important sources of economic growth in economically less developed countries. [4 marks]
- (d) Using information in the text and your knowledge of economics, examine the potential contribution of use of appropriate technology by poor rural people in Africa's economic growth and development. [8 marks]

Question B.13

- (a) (i) Describe the meaning of **project aid** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Define the term **economic development** identified in bold in the text (paragraph 3). [2 marks]
- (b) Using a diagram, explain how improved access to appropriate technologies by poor people can lead to economic growth. [4 marks]
- (c) Using a diagram, explain the positive production externalities that may arise from the use of appropriate technologies. [4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate the effectiveness of foreign aid extended by non-governmental organisations (NGOs). [8 marks]

Chapter 18 Foreign sources of finance and foreign debt

Text/data 21

Chinese direct investment in Zambia

Chinese direct investment in Zambia was more than \$1 billion in 2010, creating more than 15 000 jobs, and is expected to exceed \$1 billion again in 2011. China, a leader in the race for Africa's resources, has invested billions of dollars in African states including Zambia, the continent's largest copper producer, in the hope of securing the resources it needs for its booming economy. The recent agreement with China's privately owned Zhougui Mining Group is expected to attract more than \$5 billion into Zambia's mining sector over the next few years. This project is one of the largest **foreign direct investments** in Zambia, and will employ over 1000 Zambians.

George Fang, head of Standard Bank's Mining and Metals China, said, 'The number of deals that China is initiating has grown exponentially on every continent, but especially Africa.' He noted that as Africa is resource-rich and has a growing educated population, it will prove to be the engine that will provide growth to world economies for decades, with clear benefits for itself. Africa has low-cost providers of natural resources that have benefited from high commodity prices due to the increase in Asian demand for these, and will benefit from the development of physical **infrastructure** by foreign direct investors like the Chinese. This infrastructure is essential for the development of agriculture, manufacturing, services, trade and even **human capital** improvements. Rising incomes and rapid industrialisation drive demand for electricity, transport, telecoms and housing. Therefore, resource and infrastructure investment will drive economic growth in Africa and ultimately benefit the people.

Detlef Kotte of the United Nations Conference on Trade and Development (UNCTAD) notes that the government of Zambia must discover a way of getting a share of the profits resulting from record-high copper prices. He adds that foreign direct investment in copper mining on its own does not help the economy in the long term, unless a mechanism is found to transfer benefits from the mining sector to other sectors.

Some members of the Zambian parliament argued that a windfall tax* in the mining sector should be re-imposed, as this is the only way that Zambians, especially in rural areas, can benefit from the extraction of their own natural resources. It is meaningless to talk about growth if benefits do not trickle down to the poor.

The government decided not to re-impose the windfall tax. Supporters of this decision argued that this would kill investments in the mining sector. There were also recommendations that other taxes in the mining sector be lowered to improve investor confidence, and that mining legislation should be re-evaluated with a view to making it more investor friendly.

* A windfall tax is a tax imposed when economic conditions result in above-average economic profits. They are often used in businesses involved with commodities, which sometimes experience very high profits due to high prices resulting from a commodity boom.

Source: 'Windfall tax scrapping gets mines chamber backing' in the *Times of Zambia*, 19 October 2010; 'Chinese investment reaches \$1 billion in 2010' in *Tradeinvest*, 11 February 2011; 'Zambia – UNCTAD urges raise in mine taxes in Zambia' in *Tendersinfo* (Mumbai, India), 30 December 2010; 'China to spur Africa growth' in the *Tehran Times*, 10 February 2011.

Question B.14

- (i) Define the term **infrastructure** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Define the term **human capital** identified in bold in the text (paragraph 2). [2 marks]
- Distinguish between economic growth and economic development. [4 marks]
- 'Economic development cannot occur in the absence of economic growth.' Comment on this statement. [4 marks]
- Using information in the text and your knowledge of economics, discuss the possible effects of foreign direct investment in copper mining on Zambia's growth and development process. [8 marks]

Question B.15

- (i) Describe the nature of **foreign direct investment** (paragraph 1). [2 marks]
- (ii) State two characteristics of economically less developed countries that attract foreign direct investment. [2 marks]
- Explain the reasons why multinational corporations (MNCs) are interested in directly investing in economically less developed countries. [4 marks]
- Using a diagram, explain how rapid economic growth in China has led to increases in commodity prices. [4 marks]
- 'Economic development is the natural outcome of economic growth.' Using information in the text and your knowledge of economics, evaluate this statement. [8 marks]

Text/data 22

Foreign aid

- 1 In 2002, rich donor countries promised to make contributions of at least 0.7% of GDP to development assistance in order to help meet the MDGs (Millennium Development Goals). The only countries that have met this goal are Denmark, Luxembourg, the Netherlands, Norway and Sweden. Some of the richest countries in the world, including Germany, Japan and the United States, have fallen far short of that. On average, development assistance averages 0.31% of GDP of developed countries.
- 2 In the United States, there is pressure by a group of members of the House of Representatives (a part of the US government) to reduce funding for USAID*, which delivers US bilateral **official development assistance** (ODA). They argue that the United States spends large amounts on foreign aid, which is fiscally irresponsible in view of the large US budget deficit. However, public opinion polls show that the US public believes that an amount that would be fiscally responsible for the US to spend on aid is 21 times greater than the amount actually spent. Private donations by Americans to non-governmental organisations (NGOs) abroad are three times as large as ODA, and it is very likely that this trend will continue.
- 3 Rajiv Shah, head of USAID, argues that cuts in funding would have negative consequences for US national security. Projects in several countries focus on economic development as a means to prevent extremist activities. Lack of opportunities for employment and education, and lack of food security lead to resentful populations. In an

address to the US Congress, Shah noted that USAID is re-evaluating how it distributes aid with a view to becoming more effective.

One factor that seriously limits aid effectiveness is the practice of **tied aid**. Relief organisations estimate that as much as 75% of foreign aid by rich countries is tied, and is intended to promote rich-country exports of goods and services. In the United States, for example, due to pressures on the government by farmer interest groups, most of food aid (a type of development aid) requires recipients of aid to buy food from US agribusiness firms. This practice does not encourage poor farmers to become self-reliant food growers.

At a recent UN meeting, President Obama announced reform of US foreign aid programmes. Using food aid as an example of change, he said that the new approach would seek to empower communities to meet their own food needs, rather than continuing with old models that just provided food for decades. That's not development,' he said, 'that's dependence.'

* United States Agency for International Development.

Source: 'Cutting USAID's budget threatens national security' in *Grand Rapids Examiner (MI)*, 26 January, 2011; 'Obama at UN summit: foreign aid is "core pillar" of American power' in *Christian Science Monitor*, 22 September 2010; 'Missed goals' in *The New York Times*, 23 September 2010; 'Aid versus trade' in *South Asia Investor Review*, 23 May 2009.

Question B.16

- (a) (i) Define the term **official development assistance** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Describe the meaning of **tied aid** identified in bold in the text (paragraph 4). [2 marks]
- (b) Explain the role of NGOs as aid organisations in the process of economic development. [4 marks]
- (c) Explain the motivations of countries that extend aid. [4 marks]
- (d) Using information in the text and your knowledge of economics, examine the effectiveness of foreign aid in promoting economic development. [8 marks]

Text/data 23

Aid for Indonesia and South Africa

Use the information in the tables below to answer the questions that follow.

Table 1: Statistics for Indonesia and South Africa, 2010 (unless otherwise noted)

	HDI rank	Human development index	GNI per capita (\$ PPP)	Life expectancy at birth (years)	Mean years of schooling	Expected years of schooling	ODA received per capita (US\$) (2009)	Net ODA receipts (US\$ million) (2009)	Population (million) (2009)
Indonesia	108	0.600	3957	71.5	5.7	12.7	4.6	1050	230.0
South Africa	110	0.597	9812	52.0	8.2	13.4	21.9	1078	49.3

Table 2: Percentage of bilateral ODA by sector (2008–9)*

	Education	Health	Other social sectors	Economic infrastructure and services	Production	Multi-sector	Humanitarian aid	Other
Indonesia	13	7	17	23	7	23	2	8
South Africa	5	55	18	14	2	4	0.5	1.5

* Percentages are approximate.

Table 3: Top ten donors of ODA to Indonesia and South Africa, US\$ million (2008–9 average)

To Indonesia		To South Africa	
Japan	1370	United States	451
IDA*	369	EU	159
Australia	334	Germany	130
France	263	United Kingdom	93
United States	256	Netherlands	43
Germany	198	Global Fund	42
Netherlands	165	France	35
AsDF**	120	Norway	27
United Kingdom	88	Denmark	24
EU	84	Ireland	22

* International Development Association, a branch of the World Bank that offers **concessional loans** to very low-income countries.

** Asian Development Fund, an international development organisation whose objective is to reduce poverty and improve standards of living in its member countries.

Source (Table 1): United Nations Development Programme, *Human Development Report 2010*; The World Bank, Development Co-operation Directorate (DCD-DAC).

Source (Tables 2 and 3): Development Cooperation Directorate (DCD-DAC).

Question B.17

- (a) (i) Define the term **humanitarian aid** identified in bold in Table 2. **[2 marks]**
- (ii) Define the term **concessional loan** identified in bold in the footnote below Table 3. **[2 marks]**
- (b) Explain whether GNI *per capita* is a reliable indicator for separating countries into 'economically less developed' and 'economically more developed'. **[4 marks]**
- (c) Explain what accounts for the very similar HDI ranks and human development indices of Indonesia and South Africa. **[4 marks]**
- (d) Using information in the tables and your knowledge of economics, compare and contrast the extent, nature and sources of ODA to Indonesia and South Africa in relation to their level of human development. **[8 marks]**

Text/data 24

Aid versus trade

Part 1

- 1 In 2000, leaders of rich and poor countries promised to create a better world by 2015, committing themselves to financial contributions in the form of **foreign aid** that would help achieve the Millennium Development Goals (MDGs). At a United Nations meeting ten years later, world leaders admitted progress ‘falls far short of what is needed’ to meet the targets. Rich nations have not been contributing the foreign aid needed to meet the MDGs.
- 2 According to Helen Clark, UNDP administrator, ‘For those living in poverty, the MDGs have never been abstract or aspirational targets. They have offered a pathway to a better life – a life with access to adequate food and income; to basic education and health services; to clean water and sanitation; and to empowerment for women. Put simply, advancing the MDGs is an important milestone in our quest for a more just and peaceful world ...’
- 3 ‘[T]he international community does need to deliver on its commitments to provide development assistance as well as improve the predictability and effectiveness of aid.’

Part 2

- 4 Paul Kagame, president of Rwanda, writes the following. ‘Development aid ... has long been a key source of income for the continent. While helpful, aid has not delivered

sustainable development. It is clear that trade and investment bring greater opportunity for wealth creation. Africa welcomes investment, and Rwanda is no exception ... This call for investment and trade rather than traditional aid does not mean the latter’s contribution to addressing poverty is not recognised. However, the fundamental problem with the current development aid practice is the danger countries face as they become perpetually reliant on handouts.

‘The primary purpose of aid should be to work itself out, leaving a positive legacy behind. Aid should also be used to create opportunities for trade, enhance self-sufficiency and assist with the development of a robust private sector to attract investment ...’

‘Ultimately, Africa’s relationship with its international counterparts should be redefined. For too long, we have not been able to trade fairly with Europe and the US ... particularly in agriculture. Investment and trade with willing countries helps the continent to build a much-needed culture of entrepreneurship and development.’

Source: ‘Why Africa welcomes the Chinese’ in the *Guardian*, 2 November 2009; ‘What will it take to achieve the Millennium Development Goals? An International Assessment’, United Nations Development Programme Newsroom, 17 June 2010; ‘Missed goals’ in *The New York Times*, 23 September 2010.

Question B.18

- (a) (i) Define the term **foreign aid** identified in bold in the text (paragraph 1). [2 marks]
- (ii) Identify two groups of donors of aid (sources of aid) to economically less developed countries. [2 marks]
- (b) Using examples, distinguish between development aid and humanitarian aid. [4 marks]
- (c) Explain the meaning of the statement that Africa has ‘not been able to trade fairly with Europe and the US’ (paragraph 6). [4 marks]
- (d) Using information in the text and your knowledge of economics, compare and contrast the roles of aid and trade in economic development. [8 marks]

Chapter 18 Foreign sources of finance and foreign debt

Chapter 19 Consequences of economic growth and the balance between markets and intervention

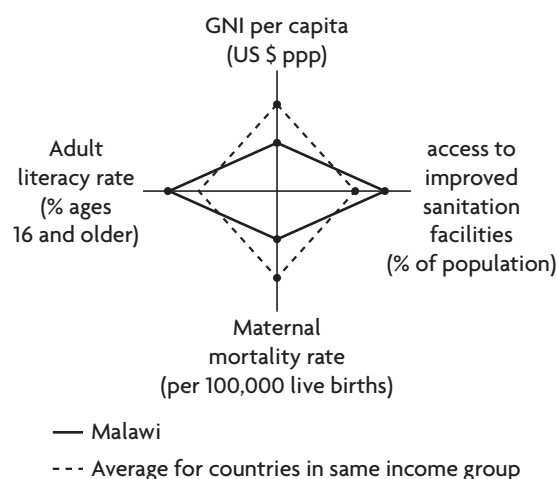
Text/data 25

Malawi's foreign debt and human development

- 1 Malawi, one of the poorest countries in the world, has benefited enormously from debt relief, though its experience shows that the Heavily Indebted Poor Countries (HIPC) Initiative of the World Bank and International Monetary Fund (IMF) is not without flaws.
- 2 Malawi accumulated much of its debt during the 1970s and 1980s when rich-country commercial banks and governments lent large sums to developing countries as the price of oil increased and the value of their exports fell. During the 1980s and 1990s, though Malawi spent an average of \$100 million per year on debt repayment, its **foreign debt** as a share of national income rose from 70% in 1980 to 150% in 2000. The economy stagnated, and GNI *per capita* fell.
- 3 Malawi entered the HIPC programme in 2000 but did not receive cancellation of some of its debts until 2006. During this period, debt repayments amounted to \$440 million, involving a huge opportunity cost. By 2005, Malawi was spending 9.6% of national income on foreign debt servicing and only 4.6% on public provision of health care, while 74% of the population lived on less than \$1 a day.
- 4 One reason for the delay in debt cancellation was that Malawi had to fulfill several requirements imposed by the World Bank and IMF in order to qualify for debt relief. This included **privatisation** of state-owned enterprises, elimination of agricultural subsidies and cuts in public spending.
- 5 In 2001–2 and again in 2004–5, the removal of support for farmers together with drought resulted in a serious food crisis in which thousands of people died of hunger and millions suffered. Due to food shortages, Malawi had to import maize at a much higher cost than the cost of the original agricultural subsidies.
- 6 In the mid-2000s the government went against World Bank and IMF demands and re-introduced seed and fertiliser subsidies, with the result that Malawi became a

net exporter of maize to other countries. The World Bank criticised this policy as being 'better for food security but worse for market development'.

In 2006, \$2.3 billion of Malawi's debt was cancelled. Its remaining debt is 25% of national income, and its debt repayments have fallen to about \$30 million a year. This has allowed Malawi to greatly increase social spending. It has abolished primary school fees, helping more than one million children go to school. In spite of its low income levels, Malawi is making good progress with respect to human development. Also, debt cancellation has helped the economy grow. Economic growth was 8.5% per year in 2006–9, compared to 2.5% in 2002–5.



Development diamond for Malawi

Source: The World Bank, *World Development Report*, 2010.

Source: 'Malawi', Jubilee Debt Campaign (<http://www.jubileedebt-campaign.org.uk>).

Question B.19

- (a) (i) Describe the meaning of **foreign debt** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Outline one reason why countries borrow from foreign creditors. [2 marks]

- (b) Explain why foreign debt servicing has opportunity costs. [4 marks]
- (c) Explain why the burden of debt has led to pressure in favour of debt cancellation for heavily indebted countries. [4 marks]

- (d) Using information in the text and your knowledge of economics, discuss the potential effects of Malawi's debt relief on its growth and development. **[8 marks]**

Question B.20

- (a) (i) Outline why Malawi's debt relief was a type of 'conditional assistance'. **[2 marks]**
- (ii) Outline the meaning of **privatisation** identified in bold in the text (paragraph 4). **[2 marks]**
- (b) Explain why the servicing of foreign debt causes problems for the balance of payments. **[4 marks]**
- (c) Using a diagram, explain why drought and the removal of subsidies caused a food crisis (paragraph 5). **[4 marks]**
- (d) Using information in the text and your knowledge of economics, discuss the strengths and weaknesses of interventionist policies in economic growth and development. **[8 marks]**

Text/data 26

Ending Tanzania's vicious cycle of poverty

- 1 Fifty years after its independence, Tanzania remains one of the poorest countries in Africa, with 33% of the population living in extreme poverty. The country is still in a vicious cycle of poverty, with low incomes, low saving and low investment.
- 2 Tanzania is one of the largest recipients of Official Development Assistance (ODA) in the form of **grants**, **concessional loans** and debt relief. About 35% of government spending depends on foreign aid.
- 3 The government is trying to attract foreign direct investment (FDI) to support broad-based economic growth that is needed to achieve poverty reduction targets. However, FDI to date has been concentrated mainly in mining and tourism, which do not offer the necessary linkages with the rest of the economy, and therefore have had little impact on economic growth.
- 4 In the mid-1960s the government had begun a programme of self-reliance and import substitution, aimed at promoting heavy industry and self-sufficiency in food. This involved the expansion of infrastructure and state-owned, capital-intensive industries that by the mid-1970s were the main importers and exporters in a highly state-regulated economy. By the mid-1980s Tanzania faced hyperinflation, huge **budget deficit** and **trade deficit**, and a very heavy dependence on foreign aid.
- 5 In contrast to countries such as the East Asian Tigers that successfully moved from import substitution to export promotion strategies, Tanzania, like many other African countries, went straight into market and trade liberalisation policies from the mid-1980s. Tanzania lowered import barriers, leading to de-industrialisation and loss of jobs, as inefficient domestic firms were unable to compete with imported goods from Asia (often subsidised) and from Europe where there were economies of scale and lower costs of production. Since the mid-1990s its policies have been determined by the World Bank and International Monetary Fund (IMF), which have extended loans on

condition that the government reduces public spending, privatises state enterprises and pursues market-oriented reforms.

The World Bank is very active in Tanzania with loans in various sectors including health, higher education, transport, electricity provision and food security. The IMF is stepping up lending for the country's balance of payments difficulties that have emerged due to the financial crisis. It claims that its approach to poor countries has changed and that it no longer imposes unreasonable conditions that prevent governments from spending on merit goods like education. However, according to a recent report, 'It is still imposing conditions to this very day and these conditions continue to block spending on education.'

The World Bank and IMF consider Tanzania to be a success story. **Inflation** has fallen, real GDP is growing rapidly, exports are increasing, and its public finances are under control. As a result, it is also becoming more interesting to foreign direct investors. Critics argue that these successes have come at a huge human cost in terms of continued poverty and deprivations in large portions of the population, and there are questions over whether economic growth is affecting the poor. Regarding the Millennium Development Goals (MDGs), progress has been made in school enrolment, gender equality and gender empowerment, but little progress has been achieved with infant and under-five mortality rates, which remain very high. Maternal deaths are rising due to poor health services.

Source: 'Breaking the vicious cycle of poverty' in *Business Times*, 20 August 2010; 'IMF: Dr. Death? Case study of how the global banker's shock therapy helps economies but hammers the poor' in *Time Magazine*, 17 April 2000; 'Overview of aid in Tanzania', Development Partners Group (<http://www.tzdp.org.tz/>); 'Hungry children do not make good learners' in the *Guardian*, 28 April 2009.

Question B.21

- (a) (i) Define the term **grant** identified in bold in the text (paragraph 2). [2 marks]
- (ii) Define the term **budget deficit** identified in bold in the text (paragraph 4). [2 marks]
- (b) Explain the possible role of foreign direct investment in helping a poor country break out of the poverty cycle. [4 marks]
- (c) Explain why countries borrow from the International Monetary Fund. [4 marks]
- (d) Using information in the text and your knowledge of economics, compare and contrast the effectiveness of import substitution and export promotion policies as strategies to achieve economic growth and development. [8 marks]

Question B.22

- (a) (i) Define the term **concessional loan** identified in bold in the text (paragraph 2). **[2 marks]**
- (ii) Define the term **trade deficit** identified in bold in the text (paragraph 4). **[2 marks]**
- (b) Explain how the poverty cycle is transmitted from generation to generation. **[4 marks]**
- (c) Explain whether the capital-intensive production methods often used in import-substitution strategies are likely to represent a type of appropriate technology in economically less developed countries. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, discuss the strengths and weaknesses of market-oriented policies in economic growth and development. **[8 marks]**

Question B.23

- (a) (i) Define the term **inflation** identified in bold in the text (paragraph 7). **[2 marks]**
- (ii) State two types of market-oriented reforms. **[2 marks]**
- (b) Explain the difference between foreign aid and multilateral development assistance. **[4 marks]**
- (c) Explain why economic growth, while necessary for economic development to occur over long periods of time, may not lead to economic development. **[4 marks]**
- (d) Using information in the text and your knowledge of economics, examine the view that the World Bank and International Monetary Fund (IMF) have played a role in making Tanzania's growth and development 'a success story' (paragraph 7). **[8 marks]**

Chapter 19 Consequences of economic growth and the balance between markets and intervention

Text/data 27

Economic growth and development in Latin America

- 1 In 1672, Potosi, Bolivia, a major centre of Spanish silver mining, was one of the largest and richest cities in the world. Today, it is poor and beset by conflict. This is but one example of commodity booms gone bust, showing that quick riches made possible by rising commodity prices do not seem to last.
- 2 In Latin America, 93% of the population and 97% of economic activity are concentrated in countries that are commodity exporters. It is therefore important that World Bank economists discovered some trends suggesting that the most recent commodity boom may have more positive results than in the past.
- 3 An important reason for this expectation is good governance. National governments and financial institutions in Latin America today have greatly improved their ability to manage commodity windfalls, using them for long-term growth rather than for short-term gains.
- 4 For example, in Chile, where exports are dominated by commodities (75%), the decision was made years ago by its leaders to save a large percentage of earnings from the copper boom and to spend the rest wisely. Chile's investments in innovation have increased by 24% annually over the past five years, and it has also invested heavily in education.
- 5 Another reason for optimism is that commodity production in Latin America is changing. While in the past multinational corporations benefited the most, extracting a country's resources and leaving it poorer, today commodity extraction is linked to activities that benefit the country. For example, in Peru an extensive network of local businesses is tied to the operations of a gold mine.
- 6 Latin America pursued strong market-oriented reforms during the 1980s and 1990s, involving abandoning **import-substitution** in favour of trade liberalisation policies, lowering restrictions on foreign direct investments and reducing state-ownership of firms. These changes, together with macroeconomic stability,

democratisation and the rising revenues made possible by the commodity boom, have transformed Latin American economies. Increasing revenues have also led to stronger social policies aiming to strengthen the **social safety net** and to reduced inequalities.

Poverty has been falling almost everywhere, and income distribution is becoming less unequal in many countries, though it still remains more unequal than in any other continent. Poverty has been falling due to more rapid **economic growth** and better social policies. **Transfer payment** programmes (cash transfers) have become more widespread, and there are about 110 million people in the continent benefiting from these. There is evidence that these have increased school enrolment and attendance, and have also increased maternal health care and vaccinations. The cash transfer programmes have helped reduce income inequality, while better-educated workers earn higher incomes.

In addition, living standards have improved because birth rates have fallen dramatically, allowing the family's income to go a longer way in satisfying material needs. Also, trade liberalisation has led to lower prices for consumers.

Yet progress is still fragile. The goal of economic development requires more reforms, including building further on the social safety net, improving the equality of opportunity for the less privileged, improving the tax system, parts of which are **regressive**, building infrastructure, reforming public health care and improving the quality of public education. Average spending per pupil remains very low compared to the levels of developed countries.

Source: 'A special report on Latin America: a Latin American decade?' in *The Economist*, 11 September 2010; 'A special report on Latin America: societies on the move', in *The Economist*, 11 September 2010; 'Latin America's commodity dependence' in the *Japan Times*, 5 October 2010.

Question B.24

- (a) (i) Define the term **social safety net** identified in bold in the text (paragraph 6). [2 marks]
- (ii) Define the term **economic growth** identified in bold in the text (paragraph 7). [2 marks]
- (b) Explain why good governance is important in economic development. [4 marks]
- (c) Draw a diagram and use it to explain how the use of health care services gives rise to positive consumption externalities. [4 marks]
- (d) Using information in the text and your knowledge of economics, evaluate the use of interventionist policies in efforts to achieve economic development. [8 marks]

Question B.25

- (a) (i) Define the term **transfer payments** identified in bold in the text (paragraph 7). [2 marks]
- (ii) Define the term **regressive** identified in bold in the text (paragraph 9). [2 marks]
- (b) Explain import substitution as a trade strategy for economic growth and development. [4 marks]
- (c) Explain why economic growth may have either positive or negative effects on income distribution. [4 marks]
- (d) Using information in the text and your knowledge of economics, discuss the view that the pursuit of economic development should involve a balance of interventionist and market-oriented policies. [8 marks]