1. IDENTIFICATION OF ESSENTIAL TOPIC AREAS FOR REVISION

This first section identifies the key areas referred to (indirectly or directly) in the stimulus material in relation to topics listed in the exam board specifications which should form the focus for revision.

Topics in Specification	Application in the Stimulus Material
Aspects of Synoptic Knowledge	
The application of supply and demand analysis.	Extract 1 - supply and demand, Price volatility
Market failure.	
Elasticity of demand.	Extract 1 - implicit reference to PED, YED, PES
Economic systems.	
S and D analysis of subsidies and indirect taxes.	
Unit Specific Content	
Macroeconomic performance:	
Recent macroeconomic performance of the UK.	
Economic growth in short and long run; deviation from trend growth and output gaps.	
Causes of economic growth – short-run (changes in aggregate demand, short-run aggregate supply, the interaction of the multiplier and accelerator, the economic cycle); long-run (changes in long-run aggregate supply, quantity and quality of the labour force, capital stock).	Introduction. Extract 3 - cyclical fluctuations - implicit reference to accelerator and multiplier
Consequences of economic growth – for inflation, employment, unemployment, the balance of payments, the government's fiscal position.	Extract 1 - bananas' export potential; Fig. 2.1 - dependence on food, primary commodities
Policy issues – role of fiscal, monetary, supply-side policies in promoting economic stability, growth and international competitiveness; and the role of policy rules, targets and constraints, including fiscal rules, inflation targeting and policy trade-offs.	Introduction. Extract 3 - reference to fiscal and monetary policy; Fig 3.1 Caribbean govt debt Extract 4 - monetary policy in a currency union
Trade and Integration:	
Absolute and comparative advantage.	Introduction. Extract 1 - comparative advantage in banana production
Specialisation and gains from trade.	Extract 2 – dependence on primary production.
Terms of trade.	Extract 1 - for banana exporters
The pattern of global trade.	Introduction. Extracts 1 & 2 - trade between banana producer and banana consumer
Alternate exchange rate systems.	
Purchasing power parity.	Figure 2.2 - GDP at PPP
Exchange rate fluctuations.	
Causes and consequences of balance of payments problems.	Extract 3 - recession and balance of payments
Policies to correct imbalances.	Extract 1 - tariffs, quotas
Stages of economic integration: free trade areas, customers unions, single markets, economic unions, monetary unions.	Introduction. Extract 4 - Single Market, Economic Union, Monetary Union
Impact of economic integration: short run – trade creation & diversion; long-run – dynamic effects.	Extract 4 / Figure 4.1 - intra and extra union trade

Development and Sustainability:	
Meaning and measurement of development: the relationship between growth and development, GDP per capita, HDI (Human Development Index), economies at different stages of development, common and diverse characteristics.	Introduction, Extract 1 - importance of bananas. Fig 2.2 - measures of development Introduction. Fig 2.2 - HDI Extract 2 - common and divergent characteristics of developing countries
Policies to promote economic development; the role of the market and the state, and international trade.	Extract 2 - International trade
The constraints of development: resource endowment, infrastructure, institutions, finance and savings, and international.	Extract 2 - in relation to Guatemala
The meaning of sustainability; the social, environmental, resource and demographic impacts of growth.	
The measurement of sustainability; limitations of economic indicators such as GDP, and adjusted economic indicators such as the Index of Sustainable Economic Welfare (ISEW).	Fig 2.2 - GDP as a measure of living standards
National and regional policies and international agreements to promote sustainability.	
The Economics of Globalisation:	
The Characteristics and consequences of globalisation.	Introduction. Extract 3 - benefits and problems of globalisation
International financial flows (private, official, short-term and long-term flows).	
Nature and impact of multinational firms. Foreign Direct Investment (FDI).	Introduction. Extract 1 - US multinationals Extract 2 - FDI in St Lucia. Extract 4- St Lucia
The role and impact of international financial institutions (WTO, IMF and World Bank).	Extract 3 - Jamaica seeks assistance from IMF; World Bank Conference; IMF forecasts
International trade negotiations and trade disputes.	Introduction. Extract 1 - an implicit reference to WTO trade negotiations.

Examination Advice

The specification for this unit includes both synoptic knowledge that you would have encountered in the previous AS and A2 units and unit specific material. To analyse the issues contained in the stimulus material it is essential to apply the unit specific material relating to recession, macroeconomic policy, economic integration, monetary union and international trade with analysis developed in the previous units, especially in relation to government supply and demand in agricultural markets and price volatility.

Always remember that the pre-released material might provide us with clues as to the likely questions, but examiners are quite capable of asking unexpected questions based on the stimulus material, or of asking expected questions in an unexpected way. Therefore, use the table above to influence your revision, but do not ignore related topics which might also crop up in the examination.

One significant feature of the stimulus material is that it takes us into areas of the world with which we are not familiar. For instance, your course of study would have included the European Union and the adoption of the euro by over one half of its members. You should be very familiar with the issues involved with economic integration in Europe. What you now have to do is to use that knowledge but apply it to the setting of the West Indies. Although this is an examination in Economics rather than Geography, it is worth spending some time familiarising yourself with some of the countries that feature in the stimulus material and, in particular, how their geographic features have some important economic implications for trade and development. In the fourth extract one country crops up time and again – St Lucia. You should commence your preparation with a brief investigation of this West Indian Island.

2. COMMENTARY ON THE STIMULUS MATERIAL

The Introduction (page 2)

The stimulus material for this examination takes the form of four extracts listed on page three together with a short introduction. The introduction is useful in terms of:

- highlighting the key issues that are likely to feature in examination questions.
- providing an overall framework to the different extracts, thus providing some unity to the data provided.

You will notice that the four paragraphs that constitute the introduction link up with one or other of the extracts. Firstly, **Paragraph one** provides an introduction to Extract 1 of the stimulus material. It refers to a trade war:

- between the USA and Latin American countries with commercial close links to the USA.
- between the EU and certain member countries which have close historical and cultural links with banana producing nations in the Africa, Caribbean and Pacific Group of nations (ACP).

The Latin American producers (backed by the USA) resented the tariffs and other import controls imposed on them by the EU which discriminated in favour of the ACP countries. The so-called Banana War was one of a number of issues that inhibited tariff reduction talks at the World Trade Organisation (WTO) and because of EU (including Britain) supported trade liberalisation, it did agree to a tariff reduction on Latin American bananas in 2009. This measure reduced the relative preference given to the ACP producers. The latter tend to be higher cost producers and would lose out in a more competitive market. Any damage to the banana trade of ACP countries would have adverse consequences for the ACP economies. As bananas, like most agricultural crops, are subject to great fluctuations in price, and as many of the smaller ACP countries are highly dependent on the banana trade, the move to trade liberation will have severe implications for ACP banana producers.

Paragraph two (which links with Extract 2) switches our attention from the international market in bananas to the nature of the economies of the banana exporting countries. All the major banana producers are classed as developing countries and, as such, they share common characteristics (eg low income per head in comparison with the developed countries). However, the group of developing countries or less developed countries (LDCs) are not a homogeneous group of economies and, indeed, there are significant differences between developing countries. These differences will be explored in greater detail in extract 2 but this introductory paragraph provides us with a clear steer towards the common characteristics of developing countries and the ways in which they diverge.

The introduction also focuses on the question of measuring economic development. As you will be aware, economists traditionally measure macroeconomic performance in terms of Gross Domestic Product (GDP) and living standards in terms of GDP per head. However, you should also be aware of the shortcomings of GDP measurement and the desirability of including variables other than national income in the assessment of developing economies. This has led to the creation of new methods of measurement, most notably the Human Development Index (HDI). This is a clear hint that there could be a question on HDI as a measurement of economic development.

Paragraph three concerns the impact of the recession on banana exporting countries, especially those in the Caribbean. Because these countries rely on exports to developed countries, it was inevitable that they would be affected by the global recession that started in 2008/9. The recession in the US and, more importantly for the Caribbean, in Europe resulted in a decline in EU purchases of Caribbean goods. This was not confined to bananas but extends to the other goods and services offered by these countries. This includes other food products, other primary products such as bauxite (used in the production of aluminium) and tourism. In addition, recession in the EU reduced foreign direct investment in the Caribbean, thus setting back the economic development of these countries. *"Negative economic growth had severe consequences for unemployment in the region and for the fiscal position of many countries".* This must be interpreted as meaning that recession led to a rise in unemployment and a deficit in public finances.

Paragraph four concerns regional economic integration as applied to the Caribbean. Here you have to use the principles and concepts that you learned from studies of the EU and apply them to this new area of the world. Notice that the paragraph refers to the creation of a single market, an economic union, and a monetary union. These are all terms with which you should be familiar with reference to the development of the EU. The final sentence refers to the hoped for benefits of economic integration, including the possibility of insulating the Caribbean countries from further global recessions.

Extract 1: The world market for bananas

Introduction

Extract 1 focuses on the world price of, and international trade in, bananas. This extract should be read in conjunction with the first paragraph of the introduction on page 2 of the stimulus material. At the same time, you should interpret the graph of world banana prices (Fig. 1.1) in relation to the written text in the extract.

The account appears to be somewhat descriptive, but do not be misled by what appears to be a straightforward account. Within the four paragraphs of Extract 1 there are references to a number of key issues relating to microeconomics and international trade. Your task in the examination will be to analyse cause and effect of the following issues relating to the world market in bananas.

1. The volatility of prices on the world market for bananas.
2. The contrasting nature of banana production in Latin America and the Philippines on the one hand, and in the Caribbean on the other.
3. The contrast between the banana exporting and the banana importing countries of the world.
4. The implications for export earnings of high dependency on a single commodity.
5. Import controls applied by the EU.
6. Changes in the terms of trade for banana produces.

In preparing for the examination you need to interpret, understand and be able to apply the following concepts:

• Export earnings / revenue • High cost production • Developing countries • Import controls • Tariffs • EU Single market • The theory of Customs Unions • ACP group of countries • Discriminatory trade practices • Trade creation and trade diversion • Volume versus value of trade	• Supply and demand • Elasticity of demand • Elasticity of supply • Supply and demand in agricultural markets • Price volatility • Terms of trade • Buffer stocks • Multinational corporations • Specialisation • Concentration ratio

Let us start off by looking in detail at the text.

Paragraph One

From the opening paragraph we learn that:

1. **Banana production is an important economic activity in many developing countries.** This means that the prosperity of the countries concerned will be affected by the output of the crop, and remember that output of agricultural products is subject to variations in the weather including, in the case of the Caribbean region, hurricanes. In addition, it will also be affected by the world price of bananas (which we know from page 2 and from Fig. 1.1) is very volatile.

2. **Production takes place in over 85 countries.** When we remember that membership of the United Nations is around 200, then we can say that bananas are produced in approximately 45% of nation states throughout the world. What is not stated in the paragraph is that production occurs in tropical climates and that the countries concerned are low and middle income countries of the developing world.

3. **Bananas are the leading exported fresh fruit both in terms of volume and value.** In the world as a whole, bananas are the leading exported *fresh* fruit, but we need to understand the significance of the word *fresh* in this context. It is possible that exports of other fruits (eg oranges) might exceed those of bananas, but are exported in the form of tinned fruit or juice. However, when it comes to the export of fresh fruit then bananas top the list, both in terms of volume and value. Volume refers to a physical measure such as weight. Although measurement in terms of volume is of some interest (especially in terms of transport costs), what is more important is measurement in terms of value. This is because the total value of banana exports constitutes the earnings from exports of bananas. As we will see in the next paragraph of the extract, export earnings from bananas represent a high proportion of total export earnings for the countries concerned.

4. **The two countries with the highest production of bananas are India and Brazil.** India and Brazil are both large emerging economies (and together with Russia and China, which have similar economic characteristics, are often called the BRIC economies). In terms of population, geographical size and GDP, they are significantly larger than the other countries named in the extract. They do produce a high volume of bananas but most of their bananas are consumed domestically and do not enter the export market. It is tempting to conclude that banana production in Brazil and India has no impact on the world price of bananas, since they consume what they produce. However, any unplanned fluctuation in Indian or Brazilian production could impact on the wider world market. Any surplus of bananas in these countries could depress the world price, whilst a shortage of bananas might drive up prices if, and only if, local suppliers seek to satisfy local demand by importing from the rest of the world. After stating this we should conclude from the passage that demand and supply in these countries are in balance and, therefore, the impact on world prices is negligible.

Paragraph Two

This paragraph offers a contrast between banana production in two categories of banana exporting economies. The first category links the Philippines with three countries in Central and South America (Ecuador Costa Rica and Columbia), whilst the second consists of Caribbean islands. Some important distinctions are highlighted in this paragraph.

The first category consists of the big four banana exporting nations. Note they are not the largest producers of bananas since we are told that India and Brazil lead the world in production. However, when it comes to exports, the four countries in this category account for around 64% of world exports (although we are not told whether it is in terms of value or weight). The significant features of banana production in these countries are:

- Production takes places on large mechanised plantations.
- The plantations are owned not by local farmers but instead by large US owned multinationals.

It is also significant to note that although these four countries are the largest exporters of bananas, they are less dependent on banana production than is the case with the smaller Caribbean islands. For instance, we are informed that although Ecuador is the world's largest producer of bananas, this crop is not the most significant export from the country. Ecuador earns more from the exports of oil than it does from exports of bananas. Columbia and the Philippines are both larger economies than the smaller West Indian islands and have a more diverse economic base.

The Caribbean islands have a much lower share of the world market (only 8%) but many of these islands have a much greater dependence on the crop compared with the big four countries mentioned above. The extreme example is the Windward Islands which provides the EU with over 30% of its bananas and where 80% of export earnings comes from bananas. We can also conclude that a high proportion of GDP, employment and government tax revenue is dependent on the banana trade. In essence, the big four have a higher market share but are less dependent on bananas.

There is a further distinction between the two categories in terms of the nature of production. We saw above that production in the big four is in the hands of large multinational companies producing on large mechanised plantations. However, Caribbean production is in the hands of family businesses in which production is small scale and methods of production are labour intensive.

We are also told that Caribbean producers are high cost producers because the bananas are grown on steep slopes which are unsuitable for irrigation and large scale production. We can also suggest that the steep slopes would make mechanisation more difficult (even if the small farmers were able to afford it). Because Caribbean production occurs in less favourable circumstances, yields (output per acre) are less than 50% of those in Ecuador. Moreover, the Caribbean farms are vulnerable to droughts and hurricanes which can have a devastating impact on output.

This paragraph suggests that the Caribbean producers are at a disadvantage compared with the "big four" in the following ways:

- It has a smaller market share.
- Production is labour intensive.
- There is less mechanisation.
- There is little scope for irrigation.
- Its costs are significantly higher.
- They are small scale producers facing competition from a handful of powerful large scale producers who can exploit economies of scale.
- They are more subject to droughts and hurricanes.

Paragraph Three

This paragraphs moves from the production of bananas to exports and imports of bananas. The distinction between the Latin American and Filipino producers on the one hand, and the Caribbean producers on the other, is maintained when it comes to exports and imports.

We are told that the USA and the EU account for 60% of world imports of bananas. Entry to the USA is unlimited for developing countries - there are no quotas, no tariffs and no import controls of other kinds. But notice that free, unrestricted entry of bananas into the US market is only available to developing countries. It does not apply to bananas produced in developed countries. You might be tempted to think that banana production is confined to developing countries, but it is worth mentioning that bananas are produced in the Canary Islands (which are part of Spain) and Martinique (a Caribbean island which is part of France and not just a colony of France). After making this qualification we can say that most producers of bananas have unrestricted access to the US market, but we assume that most bananas sold in the USA are from Latin America and the Philippines. This is because banana production in these countries is in the hands of US owned multinational companies. Moreover, we know from the previous paragraph in the extract, that these countries are low cost producers compared with the Caribbean producers.

Entry to the EU market is subject to a complex system of tariffs and quotas. To understand why this is the case we need to understand the nature and the history of the EU. Firstly, the EU is a customs union in which there is free trade between member states but a common external tariff (and other import controls) against non-members. As stated above, Martinique and the Canary Islands are not colonies of France and Spain respectively, but instead they are part of France and Spain. This means that Martinique and the Canary Islands are part of the EU Single Market. Not only does the Single Market require unrestricted access to the markets of the EU27, but EU producers are given protection against non-EU producers.

Secondly, it should be appreciated that many of the early members of the EU are former colonial powers with continuing strong links with their former colonies. In the case of France, Belgium, and Holland, they had very large empires at the time of their entry into the original European Economic Community (EEC). When Britain entered the EEC it was a post-colonial power but continued to have strong links with former colonies through the Commonwealth. The ex-colonial powers were concerned to offer preferential treatment to their former colonies in terms of EEC / EU trade policy. As a result, the EU has operated a discriminatory trade policy in favour of African, Caribbean and Pacific (APC) economies. In relation to bananas this takes the form of tariff-free access to the EU, but only up to 857k tonnes. Imports from outside the ACP group are subject to greater control…

…Imports up to 2m tonnes are subject to a tariff of €100 per tonne. Imports in excess of 2m tonnes are subject to punitive tariffs. This suggests that the import duty is so high as to effectively prohibit further imports.

In essence, the distinction between US and EU policy is that the USA operates a free trade policy in relation to most imports of bananas (the exceptions being bananas from developed countries, including the EU), whereas the EU operates a discriminatory policy in favour of internal producers (eg Canary Islands) and the ACP states.

In preparation for the examination you are advised to revise your knowledge and understanding of the case for and against import controls and the EU's trade policy.

Import controls tend to be rejected by economists for the following reasons:

- They reduce the **ability** of others to buy our exports.
- They reduce the **willingness** of others to buy our exports.
- They lead to retaliation.
- They reduce world trade.
- They force domestic consumers to buy goods at higher prices and deny these consumers access to goods at the lowest price worldwide.
- They reduce the quantity consumed.
- They reduce consumer surplus and living standards.

The discriminatory practices in relation to bananas in the EU's Customs Union might be defended on the grounds that:

- The EU is trade **creating** rather trade **diverted**.
- The Caribbean producers are handicapped in terms of being high cost producers (but in which case it suggests that they do not have a comparative advantage in banana production and, therefore, should not be engaged in this activity).
- The EU has aims in relation to development in poorer countries and has a vested interest in promoting a rise in living standards in the developing world, especially among former colonies.
- Countries of the EU, such as the UK and France, wish to retain close cultural and other links with their former colonies (but this is clearly a non-economic argument).

The arguments against a discriminatory policy are as follows:

- It diverts trade away from low cost suppliers and towards higher cost suppliers.
- It forces up prices for EU consumers.
- It reduces the consumer surplus.
- It is resented by the USA and the non-ACP producers of bananas.
- It leads to retaliation.
- It jeopardises World Trade talks.
- It reduces the volume of exports from the EU.

Before we leave this issue it is important to go back to the introduction on page 2 of the stimulus material. Extract 1 set the scene in terms of the relationship between the two sets of producers and two sets of importers. The discriminatory trade policy of the EU was clearly a source of tension between the rival groups. But, what we learned in the introduction on page 2 was that there was a partial settlement in the "banana war", where the EU agreed to reduce the tariff on Latin American bananas. This was done in the interest of facilitating wider trade liberalisation at the WTO. However, the benefits of the change in EU policy (access to cheaper sources of bananas and increased world trade) have to be considered against the harm done to the banana producers of the ACP. We know from paragraph 2, that the cost of ACP banana production is higher than that of Latin America and, therefore, they will find it difficult to compete. But however unfortunate the consequences, the principle of comparative advantage informs us that countries should specialise in those forms of production in which they have a comparative advantage, and clearly banana production is not an area of comparative advantage for ACP producers. Some might argue that a more far-sighted and, indeed, sustainable EU policy would have been to help ACP countries, over recent decades, wean themselves off bananas, and help them develop those areas where they do have a comparative advantage.

Paragraph Four

This paragraph is concerned with variations in the unit price of bananas and with the terms of trade for banana growing nations.

We learn that the volume of world trade in bananas has grown over a number of decades. Volume measures the amount of trade in terms of physical quantities such as weight. For economists, it is not the volume of trade that is important, but instead it is the total value of trade in bananas. The value of banana exports rose until 1997 but fell in the succeeding years.

How do we explain the fact that the volume of trade rose after 1997 but the value of trade fell? The answer is quite simple and lies in the following equation: value = unit price x quantity. If the rise in quantity is accompanied by a more than proportionate fall in price, then the total value of banana exports will have fallen. We must assume that the price of bananas fell between 1997- 2003 and this cancelled out any benefit from a rise in the volume of exports. In fact, not only are we informed that the trend of banana prices was downwards from 1997, but this is visible from the graph in Fig. 1.1.

After 1997 the trend in banana prices is clearly upward (although there continues to be fluctuation around the trend). Not only did prices rise but so did the volume of exports. This led to a significant rise in the total value of exports and, therefore, the export earnings of the banana growing countries.

The final sentence of the paragraph is very significant and must not be overlooked. *"These trends have important implications for developing countries dependent on banana exports and for their terms of trade".* Let us analyse both parts of this statement.

1. **Export earnings**. Although the Windward Islands, with their 80% dependence on export earnings from banana production, might be at the extreme end of the scale of dependence, it is likely that many of the banana producing countries have a high dependence on export earnings from banana growing. It is also the case that employment, GDP and government revenue is linked to banana production and exports. The earnings from banana exports will be affected by (a) the volume of production and exports, and (b) the unit price of exports. The former is, in turn, affected by fluctuations in output (eg the weather including hurricanes), whilst the latter is affected by trends in world trade. The smaller banana producing nations are at the mercy of hurricanes and trends in world trade. Any reduction in banana prices will have a significant impact on the prosperity of these countries.

2. **Terms of trade**. This refers to changes in the price of exports relative to changes in the price of imports. If the world price of bananas falls when the price of imports from the advanced economies rises, then we say that there has been deterioration in the terms of trade. If the price of bananas rises but at a slower rate than the price of exports from advanced countries, then this is also a deterioration in the terms of trade. If, on the other hand, the price of bananas rises by a greater proportion than the price of goods from the developed world, then we say there has been an improvement in the terms of trade.

   A deterioration in the terms of trade means that the country concerned has to export a higher volume of goods merely to buy the same quantity of goods from elsewhere in the world. As banana producers will not be able to increase production in the short term, a deterioration in the terms of trade will mean that the country concerned will not be able to buy as many goods from the rest of the world as previously. As these foreign imports often take the form of capital goods needed for the country's development, then this will have profound consequences for the developing country.

   An improvement in the terms of trade means that the banana producer will be able to purchase a greater volume of imports for a given quantity of exports. This will enable the banana producing country to import more capital goods from the developed world, thus aiding the country's development.

   Movement in the terms of trade will impact on all countries but, in the case of developing countries with a high dependence on exports of banana, movements in the world price of bananas (assuming that exchange rates remain unchanged) and in the resulting terms of trade will be especially significant.

Interpreting Figure 1.1

The graph in Figure 1.1 is a time series graph for the world price of bananas. We can see that the price is subject to swings and is, therefore, volatile. These fluctuations reflect short term changes in supply and / or demand. It is likely that demand is not subject to great short run swings, although there might be some changes in demand linked to changes in population size, consumer income, and consumer taste.

Although demand might be a factor in price volatility, it is more likely that short term swings reflect changes in supply. As with all agricultural products, the output of bananas will be affected by fluctuations in the weather in terms of temperature, precipitation and hurricanes. The latter have the potential of wiping out the banana crop in parts of the Caribbean and elsewhere. Therefore, if a hurricane destroyed the crop in, say, the Windward Islands, then it would drive up the price of bananas. This might be a welcome outcome for rival banana producing countries, but it would be devastating for the economies of the Windward Islands.

Favourable climatic conditions might result in an unexpectedly large crop of bananas and this would drive down the price of bananas. Such a development might be welcome in the banana consuming nations of the developed world, but would be a setback for the countries that rely on banana production for their export earnings.

Examination Advice

When tackling any question relating to changes in the price of any product or service it is essential to go back to first principles and the use of supply and demand graphs. A rise in price will be the result of a reduction in supply (a leftward shift of the supply curve) or an increase in demand (a rightward shift of the supply curve. A fall in price will be the result of an increase in supply or a decrease in demand. Make sure you illustrate your answer with sketch graphs.

But your use of supply and demand analysis should not end there. Remember that bananas are an agricultural product and you should remember (from unit 1) that the market in agricultural products has particular characteristics as follows:

- The short run supply of agricultural products is price inelastic.
- Supply is subject to unplanned fluctuations linked to factors beyond man's control ie the weather.
- The demand for agricultural products tends to be price inelastic.

If we put all these points together we can construct a sketch in which supply is vertical in the short run and demand is steeply sloping. A change in weather conditions can produce substantial changes in quantity (hence shifting the vertical supply curve). And, if demand is shown as steeply sloping, the result is violent swings in price.

Volatility of prices is a feature of agricultural production and (from earlier units) we know that a solution to volatility is the creation of a buffer stock scheme. In essence, this seeks to stabilise prices by:

- purchasing surplus production to drive up prices in years of a bumper harvest.
- releasing stock to moderate prices in years of shortage.

In theory, a buffer stock can stabilise prices and, if years of surplus balance years of shortage, then it can be self-financing. So why have not banana producers established a buffer stock scheme to stabilise prices? The reason why no buffer stock scheme exists can be explained as follows:

1. Banana production takes place in 85 countries and it would be very difficult to reach agreement amongst the 85.
2. The middle two paragraphs of the extract point to a significant division between the two groups of banana exporting nations. These differences (over the scale of production, the links with the US and EU respectively) would make agreement difficult.
3. Buffer stock schemes require an external body (eg a government or an international body) to impose discipline on producers.
4. As with cartels there is always a temptation for individual producers to operate outside the scheme for their own selfish purposes.

5. We know from experience of the EU's Common Agricultural Policy that the stabilisation of prices removes the market penalty for excess and encourages growers to produce in excess of demand.

6. Buffer stock schemes are based on the assumption that the product can be stored at relatively low cost for a number of years. Bananas are clearly more perishable than other agricultural products and, what is more, involve a high storage cost in terms of refrigeration.

These points also explain why a cartel of banana producers, which is intended to fix prices, is also unlikely to succeed. Competition between the producers is likely to remain a feature of the market and we should bear in mind that banana producers can never have the power of oil producing nations who operate a cartel known as the Organisation of Petroleum Exporting Countries (OPEC). The hard fact is that consumers can survive without bananas but, at present, the advanced economies are highly dependent on oil. An Organisation of Banana Exporting Countries could not have the same muscle power as OPEC.

So far we have looked at short term fluctuations in prices, but can we perceive any medium or longer term trends? Even a casual look at the graph should suggest to us that the graph can be divided into two time periods. If we smoothed out the fluctuations in the period 1997-2003, we would be tempted to conclude that the medium or long term trend during these years is stable, ie that there were swings in individual years but, over the period as a whole, the trend was for prices to remain fairly stable. However, this interpretation is at odds with a comment in the final paragraph of the extract. Here we are told that the trend of the world price of bananas was downwards during these years. A more careful inspection of the graph from 1997 to 2003 shows that if we ironed out the fluctuations by using the technique of moving averages, then the resulting curve would have a slightly downward slope. This downward trend reflects increased supply, or reduced demand. Given the popularity of bananas for western consumers, the explanation probably lies on the supply side.

The picture after 2003 is more clear cut. We can see that when the graph is smoothed out, then the resulting line is clearly upward sloping. So, from 2003, the medium term trend of prices was upwards, but there were fluctuations around the trend. The rising trend might reflect some problems over supply, or it might reflect rising demand in a period of prosperity before the 2008-10 recession.

A word of caution

We should be aware of a number of methodological problems associated with the graph. The first is that prices are quoted in US dollars even though Caribbean bananas are bought by EU countries where the important currencies are euros and sterling. The price in European currencies has to be converted to US dollars and, therefore, is affected by trends in the exchange rate of the dollar.

Secondly, the vertical scale does not go down to zero but instead starts at $200 per tonne. The effect of this is to dramatize the extent of the fluctuations in price.

Thirdly, the time series graph covers a relatively short period and, therefore, it is not possible to be totally certain of the long term trend in prices. In particular, can we be certain that the post 2003 rise in prices is part of a long term trend, or is it merely a temporary period of rising prices within a longer period in which prices fell? Moreover, although it is tempting to extrapolate the trend into the future, it is worth stressing that, from the graph alone, we cannot draw any conclusion about price in 2010.

Finally, the graph refers to price per tonne – not the volume of output, not the value of output, and not the export earnings of banana producing countries.

Conclusion

Extract 1 is rich in detail and could be the basis for numerous examination questions, but a number of major areas of economic analysis emerge and they should be the focus of revision:

1. The causes of price volatility in agricultural markets.
2. The consequences of price volatility for economies with a high dependence on banana exports.
3. The distinction between the two groups of banana producing nations.
4. Discriminatory trade practices.
5. The implication of changes in the terms of trade for banana exporting countries.

Extract 2: Banana exporting countries

Introduction

This extract focuses on the economies of the countries that export bananas. The banana exporters are developing countries and, as such, share a number of common characteristics. These common characteristics *"help to define and explain their lack of development".* In other words, these economies are developing (rather than developed) because of these characteristics (eg relative absence of manufacturing, reliance on primary production, poor infrastructure, lack of skills).

Although many developing countries share common characteristics, there are ways in which they differ from each other (eg in terms of population size, resource endowment, their economic system). This is true as much for the banana exporting countries as for other developing countries.

The rest of the extract explores differences between six of the banana exporting countries. These differences are revealed in the two figures included in the extract. Fig. 2.1 provides data on the importance of banana and other primary product exports to each of the six countries. Fig. 2.2 provides us with measures of development for the same six countries. One of the measures included in Fig. 2.2 is the Human Development Index (HDI). In view of the stress placed on HDI in the introduction on page 2 of the stimulus material, you are advised to thoroughly revise this measure of economic development.

In preparing for the examination you need to interpret, understand and be able to apply the following concepts:

• Developing economies • Common characteristics of LDCs • Ways in which LDCs differ • Primary commodities • Lower middle income economies • Low income economies • Economic structure • Level and rate of development • GDP and GDP per head • Living standards	• Foreign Direct Investment • Infrastructure • Measures of development • PPP (Purchasing Power Parity) • Growth rate • Human Development Index • Absolute and relative poverty • Measures of poverty • Education, skills & health

Paragraph one

The essential feature of this extract is that the banana exporting countries are largely developing countries and *"as such they share a number of common characteristics which help to define and explain their lack of development".* Put another way, this means that developing countries share certain characteristics such as low income per head. Moreover, these characteristics (eg inadequate infrastructure) go a long way to explain why these economies remain underdeveloped.

Later on in the first paragraph we are told that *"despite these common characteristics, there is a degree of diversity between banana exporting countries".* This means that neither the banana exporting countries nor developing countries as a whole are a homogeneous group of countries. There are wide variations between the countries classified as developing countries. We know this from a casual look at the developing world which ranges from large, rapidly growing countries such as India, to famine stricken countries in parts of Africa. Even in terms of income per head, the developing world shows great variations with some countries, clearly categorised as low income countries, whilst others might be seen more as middle income countries.

The text (last sentence in the first paragraph) points to three differences between banana exporting countries (although there are surely many others). These differences concern economic structure, dependence on banana exports and the level and rate of development, as follows:

1. **Economic structure.** This should be interpreted as referring to the relative importance of primary, secondary and tertiary sectors of the economy. Developing countries derive a high proportion of GDP from the primary sector. As the economy develops, there will be a shift of resources to the secondary sector. The most advanced and wealthy economies tend to allocate a high proportion of resources to the tertiary sector. The fact that there is diversity within the banana exporting group suggests that some of these countries have developed secondary or tertiary sector activities to complement the primary sector activities. As we will see below, St Lucia relies on bananas for nearly 20% of its export earnings, but has developed tourism and offshore banking (which are tertiary activities) in order to diversify.

2. **Dependence on banana exports.** We know that Ecuador is the leading exporter of bananas and yet, because it has other primary products (oil), it is less reliant on bananas than St Lucia.

3. **The level and rate of development.** This suggests that some developing countries are on the verge of economic prosperity and will be reclassified as advanced / high income, or industrialised. Consider the case of the emerging economies such as India and Brazil (banana producers but not exporters). These countries are seen as future economic superpowers and have clearly reached a state of development far beyond that of some of the poorest countries in the developing world.

These are just three ways in which developing countries differ, but before moving on to look at the second paragraph, it would be useful to consider the following lists of the common characteristics of developing countries (including banana exporting countries) and ways in which they differ.

Common characteristics of developing countries	**Ways in which developing countries diverge**
• Low living standards. • High population. • Young population. • Relatively low life expectancy. • Low productivity of factors of production. • A narrowly focused economy. • High dependence on a limited range of exports. • A dualistic economy combining a small modern sector with a large peasant and informal sector. • High levels of unemployment. • Low levels of literacy and skills. • Inadequate infrastructure. • Subsistence farming.	• Degree of equality / inequality. • Size of population and of land. • Geographical features. • Resource endowment. • Political regime. • Position of women in society. • Educational opportunities and attainment. • Colonial experience. • Openness of the economy. • The exact nature of the mixed economy. • The extent to which the market is free. • The level of corruption. • Democracy and transparency.

Paragraph Two

The second paragraph contrasts two of the banana exporting countries that feature in Figures 2.1 and 2.2 – Guatemala and St Lucia. In part, this is designed to illustrate the fact that banana exporters are not a homogenous group, but differ in many respects. You should also take as a hint that the examination might feature a question which contrasts the two. Some pre-exam research into the backgrounds and wider economic characteristics of these two countries in particular, would enable you to analyse in greater depth, and draw more informed and relevant conclusions. As a starting point for this process, let us analyse the paragraph and then extract relevant information from the two tables.

We are informed that there is a difference between the two in terms of economic structure. Agriculture contributes a higher % of Guatemala's GDP and employs a larger % of the workforce than St Lucia. This suggests that the secondary and / or tertiary sectors of the St Lucian economy employ a higher proportion of its workforce, and these sectors account for a higher % of its GDP. We discover further down in the paragraph, that St Lucia has attracted large amounts of foreign direct investment (FDI) in offshore banking and tourism. This means that St Lucia has a more diversified economy than Guatemala, even though a casual reading of Fig. 2.1 might lead to the conclusion that St Lucia has greater dependence on bananas and other primary products than Guatemala. After all:

- bananas account for a higher % of St Lucia's export earnings.
- primary products are a higher % of St Lucian exports.
- food exports are a higher % of St Lucia's exports.

How do we square the apparent contradiction between statements that agriculture is more important in Guatemala than St Lucia, and yet the statistics seem to point to the reverse?

Firstly, it is likely that that even though agriculture provides a lower proportion of Guatemala's exports, it is important in terms of domestic production and consumption. It is likely that Guatemala has a large informal or peasant sector producing food for family consumption (subsistence production). Hence, alongside the US multinational banana there might be a large peasant sector. This coincidence of a modern and a peasant sector is called a dual economy and is a feature common to many developing countries. Therefore, the lower export % for Guatemala might disguise a greater dependence on agriculture overall.

Secondly, two of the three columns refer to export **volumes** rather than export **values**. We can be confident that volume refers only to trade in goods (visible trade) and, therefore, excludes trade in services. 41.9% of exports by volume from St Lucia consist of food products, but this should not be read as meaning that 41.9% of export earnings are derived from food exports. It is possible that earnings from invisible trade in services exceed that of earnings from agriculture in St Lucia.

We are also told that average living standards are significantly lower in Guatemala than they are in St Lucia. This is revealed in the per capita GDP figures in Fig. 2.2. You will notice that this is expressed in different ways - GDP per capita at the exchange rate with the US dollars, and GDP per capita in terms of purchasing power parity. Whichever method is used, the fact is that GDP per head in St Lucia is double that of Guatemala and this points to the fact that living standards are, on average, much higher in St Lucia.

However, before we jump to the conclusion that St Lucians are better off than Guatemalans, attention should be drawn to the final column on Fig. 2.2. Despite income per head of $5,834 (or $9,786 at PPP), 40.6% of the people of St Lucia have less than $2 per day ($104 per year). This means that although average living standards might be higher in St Lucia compared with Guatemala, there is still a large % of people living in abject poverty. St Lucia has attracted inward investment, offshore banking and tourism, but clearly the benefits have not "trickled down" to the people on less than $2 per day.

Analysis of Figure 2.1

Figure 2.1 provides data on the export structure of six selected banana exporting countries. Two of the countries are in Latin America, two are in the Caribbean and two are in Africa. The last four countries are members of the APC group which, as we saw in extract 1, had preferential access to the EU market.

You should notice that the figures shown in the table are annual average figures for the period 2004-2009. Therefore, we should not see these figures as accurate for any individual years, but over the five years the position averages out to be the figure shown.

The **first column** of figures shows revenue from banana exports as a % of total export earnings. We can see that St Lucia receives 19.7% of export revenue from the sale of bananas. The other three countries for which figures are provided are less reliant on earnings from the sale of bananas. Significantly, this includes Ecuador which we know from extract 1 is the world's leading exporter of bananas. Ecuador's lower dependence on bananas can be explained by the fact that Ecuador (a much larger country than St Lucia) has a range of other exports including oil which is its main export.

Rather unhelpfully we are not told the export earnings from banana sales in the case of the two African countries which are Cote d'Ivoire (Ivory Coast) and Cameroons. We are assuming that "na" in the figure refers to "not available" rather than "not applicable". The fact that these countries are included in the list should be taken as indicating that they do export bananas, but that we have no data on the importance of this fruit in terms of their export revenue.

The **second column** refers to primary commodities as a % of the total *volume* of exports. Notice that this refers to volume of exports which should be taken as meaning a physical measurement such as weight. We should also interpret this as referring to visible exports of goods and excludes invisible exports. In terms of export volume these countries (with the exception of the Dominican Republic) seem to rely heavily on the export of primary products. You will be aware that primary products are extracted from nature and include the output of agriculture, mining, forestry and fishing. We know from extract 1 that Ecuador's main export is not bananas but is in fact oil. So, even though Ecuador is the world's leading exporter of bananas, the fruit is not the main export from the country.

The greatest deficiency in this second column (and this applies equally to the third column) is that, for economists, what matters is not physical measures of volume but measures of value. Just a simple example will illustrate this point. We are told that 91% of Cameroon's exports by volume consist of primary commodities. This might hide the fact that over 50% of Cameroon's *export earnings* might take the form of secondary or tertiary products. In reality this is unlikely to be the case. Nevertheless, it is designed to illustrate the limitations to economists of data in volume terms.

If we assume that the figures quoted are a reasonable proxy for the importance of primary products in the visible export trade of the countries concerned, then we can conclude that in five of the six countries primary products accounted for over 50% of the country's visible exports. In the case of Cameroons and Ecuador, primary products constituted 91% of exports (by volume at least). This high dependence on the export of primary products is what we expect when investigating a developing economy. The exception is the Dominican Republic where exports of primary products constitute only 16.4% of exports by volume.

The **third column** is similar to the previous column except in one respect; this column concerns exports of food alone and excludes primary products other than food. Logically, the difference between the two columns is exports of oil, minerals and forestry products such as timber. Notice that for Ecuador and Cameroon, despite their exceptional dependence on exports of primary products, food exports account for a relatively small proportion of products. We know that Ecuador's main export is not bananas or any food, but instead it is oil. In the case of Cameroon 91% of exports are primary products but only 18.7% of exports are food. Much of the rest of Cameroon's exports takes the form of oil, timber and rubber. Note also that in the case of the other four countries, food exports constitute a much higher percentage of total primary products.

Analysis of Figure 2.2

Figure 2.1 provides data on measures of development for the same six countries. If these are presented as measures of development then we should consider answers to the following questions:

1. What exactly is economic development and is it the same as economic growth?
2. To what extent are these satisfactory measures of development?

Economic development is the process of improving people's economic wellbeing and quality of life. An alternative definition is that economic development concerns an increase in the availability of food, medicine, education and a properly functioning civic society. Development expert Michael Todaro argues that development is concerned with seeking to achieve an:

- increase in the availability and distribution of basic life sustaining goods eg food, shelter, basic clothing.
- increase in the standard of living.
- expansion of economic and social choice.

These definitions should convince us that economic development is not the same as economic growth. **Economic growth might be a necessary condition for development but it is not enough in itself.**

If we take this argument further we must conclude that % change in GDP, which might be seen as a measure of growth, does **not** constitute a measure of the rate of development. Similarly, GDP per head might be seen as a reasonable measure of average living standards but is **not** a measure of development.

Column one of the figures provides us with per capita GDP figures in US dollars for the year 2007. As stated above, GDP and GDP per head is the traditional measure used by economists. It provides us with a measure of average living standards in each country using the common measuring rod of the US dollar. We can see that the Latin American and Caribbean countries with income per head of $2,500 to $6,000 fit in the category of lower middle income countries, whereas the two African countries with income per head around $1,000 would only just fit into the lower middle income group of countries. If all six countries are seen as developing, then this provides evidence for the point made about divergences within the broad group of developing countries.

Definitions for comparison of per capita income

Low income countries	Countries with a GDP per capita of $905 or less
Lower middle income countries	Countries with a GDP per capita of $906 - $3,595
Upper middle income countries	Countries with a GDP per capita of $3,596 - $11,115
High income countries	Countries with a GDP per capita of $11,116 or more

Source: World Bank

Column two is based on the same GDP data but, instead of quoting figures in terms of the exchange rate of the local currency to the US dollar, the figures have been adjusted to take account of variations in purchasing power in each of the countries. The purpose behind the adjustment is to provide a common measuring rod so that $100 in the USA would buy the same bundle of goods and services as the local currency equivalent of $100 in each of Ecuador, Guatemala, Dominican Republic, St Lucia, Cote d'Ivoire and Cameroon.

If we place the six countries in descending order for each of the two columns we find that there are few differences in the order, although the disparity is greater when looking at the PPP column. In terms of the PPP figure we can conclude that the average resident of St Lucia can buy 5.8 times as many goods as the average person in Cote d'Ivoire (9786 / 1690). Similarly, the average person in St Lucia can buy approximately twice as many goods as the average person in Guatemala (9786 / 4562).

Before leaving the topic per capita GDP, it might be useful to review the limitations of this measure of comparative average living standards in different countries.

Limitations of GDP per capita as a measure of living standards

GDP per capita is a measure of average living standards since it is a measure of access to resources, goods and services. Ultimately, our standard of living is dependent upon our ability to acquire goods and services.

It is a measure of average living standards but it tells us nothing about distribution of income.

The degree of equality / inequality varies from country to country.

As comparisons require conversion of national values to a common measuring rod (US$) there are problems relating to the choice of exchange rates.

Price levels vary in different countries and, therefore, GDP in $ at PPP is a superior measure since it takes account of price levels in different countries.

There are variations between countries in terms of:

- the accuracy of statistics.
- accounting techniques and definitions.
- the size of the subsistence and non-money sector of the economy.
- the size of the hidden (tax evading economy).
- investment which does not add to living standards eg defence spending.
- the quality of the environment.
- the level of taxation.

At best GDP per head is a measure of average living standards but is not a measure of the quality of life or of development.

As stated above, GDP per head (however it is calculated) is a measure of average living standards but it is not a complete measure of development. GDP per head is a quantitative measure, whereas development is qualitative as well as quantitative.

Column three is a measure of the economic growth in each of the countries expressed as an annual average over a 17 year period. Three of the western hemisphere countries recorded disappointing growth rates which average just over 1% per year over 17 years. Only the Dominican Republic recorded a satisfactory growth rate of 3.8% per year over 17 years. One of the two African countries (Cameroon) recorded an even more disappointing growth rate of 0.6% per year over the period, whereas the other (Cote d'Ivoire) recorded a negative growth rate over the 17 year period. Certainly, in the case of Cote d'Ivoire it suggests that output did not rise as fast as the population. This provides some evidence that growth rates in the developing countries vary considerably but, once again, it is not a measure of development.

Column four provides us with data on the Human Development Index. But what is the HDI? The HDI is an indicator of development published by the United Nations which focuses attention on the outcomes of development rather than just economic growth. It measures outcomes that might be valued in the development and, in particular, the outcomes identified by Todaro. The HDI is a composite indicator of a country's development and combines three elements:

1. Longevity - as measured by life expectancy at birth.
2. Educational attainment - as measured by adult literacy and school enrolment.
3. Living standards and command over resources - as measured by GDP per head at PPP.

Data on each element is collected and combined in an index ranging from zero to one. If the resulting number is above 0.8 then the country concerned is considered to have high human development. You will find that USA and UK have an HDI very close to one. An index number of 0.5-0.8 is medium human development, whereas below 0.5 is low human development.

We can see that two of the six countries are in the high human development category despite their relatively low income per head. Three of the countries are classed in the medium HDI group, but Cote d'Ivoire is classed as low HDI.

Column five is a measure of progress in terms of human development. Each of the six countries made steady progress in terms of human development, although the greatest gains were made by Guatemala and the Dominican Republic. St Lucia made the smallest gain in HD but with a high existing HD there would be more limited scope for improvement. Notice that the two African countries have the lowest HDI, but also made only a small improvement in HDI.

Rank order of countries in terms of GDP and HDI (Based on Fig. 2.2)

	GDP per head	GDP per head (PPP)	HDI	HDI Improvement
1	St Lucia	St Lucia	St Lucia	Guatemala
2	Dominican Republic	Ecuador	Ecuador	Dominican Republic
3	Ecuador	Dominican Republic	Dominican Republic	Ecuador
4	Guatemala	Guatemala	Guatemala	Cameroon
5	Cameroon	Cameroon	Cameroon	Cote d'Ivoire
6	Cote d'Ivoire	Cote d'Ivoire	Cote d'Ivoire	St Lucia

From the rank orders shown above we can see that:

- There is a close but not perfect correlation between per capita GDP and the other measures,
- There is a closer correlation between GDP per head (at PPP) and HDI.

The closest of the correlation in the second case is not surprising when we remember that GDP per head (at PPP) is a component of the HDI. If we had a sample of more countries we would find that the correlation might be close but is not perfect. This, again, is not surprising when we remember that development is broader than just a quantitative measure of living standards.

Before leaving this topic it should be pointed out that HDI can be criticised on the following grounds:

- The range of variables captured in the index is too narrow and should be extended to include the level of political freedom and the conditions of the physical environment.
- The elements should be weighted rather than simply averaged out.
- As well as the length of life there should be some reference to how healthy life has been.
- The index does not provide evidence on income and wealth inequality within an economy.

Column six concerns a measure of absolute poverty and, implicitly, income inequality. People who are living on less than $2 a day can be said to be living in absolute poverty. Remember, social scientists define poverty in two ways:

- relative poverty in terms of income substantially below the average for the country.
- absolute poverty in terms of being below the income needed to remain fit and healthy.

We can say that anyone surviving on an income of less than $2 per day is not only very likely to be **relatively** poor but will also be **absolutely** poor.

Let us consider the two African countries. 57.7% of the population of the Cameroons are living on less than $2 per day and the percentage in Cote d'Ivoire is not that much better at 46.8%. Looking at columns one and two together we can say that average annual income in these countries is slightly more than $1,000, and yet around 50% or more of the population have an income less than $104. These countries are poor but within them there are people with incomes significantly below even the low figure that is the average.

Similar comments apply to the other four countries. Average income in Ecuador is $3,335 and yet 12.8% of the population survive on less than $104 per year. The average income in Guatemala is $2,536 and yet nearly a quarter has to make do with $104 per year or less. The average income in the Dominican Republic is $3,772 and yet 15.1% have only $104 per year or less. The country that comes out worst in this respect is St Lucia. Average incomes in St Lucia are $5,834. These are the highest of the six and yet 2 in 5 people in St Lucia live on less than $104 per year.

Conclusion

Three major themes emerge from Extract 2 and each could be the basis of a question in the examination:

1. The common and contrasting features of developing countries with reference to the six banana exporting countries.
2. Dependence upon the exports of primary products and its consequences.
3. The meaning of development and the validity of different ways of measuring it.

Extract 3: Impact of the global downturn on economies in the Caribbean

Introduction

This extract concerns the impact of the recession on the economies of the Caribbean. Note that we are no longer focusing on banana production and exporting, but looking at the economies as a whole. The extract starts with an upbeat message from a senior official at the International Monetary Fund. Takatoshi Kato explains how the Caribbean is especially well placed to benefit from globalisation at a time of economic expansion. Globalisation is defined as *"the processes that have resulted in ever closer links between the world's economies"* and Kato was arguing that globalisation would be especially beneficial for Caribbean economies in terms of expanding markets for their produce.

One year later the mood had changed considerably as the economies of the developed world were plunged into recession. The global economic crisis had severe consequences for developing countries in terms of fall in global demand, negative growth, decline in export earnings, the cancellation of development projects, unemployment, increasing poverty, rising government debt and balance of payments deficit. So, just as the Caribbean countries benefited from globalisation, they were now suffering from their dependence on the developed countries of the world.

In preparation for the examination you need to interpret, understand and be able to apply the following economic concepts and issues.

• Recession • Global economic downturn crisis • Integration into the global economy • Globalisation • Foreign direct investment • Export revenue • Unemployment • Fiscal position • Fiscal deficit • Government debt • Fiscal stability • Economic significance of democracy • Strong Institutions • International reserves	• Comparative advantage • Commodity prices • Economic fluctuations • Unemployment • Remittances • Income elasticity of demand • Current account deficit • Monetary policy • Inflationary pressure • Recovery • World Bank • Borrowing from IMF • Foreign direct investment

Paragraph One

The extract starts with this upbeat message from Takatoshi Kato of the IMF speaking in 2007 (ie before the recession). Kato argued that the Caribbean is especially well placed to benefit from globalisation. This is because of its:

- democratic history.
- generally strong institutions (banks, civil service, education).
- impressive social indicators (educational standards and health care).

Here Kato is arguing that the countries of the Caribbean are both attractive for foreign investors and have the institutional and social foundation for development. He then goes on to argue that the region has the entrepreneurial talent to seize new opportunities by developing tourism. This exploits a comparative advantage enjoyed by these islands in the sun. Not only does the Caribbean attract visitors from North America and Western Europe, but the local tourist industry is working to tap a growing market in terms of tourism from Asia and Eastern Europe. Kato appears to be saying that integration with the advanced economies can only benefit the Caribbean islands, and that they have the foundations to prosper in what was then a period of growth and prosperity.

Paragraph Two

This paragraph introduces the downside of the integration into the global economy. Just as the Caribbean islands benefitted significantly from a boom in the global economy, so it was inevitable that it would suffer significantly in the downturn of the global economy. The IMF forecasts a reduction in GDP of Caribbean economies by 2.5%. Output was expected to fall by 2.5% during 2009 even though some of the stronger countries (such as Trinidad and Tobago with its gas and oil) would experience some problems, although not necessarily a 2.5% reduction which should be seen as an average figure.

Paragraph Three

This paragraph seeks to explain the mechanisms by which the recession in the developed world was transmitted to the Caribbean. Let us consider each point in turn.

Firstly, the global recession led to a **30% decline in revenue from tourism**. This is not surprising when we consider the likely income elasticity of demand for holidays in the West Indies. Caribbean holidays are a luxury product for which there are cheaper alternatives available (holidays in Spain or even Britain). We know the income elasticity of demand for luxury products exceeds one and, therefore, it is not surprising that the % fall in revenue from tourism to the Caribbean exceeded the fall in per capita incomes experienced by consumers in the developed countries.

Secondly, there was a **fall in remittances from the developed world to the Caribbean**. Remittances refer to transfers of money from one country to another. Much of this would be transfers from West Indian immigrants and migrant workers in North America, Britain and other European countries to their relatives back home. It is to be expected that the amount of money remitted to the West Indies will fall during a recession. If Caribbean Britons are unemployed they will be less able to send money back to their family and friends in the West Indies.

Thirdly, there occurred **cancellation of some projects**. This might take the form of cancellation of foreign investment in the West Indies. It is also worth mentioning the **accelerator principle** which links the rate of investment to the rate of change in income. If growth starts to slow down it will have an accelerator impact on capital investment, resulting in swings in investment being more pronounced than any fluctuations in consumer spending. The recession was not a slowing down in the rate of growth, but it was a period of negative growth, (in terms of the technical definition it is 2 quarters of negative growth) and, therefore, it is not surprising that investment fell.

Whilst mentioning swings in investment, it is worth mentioning the **downward multiplier**. A reduction in injections into the economy will result in a multiplied impact on output and, therefore, income.

Fourthly, we need to consider the **collapse of commodity prices**. This is not confined to swings in the price of bananas, but extends to all primary products. This paragraph places a particular emphasis on bauxite production. Bauxite is used in the manufacture of aluminium which we use widely in developed countries. The global recession led to a decline in demand for aluminium and, therefore, in the demand for bauxite. This fall in demand would initially lead to a fall in price, but given the growing surplus of the raw material, it led to a significant cut in production. Output of bauxite in Guyana was cut by 61%, whilst Jamaica temporarily ceased production. We are not told how dependent the economies of these two countries are on bauxite, but we must assume that it is high. Such a significant reduction in prices and production would have a devastating impact on the economies of the countries concerned.

From the final two sentences of the paragraph we learn that fluctuations within the bauxite industry exceeded the fluctuations in the global economy. Fluctuations in aluminium consumption fluctuate more violently than fluctuations in GDP – ie rise at a higher % than GDP on the upturn, and fall by a higher % on the downturn. What is worse for the producers of bauxite is the fact that demand for bauxite is subject to even greater fluctuations than the demand for aluminium. As we can see, a 7% decline in demand for aluminium led to a 15% decline in the demand for bauxite. It should be appreciated that fluctuations in capital goods industries exceed those of consumer goods industries.

Paragraph Four and Figure 3.1

The decline in economic activity has led to a **rise in unemployment**. This is not surprising when we consider the fall in tourism and bauxite production (amongst other sectors of the economy) would result in job losses. Tourism is a particularly labour-intensive business sector. Unfortunately, this leads to a further reduction in aggregate demand and a downward multiplier impact on the economy.

In addition, to a rise in unemployment, the recession has led to a **rise in government debt**. This is because tax revenues fall and welfare spending tends to rise during a recession. This rise in government debt is on top of what is a high government debt in some of the Caribbean economies. In Fig. 3.1 we are given figures for the government debt (what we in the UK call the national debt) expressed not in money terms but in terms of a % of GDP. The highest government debt to GDP ratio is St Kitts. Its government debt is nearly twice the size of its current GDP or national income. Three of the other countries named have a government debt slightly higher than their GDP, while the government debt of Barbados is slightly below its GDP. Only Trinidad and Tobago has a government debt well below its national income. Probably because of taxes from oil and gas, Trinidad and Tobago has a government debt of around one quarter of its GDP.

But does it matter that the government has a high and rising debt? Clearly the present UK government considers high deficit and high government debt to be a matter of concern and the case for regarding it as a problems is as follows:

- Government debt creates a liability in terms of interest payments on the debt.
- Taxes have to be raised to service the interest payments.
- Government debt creates an inter-generational shift in which future generations have to pay more because of the excess spending of the current generation.
- If government debt is owed to people and organisations abroad it creates a balance of payments problem.
- High debt reduces the ability of the country to raise future loans.
- High debt and borrowing will push up interest rates, thus impeding recovery.
- Financing debt and indeed paying it off depends on securing significant and sustained economic growth.

Comparison with Selected Advanced Economies

Economy	Debt as % of GDP
USA	92.7
UK	76.6
Republic of Ireland	93.6
France	84.1
Germany	75.3
Italy	118.3
Greece	130.2
Spain	63.5
Portugal	83.1
Belgium	100

Source: The Times 15 November 2010.

Paragraph Five

Paragraph 5 concerns fiscal and monetary policies pursued by Caribbean states in response to the global recession. The starting point is the impact of the recession on attracting private external finance to the Caribbean. This would inevitably lead to a decline in the rate of investment in the Caribbean.

The downturn in the global economy led to **large deficits on the balance of payments current accounts** of many Caribbean countries. This can be explained in terms of the fall in the price of bananas and many other commodities. This led to a reduction in export earnings. In addition, the Caribbean countries with a large tourism sector suffered a decline in the number of tourists from the developed world. Those countries which relied on exports of raw materials such as bauxite, also suffered a fall in exports as the global downturn reduced the demand for these commodities.

As in the case of the UK, the global recession led to a **fiscal deficit in terms of the government's budget.** This is because tax receipts move in sympathy with the state of the economy, whereas government spending moves in the opposite direction. In short, a recession reduces tax yield and increases spending on welfare. The result is called a cyclical deficit.

In additional to these problems, the global downturn increased the problems of attracting private external finance into the Caribbean countries and, hence, FDI would not be available to fill the gap either in government finances or the balance of payments.

Because of these financial problems governments were constrained in what they could do to relieve the problems created by recession. We know that some of these countries have a high level of government debt and were not able to increase the size of the deficit in order to stimulate the economy. Jamaica (one of the largest West Indian states) was forced to seek assistance from the IMF to overcome its financial problems. However, IMF assistance always comes at a price in terms of limits on government spending, borrowing and government debt. It was only the oil rich countries such as Trinidad and Tobago, and Guyana with its range of natural resources, which had built up the international reserves to avoid these problems.

One more positive trend was that the fall in food and fuel prices (significant expenditure items in less developed economies) reduced inflationary pressure in 2009. As a result, the monetary authorities of these countries were able to relax monetary policy. Hence, like the Bank of England, they were able to reduce interest rates and perhaps introduce some quantitative easing. An expansionary monetary policy might mitigate some of the consequences of recession, but the limitation of interest rate policy is that unless people are willing to borrow then banks cannot lend. Interest rate policy only succeeds when the demand for loans is interest elastic.

The final sentence of the paragraph reinforces the idea of the vulnerability of the Caribbean states to the global economic cycle. Even after recovery there will be a delay and Caribbean recovery will not occur until American and European firms place new orders for Caribbean commodities, and when tourists from the developed world return in greater numbers. This vulnerability of the Caribbean to the global cycle is one reason why the Caribbean nations are seeking a greater degree of insulation from global trends by means of regional economic groupings. This is the subject matter of the final extract.

Conclusion

The focus of this extract is on the way in which the global economy impacts upon the Caribbean states. In times of expansion, globalisation creates expanding markets for the various products of the Caribbean. However, it also exposes them to economic problems during economic downturns. In addition to negative growth and unemployment, the worldwide recession led to problems of government debt and current deficits. Admittedly, these problems were faced by other countries such as the UK, but the weaker Caribbean economies were less able to cope with the problems, given the established higher levels of poverty and the weakness of the tax base already.

Extract 4: The move to deepen regional economic integration in the Caribbean

Introduction

Extract 4 concerns regional economic integration through the development of a regional economic group. You might not have heard of the Caribbean groups mentioned in the passage, but when you read the passage you should be reminded of the development of the European Union. The economic principles that you learned in relation in the EU can be transferred to the Caribbean groups, but you must apply these principles to the situation described in the stimulus material.

In preparation for the examination you need to interpret, understand and be able to apply the following concepts:

• Economic integration • Stages in economic integration • Single market • Monetary union • Common currency • Economic union • Benefits of economic integration • Globalisation • Recession • Common trade policy • Common external tariff • Fiscal policy • Extra CARICOM and Intra CARICOM trade • Education • Infrastructure	• FDI • Economic reforms • Price controls • Privatisation • Trade creation/ trade diversion • Trade barriers • Harmonising product standards • Free movement of capital • Exchange controls • Harmonising laws and social standards • Monetary policy • Indirect taxes • Budget deficit • Optimal currency area

Economic Integration

Before analysing the extract it is advisable to review our understanding of economic integration. This is defined as the process of blurring the boundaries that separate economic activity in one national state from that in another.

We can understand the extract in terms of the well known model of the stages of economic integration.

1. **Stage one: Free trade area (FTA)** – free trade between member states.
2. **Stage two: Customs Union (CU)** – FTA plus a common trade policy including a common external tariff.
3. **Stage three: Single Market (SM)** – CU plus removal of all barriers to the free movement of goods, services, labour and capital.
4. **Stage four: Monetary Union (MU)** – CU plus a single common currency. This implies a common monetary policy.
5. **Stage five: Economic Union** – MU plus harmonisation of fiscal policy.

Paragraph One

The opening paragraph is a description of the economy of St Lucia and many of the points made are repeated from the earlier extracts. We learn that St Lucia is a Caribbean island and is one of the Windward Islands. We are not told (but, nevertheless, it is of some relevance) that St Lucia is a small state with a population of around 167,000 (roughly the same size as some smaller cities in the UK). It is one of the more mountainous islands in the Caribbean and this confirms a point made in Extract 1 that Caribbean banana production takes place on slopes which are less conducive to plantation and mechanised production than is the case in Latin America. St Lucia achieved full independence from the UK in 1979. So, despite its small size it is a sovereign independent state.

The economy of St Lucia is based on:

- the production and export of bananas (which accounts for nearly 20% of export earnings – Fig 2.1.
- tourism (helped by its island position, mountains, sunshine and political stability).
- offshore banking.

The island has a well educated labour force (we saw it had a high HDI in Fig. 2.2), and a well developed infrastructure. The latter is partly the result of FDI.

So far we have not been told anything new about St Lucia, but the final sentence adds to our understanding of the success of St Lucia. We are told that the island's recent success can be attributed in part to economic reforms recently introduced. These economic reforms included the ending of price controls and the privatisation of the state banana company. These economic reforms would have made the economy more sensitive to market forces and allowed the price mechanism to fulfil its role in terms of signalling, motivating and allocating resources. Economic reforms also made St Lucia more attractive to foreign investors.

Paragraph Two

This short paragraph informs us that St Lucia has pursued regional economic integration through the membership of three regional bodies:

The Caribbean Community (CARICOM). This consists of 15 Caribbean nations. Its main aims are to:

- promote economic integration.
- ensure that the benefits of integration are equitably shared.
- co-ordinate economic policy and development planning.

The Organisation of Eastern Caribbean States (OECS) - an inter-governmental organisation dedicated to:

- economic harmonisation and integration.
- the protection of human and legal rights.
- the encouragement of good governance.
- economic union.

The Eastern Caribbean Currency Union (ECCU) - a development of the OECS and, as the name suggests, it is a monetary union with a single currency known as the East Caribbean Dollar. The single or common currency is issued and controlled by the East Caribbean Central Bank.

These are the three organisations with overlapping membership. In terms of the well known model of stages of economic development it would appear that economic integration has proceeded to its greatest extent in the OECS and ECCU. The former seeks economic union and the latter has established monetary union. However, the Eastern Caribbean states tend, like St Lucia, to be rather small countries. This is reminiscent of the early days of European integration, when Europe seemed to be divided between the big players in the EEC / EU and the smaller and less successful countries in the European Free Trade Association. Eventually most of the EFTA countries decided that it was preferable to be in the "big boys club".

Membership of Caribbean Regional Groups

CARICOM	OECS	ECCU
Antigua and Barbuda	Antigua and Barbuda	Antigua and Barbuda
Bahamas *		
Barbados		
Belize		
Dominica	Dominica	Dominica
Grenada	Grenada	Grenada
Guyana		
Haiti *		
Jamaica		
Montserrat *	Monserrat	
St Kitts and Nevis	St Kitts and Nevis	St Kitts and Nevis
St Lucia	St Lucia	St Lucia
St Vincent & the Grenadines	St Vincent & the Grenadines	St Vincent & the Grenadines
Suriname		
Trinidad and Tobago		
	British Virgin Islands	British Virgin Islands
	Anguilla	Anguilla

* Members of CARICOM but not in the CARICOM SME
Note: Dominica is **not** the same as the Dominican Republic.

Paragraph Three

This paragraph focuses on developments in CARICOM which, as we can see from the above table, is the largest of the regional groupings in terms of membership, and which contains major regional players such as Jamaica and Trinidad and Tobago.

We are told that CARICOM has not brought the expected benefits in terms of trade creation and this is illustrated in Figure 4.1 (see below). As you should be aware - from studies of the EU - the benefits of regional economic groupings are seen in trade creation between member states. This produces further benefits to the economies of the regional group in terms of increased output, economies of scale, increased competition between member states, lower prices for consumers, and higher living standards. Unfortunately, CARICOM has not yet produced the benefits that member states were seeking and, as a result, it was decided to move to a deeper degree of integration by the creation of the CARICOM Single Market and Economy (CSME).

Note that there are 15 states in CARICOM but only 12 in CSME. The non-members of CSME are Bahamas, Haiti and Montserrat (the latter is seeking arrangements with the UK to allow it to join).

If you inspect the bullet points in the extract you will realise that, with one or two exceptions, the list is very similar to the EU Single Market programme that came into force in Europe in 1993, under the Single European Act (SEA). As you can see, the CSME programme involves the removal of barriers to achieve the free movement of goods, services, labour and capital within the CSME. The barriers to be removed are not confined to tariffs and other import controls, but extend to previous national differences over products' standards, laws on businesses, national qualifications and controls on currency movements. The single market will ensure resources are allocated to their most productive use within the regional grouping.

The fourth bullet point relates to a common trade policy, including a common external tariff on goods imported from outside CSME. This measure was not part of the EU's Single European Act for the simple reason that a common trade policy within the EEC / EU had already been achieved before the SEA. The original members of the EEC (the EU6) had moved to a common trade policy, including a common external tariff as early as the 1960s. In fact, we normally slot a common trade policy in stage two of economic integration (ie customs union) rather than stage three (single market). It is tempting to suggest that CARICOM is seeking to conflate stages 2 and 3.

The final bullet point concerns the harmonisation of monetary and fiscal policy. Harmonisation of monetary policy was not a feature of the SEA but is an essential requirement for monetary union. The members of the Eurozone are subject to a common monetary policy which is in the hands of the European Central Bank. However, this does not apply to the UK and other members of the EU Single Market who are not in the Eurozone. There is limited amount of fiscal harmonisation within the EU (mainly in the form of constraint on changing excise taxes such as VAT by member states). The rationale for fiscal harmonisation is that it is designed to prevent member states exploiting tax law in order to discriminate against goods and services from other member states. In addition, it is designed to prevent member states offering tax concessions to gain an unfair advantage in attracting inward investment.

Figure 4.1

The graph in Figure 4.1 refers to the situation in CARICOM before the agreement to move to a Single Market. In fact, the graph is the rationale for the decision to deepen the relationship between CARICOM states by the signing of a single market agreement.

The graph shows that, apart from temporary downturns in 1998 and 2002, there has been a steady rise in the exports of CARICOM states. However, more important than the total value of exports is the balance between extra-CARICOM and intra-CARICOM trade. Intra means 'within' the group, whereas extra means exports to the outside world. We should focus on the value of intra CARICOM trade – that is, from one member state to another.

Economic theory in the form of the theory of customs unions leads us to expect that the creation of a regional economic group will result in an increase in trade members. In fact, the rationale for a regional economic group is that it results in trade creation, which increases economic welfare. Admittedly, the downside of regional economic groups such as customs unions is that they also **divert** trade rather than **create** trade. Trade diversion reduces economic welfare. Whether the regional groups is of net benefit or not, depends upon the extent to which it is trade creating rather than merely trade diverting.

What can we deduce about the extent of trade creation from the graph in Fig. 4.1? If we inspect the vertical distance between the two curves we can gauge the amount of intra-CARICOM trade. There is no doubt that the value of intra-CARICOM trade is higher at the end of the period than at the beginning. However, we must assume that the value of exports shown refers to value at prices at the time. This means that any rise in the value of exports might merely reflect changes in prices (or in exchange rates), rather than any rise in the amount of exporting in real terms.

But, even if the values are at constant prices, then we have to admit that:

- The amount of intra-CARICOM trade is insignificant, and has become more insignificant.
- There was little growth in intra-CARICOM trade either in the form of trade creation or trade diversion.

The disappointing trend in intra-CARICOM trade explains why the member states seek to deepen the relationship by moving to a single market. However, we should consider why intra-CARICOM has not grown as much as expected. One explanation might be that the member states of CARICOM have competitive, rather than complementary economies. The following statements are over simplifications but there is an element of truth in them. The success of the original EEC / EU6 was, in part, due to the fact that industrial West Germany was complementary to France and Italy with their large agricultural sectors. But, many of the CARICOM are banana exporting countries and there is little scope for countries reliant on banana exports trading with each other. So, perhaps the disappointing trade results reflect the lack of complementarity between member states. If this is the case, then we have to be sceptical about the results of the new Single Market.

Paragraph Four

This is a short paragraph from which we learn that some of the Caribbean states have moved to monetary union involving the creation of a common currency. Just as the euro is the currency of the EU states in the Eurozone, so the Eastern Caribbean dollar is the currency of the members of ECCU.

We know from studies of the EU that a single currency necessitates a single central bank and a common monetary policy. Like the European Central Bank, interest rates within the ECCU will be set by the Eastern Caribbean Central Bank. In preparation for the examination, you should revise your notes on the case for and against a single currency such as the euro. The standard case for and against the adoption of a single currency is summarised in the table below. The notes above should be seen as standard textbook points in relation to the adoption of a single currency, but you will not gain high marks unless you can adapt them to the situation in the Caribbean.

The case for a single currency	The case against a single currency
A single currency results in: • the elimination of transaction costs for trade between members. • a reduction in risks associated with trade. • an expansion of trade within the monetary union. • increased transparency in pricing. • increased competition. • increased productivity. • economies of scale from supplying to an enlarged market. • increased ability to source inputs at the lowest costs. • new market opportunities from reduced entry barriers. • lower prices for consumers. • an increase in GDP and living standards. A single currency is a necessary condition for a genuinely single market.	The main disadvantages concern the loss of national government control over macroeconomic policy instruments: • Interest rates are set centrally and may not suit the economic circumstances of individual countries. • Fiscal policy is constrained by rules on government borrowing and debt. • The exchange rate is no longer available as a weapon of macroeconomic policy; therefore, devaluation to compensate for differences in competitiveness is no longer an option. If the monetary union is not an optimum currency area then the adoption of a single currency will be detrimental to one or more members. Asymmetric shocks will lead to great strains on the monetary union if some countries are more significantly affected than others.

As St Lucia occurs throughout the stimulus material it is possible that any question on monetary union will be slanted towards the adoption of a single currency by St Lucia. Therefore, you need to make points relevant to this Caribbean island. Some suggestions are provided in the following paragraphs.

St Lucia is a tiny country with a population smaller than most cities in the UK. It is too small to have its own currency for the purposes of international trading. If you consider the microstates of Europe, such as Andorra and San Marino, they adopt the currency of their large neighbours. Also, some non-members of the EU, such as Montenegro, have effectively adopted the euro in the absence of a stable national currency. If there was no Eastern Caribbean dollar it is highly likely that St Lucia would adopt the US dollar or UK sterling as its national currency. The adoption of another country's currency means that you have no say on monetary policy, whereas joining a monetary union means that at least you have some input into decision making.

We have seen throughout the stimulus material that St Lucia has attracted inward FDI and has developed an offshore banking sector. We can argue that the development of St Lucia as a financial and tourist economy must have derived some benefit from the adoption of a stable regional currency.

Conversely, we know that St Lucia with its offshore banking sector is very different from its partners in ECCA. This leads us to question whether the ECCA is an optimal currency area (OCA). An OCA refers to the conditions that need to be met to avoid the cost of monetary union. These conditions include:

- a high degree of labour market flexibility.
- mechanisms for fiscal transfer.
- an absence of external shocks that have a differential impact on different economies (ie asymmetric shocks).

Let us focus on the last point. We know that St Lucia is different from its partners in ECCA and, therefore, an external shock is likely to have a different impact on St Lucia than on the rest of the monetary union. Outside a monetary union, the country would have the independence to solve the problem in its own way but is constrained by the conditions of the monetary union. To draw a parallel with the UK, it is often argued that even if the adoption of the euro is beneficial to other EU countries, it would not be beneficial to the UK because the UK is different from the rest of Europe - for example - in terms of the timing of the business cycle, sensitivity to interest rate changes. We could make a similar point in relation to St Lucia.

Conclusion

When you first saw this extract you might have felt that you knew nothing about the various Caribbean organisations mentioned in the passage. The pre-release of the stimulus material provides you with an opportunity to investigate these organisations. But, you should also remember that the issues referred to in Extract 4 are very similar to issues that you encountered in the study of the EU. The best advice to give is "revise the EU and develop the skills to apply these points to a Caribbean setting".

The most likely questions that are prompted by the extract are:

1. The costs and benefits of regional economic integration.
2. The advantages and disadvantages of a single market.
3. An analysis of why intra-CARICOM trade is small and rising only slowly.
4. The costs and benefits of a single currency.

3. QUESTIONS TO CONSIDER

General

The focus of the exam is to test your command of the toolkit of economic concepts in a global context. You will, nevertheless, also be expected to know and understand about European and other international institutions and their policies, and their significance for economic policy development, economic progress and wider welfare, in the context of the stimulus material.

Before looking at questions based on the stimulus material you should bear in mind the typical structure of assessment which is:

1. Two questions based on knowledge and understanding of economic terms, each worth 4 marks.
2. Two questions requiring economic analysis, each worth 6 marks.
3. Two questions requiring a commentary supported by economic analysis, each worth 10 marks.
4. A final question, usually based around the theme of the extracts, or one that integrates the stimulus material, which requires discussion worth 20 marks.

The purpose of the questions below is not to question spot – many are unsuitable as exam questions. However, they are designed to:

a) Encourage you to study the stimulus material comprehensively.
b) Prompt you to pursue your own lines of research and discovery.
c) Help you identify and, thus, respond to any shortcomings in your understanding of the concepts.
d) Consider the issues the questions raise from both a macro and a micro economic perspective.
e) Develop your ability to draw on and use the full range of economic concepts to understand, analyse and evaluate economic problems.
f) Present economic solutions backed by sound economic analysis and discussion.
g) Provide you with opportunities to develop higher order skills, necessary to answer examination questions at level 4.

Questions

Questions Relating to the Introduction, Paragraph 1 and Extract 1:

1. Explain why Caribbean banana yields are only 50% of those in Ecuador.
2. Explain the implications of the lower yields and higher costs of Caribbean banana production.
3. Explain the term a 'common trade policy'.
4. What is meant by the banana wars and why was there a settlement?
5. Explain the difference between the **volume** of trade and the **value** of trade.
6. What conclusions do you draw from Fig. 1.1?
7. Explain the terms (i) tariff (ii) quota (iii) punitive tariff.
8. Why does the EU discriminate in favour of specified ACP countries?
9. Explain the terms of trade and analyse the consequences of a deterioration in the terms of trade.
10. Using an appropriate diagram, account for short term volatility of banana prices.
11. Evaluate the discriminatory trade practices adopted by the EU in relation to banana imports.
12. Analyse banana production in Latin America and the Caribbean, in terms of the principles of absolute and comparative advantage.
13. Analyse the consequences for banana producers and for the economy of banana producing countries of unplanned fluctuations in supply.
14. Evaluate the potential of a buffer stock scheme to solve the problem of price volatility.
15. Evaluate scope for a cartel of banana producers to raise the price of bananas on world markets.
16. Identify and explain the characteristic features of a multi-national business, using Dole, Del Monte and / or Chiquita to illustrate your observations.
17. Identify and explain the economies of scale which these multi national businesses could be expected to benefit from.
18. Using appropriate diagrams, explain the welfare implications of tariffs and quotas for consumers and producers.
19. Analyse the implications of the EU banana policy for EU consumers, who pay up to twice the world price for bananas.

Questions relating to the Introduction, Paragraph 2 and Extract 2:

1. Explain what is meant by 'economic development'.
2. What is meant by the 'economic structure' of an economy?
3. Explain the meaning, value and limitations of the Human Development Index, as a means of determining economic progress.
4. Explain the term 'purchasing power parity'.
5. Explain the difference between GDP per head at market rates, and GDP per head at PPP.
6. Assess living standards and human development in the two African countries featuring in Fig 2.2.
7. Explain the difference between economic growth and economic development.
8. Describe (i) the common characteristics of developing economies (ii) ways in which they diverge.
9. Evaluate GDP per capita as a measure of (i) living standards (ii) economic development.
10. Using the data in Fig. 2.2 evaluate average living standards, human development and the extent of absolute poverty in St Lucia.
11. Analyse the correlation between GDP per head at PPP and the Human Development Index.
12. Analyse the benefits and drawbacks of inward foreign direct investment.
13. Analyse the consequence for an economy of its over-reliance on a single primary product such as bananas.
14. Analyse the consequence of excessive reliance on the primary production sector of the economy.
15. With reference to the stimulus material discuss the factors that make an economy attractive to foreign investors.
16. Using the evidence available from the stimulus material as a basis, evaluate the extent to which each of the countries featured in the stimulus material conform to characteristic features of a developing country.
17. Use this evaluation (from Q.16) to determine the common explanations for failure to develop.

Questions relating to Extract 3:

1. Explain what is meant by 'globalisation'.
2. What is meant by integration into the global economy?
3. Why did Takatoshi Kato believe that the Caribbean was especially well placed to benefit from globalisation?
4. What are the roles of the IMF and World Bank in the international economy?
5. Why would Caribbean economies face difficulties in attracting private external finance?
6. Analyse the mechanisms by which a downturn in North America and Europe is transmitted to the Caribbean.
7. Analyse why the demand for aluminium is more volatile than changes in GDP.
8. Account for the relationship between global recession and rising government debt.
9. Analyse the reasons why high levels of government debt is seen as undesirable.
10. Discuss the extent to which indebtedness matters.
11. Why did the global recession lead to current account deficits for Caribbean countries?
12. Discuss the constraints that large current account and fiscal deficits place on government policy at a time of recession.
13. Why were the monetary authorities in the Caribbean able to relax monetary policy?
14. Evaluate monetary policy as a way of combatting recession.
15. Explain reasons why recovery in the Caribbean is expected to lag behind recovery in the USA and Europe.
16. Analyse the reasons why a high government debt is seen as a matter of concern.
17. Evaluate the extent to which a developing country might welcome intervention from the World Bank and / or IMF.
18. Identify, explain, analyse and discuss policies which less developed countries could adopt to protect themselves better from the effects of world recession.

Questions Relating to Extract 4:

1. Explain the term 'economic integration'.
2. Analyse arguments for and against deeper economic integration in the Caribbean.
3. Explain what is meant by (i) a free trade area, (ii) a customs union (iii) a single market.
4. Compare and contrast the CARICOM Single Market with the EU Single Market.
5. Explain three non-tariff barriers to trade.
6. What is meant by an 'optimal currency area'?
7. Explain why a single currency requires a common monetary policy.
8. In terms of the theory of customs unions, what is meant by 'trade creation' and 'trade diversion'?
9. What is meant by 'intra-CARICOM exports' as distinct from 'extra-CARICOM exports'?
10. Using data from each of the extracts, evaluate the economy of St Lucia.
11. What conclusions can be drawn from Fig. 4.1 and in what ways does the experience of CARICOM differ from the EU?
12. Evaluate the likely consequence of a single market.
13. Evaluate the benefits of the removal of exchange controls.
14. Analyse the consequences of the free movement of labour.
15. Evaluate the benefits of a single currency.
16. Analyse the case for fiscal harmonisation as part of a single market programme.
17. Discuss the prospects of the Caribbean area becoming an optimal currency area.

4. MOCK EXAMINATION PAPER

Time Allowed: 2 hours

1 (a) Distinguish between economic growth and economic development.

(4 marks)

(b) With reference to Extract 1 and 2, (including Fig.2.1 and 2.2), analyse the economic performance of Ecuador and St Lucia.

(6 marks)

.

(c) With reference to Fig. 2.2, comment on the value of the Human Development Index as a means of assessing the economic performance of these countries.

(10 marks)

2 (a) Explain the concept 'terms of trade'.

(4 marks)

(b) Using a diagram, analyse the causes of the volatility of the world price of bananas.

(6 marks)

(c) Comment on the implications of price volatility of bananas for economic growth and development in banana exporting economies.

(10 marks)

3 With reference to the stimulus material as a whole, discuss the extent to which St Lucia will be able to insulate itself from global economic fluctuations by deeper regional economic integration.

(20 marks)

5. MODEL ANSWERS

Foreword

Every effort has been made to provide appropriate answers and mark allocations for the questions posed. These should, however, be seen as a set of guidelines, not rigid performance criteria.

Answers to questions posed are not exhaustive. Any valid response should be given due credit.

It should be emphasised that these model answers are intended as an aid to the teacher who must retain full responsibility for checking specification requirements and the final delivery of subject matter to students. In this context, APT is always available to discuss any aspect of these answers, should the teacher wish to discuss APT's interpretation.

Model Answers

1 (a) Distinguish between economic growth and economic development. [4]

Economic growth is an increase in output and real incomes. Hence, it is a useful (although arguably an incomplete) measure of economic welfare. It is measured in terms of the percentage rise in Gross Domestic Product in real terms. Economic development, on the other hand, is a much broader concept and can be defined as the process of improving people's economic well being and quality of life. This suggests that economic development has qualitative as well as quantitative aspects, whereas economic growth is a quantitative measure of output and welfare.

Comments re marks:

- *Up to 2 marks for definitions of the terms.*
- *Up to 2 further marks for an answer which makes a distinction between the two concepts.*

1 (b) With reference to Extract 1 and 2, (including Fig. 2.1 and 2.2), analyse the economic performance of Ecuador and St Lucia. [6]

The six countries that feature in Extract 2 are developing countries but are clearly at different stages of development. In economic growth and development terms St Lucia and Ecuador are the most successful of the countries that are featured. This is seen in terms of their GDP per head (PPP) and their scores on the Human Development Index. However, there are differences between the two that deserve some attention.

Both St Lucia and Ecuador are banana exporting countries. In terms of both volume and value, banana exports from Ecuador exceed those from St Lucia. However, banana exports provide only 9.3% of Ecuador's export earnings whereas the smaller volume of exports from St Lucia accounts for 19.7% of its export earnings. Moreover, St Lucia and other Caribbean islands tend to be high-cost producers of bananas and it is questionable whether they have a comparative advantage in producing this crop. What has kept the Caribbean producers in business up to now is the preferential treatment according to the ACP (African, Caribbean and Pacific) group of countries by the European Union. The reason why Ecuador has a lower reliance on banana exports (compared with St Lucia) is that it has reserves of oil which it exports. Nearly 92% of Ecuador's exports by volume (not value) take the form of primary products but food exports account for only 32.4% by volume. It is reasonable, therefore, to assume that oil makes up a large proportion of the difference.

St Lucia is able to boost its exports earnings by selling tourist services and by earnings from off shore banking. The latter has expanded as a result of Foreign Direct Investment in St Lucia. This reliance on earnings from invisible items on the balance of payments reduces the value of the volume statistics shown in Fig. 2.1. Nearly two thirds of exports by volume from St Lucia take the form of primary products, and this is a characteristic of a developing country. Yet, we can assume that earnings from invisibles account for a high percentage of St Lucia's foreign exchange earnings. The fact that there has been the development of the service sector activities in St Lucia suggests that it has reached a higher level of development than many other developing countries.

Figure 2.2 provides data on living standards, human development and poverty. Of the two GDP per capita figures the more valid figure is GDP per capita (PPP US$), since it takes into account the relative price levels in different countries. The average St Lucian is able to buy $9786 worth of goods compared with $7449 worth of goods by the average person in Ecuador. This means that living standards are higher on average in St Lucia than they are in Ecuador. In relation to the bulk of people in developing countries, people in these countries enjoy significantly higher per capita incomes. We can regard each of the two countries as middle income countries.

Over the period 1990-2007 output per head grew. This illustrates the fact that the economies of the two countries grew by a faster rate than the population. However, of the two countries St Lucia achieved a slightly higher rate of growth per head of population.

The Human Development Index is a composite measure which includes GDP per head, life expectancy and access to education. Both countries are in the high HD group (ie over 0.8), although St Lucia scores better on this measure. Ecuador has made more substantial improvement in terms of its HDI rating (data column 6), but it is always easier to demonstrate improvement if you start from a lower base.

So far, on many of the measures St Lucia has a superior score, but the worrying statistic is the fact that 40% of St Lucia's population live on less than $730 per year and are, therefore, in poverty. This compares with one in eight of the population of Ecuador living on less than $730 per year. All this suggests that, despite the economic growth and development in each of the countries, the benefits have not trickled down to the poorest in society. Certainly, in the case of St Lucia, it is tempting to conclude that the development of the service sector based on FDI distorts the true picture of the St Lucian economy.

Comments re marks:

This 6 mark question would be marked in terms of levels of response:

- *Level 1: [1-2 marks] for knowledge and understanding of the economic variables presented in the two extracts and figures.*
- *Level 2: [3-4 marks] for application of knowledge and understanding of the variables to assess the economic performance of Ecuador and / or St Lucia.*
- *Level 3: [5-6 marks] for an analysis of the variables to assess the economic performance of Ecuador and St Lucia.*

Note:

In levels of response marking you receive a mark in the highest band that you achieve – in other words, make sure in the 6 mark question that you include analysis (and, in questions worth 10 or more marks (below) that you also include evaluation in order to gain a mark in the highest mark band).

It should also be appreciated that to gain an A grade on a question (and even full marks), it is not necessary to produce a perfect answer. In fact, levels of response marking rewards quality rather than quantity, so what the examiners look for is evidence that you have reached the highest level of skill for the particular question. This might mean analysis (L3) in this case, or it might mean evaluation (L4) in questions worth 10 or more marks. Analysis involves breaking a point down and identifying relationships between different pieces of evidence eg cause and effect. Evaluation requires a reasoned judgement.

1 (c) With reference to Figure 2.2, comment on the value of the Human Development Index as a means of assessing the economic performance of these countries. [10]

As economic development is a broader concept than economic growth it is essential to measure it in ways other than GDP per head, which merely measure average living standards. The Human Development Index is a measure that combines outcomes that might be valued in the development process, namely life expectancy at birth, adult literacy rate and the percentage of the relevant population enrolled in primary, secondary and tertiary education, and GDP per capita in US$ at purchasing power parity. In other words, it is a composite measure and includes, but is not confined to, standards of living as measured by GDP per head. The aggregation of the elements into the HDI produces a single result ranging from zero to one. Any number above 0.8 is considered high human development, 0.5 to 0.8 is considered medium human development, and below 0.5 is considered low human development. Interestingly, there is a correlation between a country's HDI and its GDP per head (PPP US$).

Of the six countries listed in Fig. 2.2, two are in the high HD category, three are in the medium HD category, and one is in the low HD category. Each of the countries achieves a higher HDI score than might be expected from merely looking at living standards per head. This might be attributed to higher scores in terms of education and life expectancy, but does this provide a valid measure of development?

There are major criticisms and deficiencies of the HDI. Firstly, although it is broader than merely living standards, it does not take account of other important outcomes of economic development. For instance, the composite measure does not include the extent of political freedom, democracy and political stability. These are seen as essential characteristics of a developed country, and have significant economic implications.

Secondly, it does not take account of changes to, and damage to, the physical environment. As a country grows and develops it is likely to experience degradation of the environment and, since this affects economic welfare, this should be included in the measure.

Thirdly, the HDI includes reference to the length of life but it ignores the quality of life - for instance - how healthy the life has been.

Fourthly, we can criticise the HDI on methodological grounds in that it is a mere aggregation of the three elements. A superior measure would take the relative importance of the elements into account by a system of weighting.

Finally, the final column of Fig. 2.2 illustrates a major deficiency in both measures of both standards of living and the HDI. Both types of measure are averages and ignore variations in the standards of living and quality of life within a country. One alarming feature of each of the countries is the degree of inequality. This is not included in the HDI but is a factor that should be taken into account. Surely economic development should be judged, not just in terms of the position of the average (mean) resident, but in terms of the level of absolute poverty. From around 1 in 8 people in Ecuador to merely 60% of those in Cameroon, are living in poverty on less than $2 per day ($730 per year). Consider St Lucia which is presented as a success story in the extracts. At current market exchange rates the average income in St Lucia is $5834 (or $9786 incorporating PPP), and yet 2 in 5 residents have less than $730 per year. This means that high incomes in the tourist and off shore banking sectors have boosted average incomes, and yet the benefits have not "trickled down" to the poorest in society. This is evidence of one feature of developing economies – the existence of a dual economy.

In conclusion, we can regard the HDI as a measure of economic development but it is a flawed measure. We can see that the six countries have made progress in terms of the HDI and four are either high HDI, or very close to being high HDI. Nevertheless, inequality within each country (which is not captured in the data) means that large numbers of people remain in abject poverty.

Comments re marks:

This question would use a levels of response type of mark scheme which would run up to level 4 (evaluation) as shown below, and so it is necessary to add in a judgement or conclusion based on reasoning.

- *L1: [1 mark] for knowledge and understanding of the HDI.*
- *L2: [2-3 marks] for application of knowledge and understanding of the HDI as a means of assessing the economic performance of the countries shown in Fig. 2.2.*
- *L3: [4-6 marks] for an analysis of the HDI as a means of assessing the economic performance of the countries shown in Fig. 2.2.*
- *L4: [7-10 marks) for a commentary on the value of the HDI as a means of assessing the economic performance of the countries shown in Fig. 2.2 with a reasoned judgement.*

Always make sure in a question asking you to "comment on" something that you add a clear conclusion. But, your conclusion must be backed by reasoning if it is to be regarded as reaching L4 (securing 7 – 10 marks). You should also appreciate that you only have to hit L3 once in an answer to get a L3 mark. A second, or subsequent, hitting of L3 will raise your mark within the band. Better than bringing in more L3 comments is the inclusion of an evaluative comment which pushes you into the L4 mark band. Once again, one hitting of L4 secures a mark in the top band. But you must back up your conclusion with a reason.

2 (a) Explain the concept 'terms of trade'. [4]

Terms of trade is an index based on the relationship of export prices to import prices. An improvement in the terms of trade occurs when the price of a country's exports rises faster than the price of its imports (or falls less rapidly than that of its imports). A worsening (or deterioration) in the terms of trade occurs when the price of a country's exports rises more slowly than that of its imports (or falls more rapidly than the price of imports). In essence, changes in the terms of trade provide a measure of changes in the volume of imports that can be purchased with a given volume of exports.

Comments re marks:

- *Up to 2 marks for the definition of terms of trade.*
- *Up to 2 further marks for demonstrating understanding of the concept.*

2 (b) Using a diagram, analyse the causes of the volatility of the world price of bananas. [6]

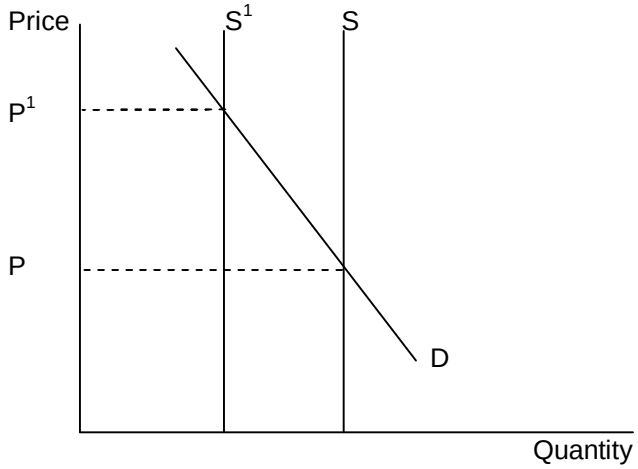
Changes in price can be attributed to changes in the conditions of supply and / or demand. The volatility revealed in Fig.1.1 must be attributed to shifts in the supply or demand curve. As it is unlikely that demand for bananas will not fluctuate violently from one year to another, we must conclude that that price volatility is the result of fluctuations in supply.

Bananas are an agricultural product and, as such, are characterised by:

- **price inelasticity of supply in the short run.** Supply cannot respond to a rise in price in the short or, even, medium term because of the length of the production cycle. In fact, this is likely to be longer than the production cycle for arable crops like wheat. Wheat farmers can at least respond by growing more wheat next year. Banana producers can only increase output when newly planted banana trees bear fruit.
- **unplanned fluctuations in supply.** For arable farmers in Britain this takes the form of differences in the size of the harvest caused by changes in the weather. For the banana producers there is the additional problem, especially in the Caribbean, of hurricanes or droughts which wipe out the crop, causing a shortage of bananas in world markets. If a hurricane strikes the Windward Islands (which include St Lucia) then there will be a shortage of bananas in the EU and prices will rise.

These two characteristics result in a short run supply curve which is vertical but which could shift dramatically to the left or right, depending on the forces of nature.

There is a steady demand for bananas in the developed world since they are a popular fruit. Because they are really inexpensive in relation to our income we can suggest that demand is relatively price inelastic. The result is that the demand curve slopes downwards rather steeply. If we put the supply and demand curves together we can analyse price fluctuations:



The short run supply curve is S and the fact that it is vertical means that supply is unable to respond to price changes. A hurricane then strikes a leading banana producer and the result is an unplanned fluctuation in supply which decreases to S^1. This pushes up price from P to P^1, but because the demand curve is steep, the rise in price is more dramatic than it would have been if the demand curve had a gentler slope.

We can reverse the two supply curves to illustrate the impact of good weather producing an unexpectedly high crop of bananas. The rightward shift of the supply curve would drive prices down.

To conclude, price volatility is the result of inelastic supply, unplanned fluctuations in supply resulting from forces of nature, and relatively inelastic demand for bananas in the richer countries of the world.

Comments re marks:

Based on the January 2010 mark scheme, this 6 mark question would be marked as follows:

- *Knowledge marks: [1-2 marks] 1 mark for correctly labelled axes, 1 mark for correctly drawn demand and supply curves.*
- *Application marks: [1-2 marks] Up to 2 marks for showing the effect of changes in supply/demand on the price of bananas on the diagram.*
- *Analysis marks: [1-2 marks] Up to 2 marks for an analysis of the causes of volatility of the world price of bananas.*

2 (c) Comment on the implications of price volatility of bananas for economic growth and development in banana exporting economies. [10]

The sales revenue of the banana plantations in Latin American and the family-run farms of the Caribbean is equal to the quantity of bananas produced and sold multiplied by the price of bananas. In the short run there is little scope for increasing the supply of bananas and, therefore, we can say that the income of banana producers is primarily a function of price. High banana prices will increase farmers' income, whereas low prices will reduce incomes.

For the banana exporting economies the impact of price volatility depends upon the extent of the countries reliance on banana production. It is known that one feature of developing countries is their reliance on exports of primary products in general and, often, a single product in particular, but let us look at the evidence presented. The Windward Islands are, perhaps, an extreme case in that it is the biggest sector of the economy, employs the greatest number of people and accounts for 80% of export earnings. For the Windward Islands especially, but also for other bananas exporting countries, any reduction in the world price of bananas will have a severe impact on the economy of the Islands. It will reduce the:

- earnings from banana exports (since supply is inelastic in the short run).
- earnings of the banana producers.
- GDP of the economy - through the downward multiplier.

The reduction in GDP will reduce GDP per head, except in the unlikely event that population size declined. This will reduce living standards and the HDI score for the country concerned. Furthermore, given the extent of income inequality that exists in developing countries (and as revealed in Fig. 2.2), the decline in incomes might plunge even more for people below the poverty line.

The reduction in GDP will also reduce tax revenue since this is closely linked to changes in GDP. Any decline in income, spending or trading internationally will reduce tax, excise duties and customs duties respectively. With declining tax revenue, governments in developing countries will have less money to spend on infrastructure, health and education projects which are essential for development.

The fall in GDP will also reduce the level of investment. This is because of the drying up of funds to finance development and also because we know - from the accelerator principle, that even a slowing up of the rate of growth of GDP will cause an accelerated decline in investment. The decline in private sector investment will lead to a further slowing up in the rate of growth.

For Caribbean producers the harm caused by a reduction in price will be especially severe. Not only do they have a high reliance on banana exports, but evidence from Extract 1 indicates that they are high cost producers of bananas. This means that they will be less able to cope with a decline in banana prices than their rivals in Latin America and the Philippines. Banana production in these latter countries is in the hands of US multinational owned plantations. Production is on a larger scale, more mechanised, and makes greater use of irrigation. This results in higher yields and lower costs. Therefore, the Latin American and Filipino producers are in a stronger position to withstand an unfavourable movement in prices.

For countries highly dependent on banana exports, any change in the price of bananas will have a major impact on the country's terms of trade. A fall in banana prices will worsen the country's terms of trade (if we assume that the price of imports is rising or, at least, not falling as fast as banana prices). This means that a given volume of banana exports will buy a smaller volume of imports. In view of the relatively low income of developing countries and their need for capital goods for development, the deterioration in the terms of trade could be devastating for the economy concerned.

After reviewing the impact of a downward movement in banana prices we qualify our analysis with reference to the extent of dependence on bananas. The Windward Islands as a whole are very reliant on bananas, but St Lucia (one of the Windward group) is only 19.7% dependent on bananas for its export earnings. We can see Fig. 2.1 that St Lucia exports other foods and other primary products but, more importantly, that it has benefited from earnings from invisibles in the form of tourism and offshore banking. The other Caribbean country in the table (Dominican Republic) has a 6.8% dependence on bananas, and both food and primary commodities form only a small proportion of export volume. It is known that the Dominican Republic has a well developed tourist trade. The two Latin American countries also have a low dependence upon bananas. For instance, even though Ecuador leads the world in banana exports this fruit is not its main export. The presence of oil enables Ecuador to be less concerned about movements in banana prices.

It is unfortunate that we have no figures from the two African countries, especially as the columns of figures are not really comparable; one refers to export earnings in money terms, whereas the other two columns refer to volume eg weight. Nevertheless, we can see that both countries export non-food products and, in the case of Cameroon, 82.3% of exports by volume take the form of non food primary products eg timber.

In conclusion, we can say that price volatility will have a serious impact on banana producing countries. But for all the countries for which we have data, banana exports are responsible for a low percentage of export earnings. As reliance on bananas increase, so will the severity of the impact of price volatility on the economy. It is also clear from this analysis that the impact on growth and development is more severe where production costs are already fairly high, due to small scale and lack of mechanisation.

Comments re marks:

This question would use a levels of response mark scheme which would run up to level 4 (evaluation) as shown below. Thus, it is necessary to add in a judgement or conclusion based on reasoning.

- *L1: [1 mark] for knowledge and understanding of how price volatility affects economic growth and development.*
- *L2: [2-3 marks] for application of knowledge and understanding of how price volatility of bananas affects economic growth and development in banana producing economies.*
- *L3: [4-6 marks] for an analysis of the implications of price volatility on economic growth and development in banana producing economies.*
- *L4: [7-10 marks] for a commentary on the differential impact of price volatility on economic growth and development in banana producing economies.*

3 With reference to the stimulus material as a whole, discuss the extent to which St Lucia will be able to insulate itself from global economic fluctuations by deeper regional economic integration. [20]

Extract three concerns the downside of globalisation which is defined as the processes that have produced ever closer links and, therefore, greater interdependence between the world's economies. Caribbean countries like St Lucia benefited from expansion in the global economy, but during the recession they suffered from:

- reduction in demand for their primary products.
- a fall in earnings from exports of bananas and other goods.
- a fall in remittances received from family and friends in the high income countries.
- a fall in inward direct foreign investment.
- a fall in tax revenue and rise in government spending.

This all led to a decline in the GDP of Caribbean countries like St Lucia, and problems on their current account and government finances. Moreover, the statement at the end of Extract 3 presents the worrying prospect that their problems will continue even after the upturn in the economies of Europe and North America. Partly because of the problems that result from dependence on the rest of the world, the countries of the West Indies look for support through closer regional integration by means of a CARICOM single market and monetary union within the Eastern Caribbean sub group of CARICOM.

Let us look at the expected benefits of regional economic integration. The CARICOM single market seeks to remove all barriers to trade between member states. The single market programme outlined in Extract 4 is very similar to the single market programme adopted by the EC / EU back in the 1980s. It seeks to achieve free movement of goods, services, labour and capital in order to:

- increase the volume of trade between members.
- increase output.
- increase the degree of competition.
- provide scope for economies of scale (which would not be available in the small economies that characterise states like St Lucia).
- reduce prices.
- raise living standards.
- raise the rate of economic growth and development.

The move to a single market was prompted by the disappointing growth of intra-CARICOM trade (that is trade between members) - as shown in Fig. 4.1. We can see that, over the regional group as a whole (and St Lucia is probably no exception), intra-CARICOM trade is a small percentage of total trade and, if we exclude the impact of inflation, grew only very slowly over the decade. The expectation is that a single market will boost the amount of intra-CARICOM trade in the same way that the EC / EU led to growing trade between member states.

St Lucia has also embarked on monetary union with its Eastern Caribbean neighbours involving a common currency and a common central bank. A single currency has a number of benefits:

- elimination of currency exchange transaction costs.
- reduction in risks associated with exchange rate movements.
- greater price transparency.
- lower prices.
- lower interest rates.
- lower inflation.

These were all strong arguments used in connection with the deepening of the EC / EU and it is natural that the countries of the Caribbean would seek similar arrangements to benefit their own economy and people.

However, the hard facts of economic life might result in disappointment. Firstly, the theory of customs unions reminds us that there is a danger that instead of producing welfare-enhancing trade creation, the result of a customs union and single market might be welfare-reducing trade diversion. In other words, the additional trade with partners in the regional economic group might be at the expense of trade with the outside world, rather than additional to it.

Secondly, the disappointing amount of intra-CARICOM trade might reflect the fact that the member states are competitive rather than complementary. They are all producers of primary products such as sugar and bananas and, quite frankly, there is little scope for banana producers exporting to each other. Therefore, the low proportion of intra-CARICOM trade revealed in Fig. 4.1 might be the result of the countries concerned being too similar in their economic structure.

Thirdly, countries like St Lucia inevitably depend upon the high income countries of the world. It is not revealed in the stimulus material, but the fact is that St Lucia is a tiny state with a population of 167,000. This is an argument for closer integration with its neighbours, but most of those neighbours also have small populations. CARICOM as a whole would constitute a small market with only limited scope for economies of scale.

Fourthly, the present structure of the St Lucian economy inevitably means that it has to maintain close links with the UK and other developed countries. St Lucia has a relatively high dependence on banana exports. We know that for a variety of reasons the Caribbean is a high cost producer of bananas. It has received preferential treatment by the EU and would not be able to compete in the US market against the bananas produced in Latin America by US multinational companies. St Lucia and certain other Caribbean states have developed tourism in recent decades and this is dependent upon visitors from the high income countries. Finally, inward investment has led to the creation of an offshore banking sector in St Lucia. This can be criticised on the grounds that some (at least) of the profits are remitted abroad, and on the grounds that the benefits have not trickled down to the poorest members of society. Nevertheless, these developments have contributed to the relatively high GDP per head on the island and must be seen as the result of inward investment.

In conclusion, the nations of the Caribbean will undoubtedly derive benefit from closer regional integration, but their small size and the nature globalisation in the world means that they cannot insulate themselves completely from global trends.

Comments re marks:

A 20 mark question, such as this, is likely to be marked using the following levels of response bands:

- *L1: [1-2 marks] for knowledge and understanding of the advantages or disadvantages of regional economic integration, OR the reasons why St Lucia is affected by global economic fluctuations.*
- *L2: [3-4 marks] for application of knowledge and understanding of how regional economic integration may, or may not, protect St Lucia from global economic fluctuations.*
- *L3: [5-10 marks] for an analysis of how deeper regional economic integration may or may not insulate St Lucia from global economic fluctuations.*
- *L4b: [11-15 marks] for a balanced discussion on the extent to which deeper regional economic integration will insulate St Lucia from global economic fluctuations.*
- *L4a: [16-20 marks] for a discussion that includes a reasoned judgement as to the extent to which deeper regional economic integration will insulate St Lucia from global economic fluctuations.*

6. REVISION & EXAMINATION TECHNIQUE

Preparing for the Examination

1. Thoroughly revise all aspects of the specification but with particular emphasis on the **topic areas identified at the start of the analysis.**
2. Familiarise yourself with all aspects of the stimulus material, **including the introduction**.
3. Develop an understanding of the **connections** between the different Extracts that make up the stimulus material
4. Identify and understand with confidence the **economic principles and analysis** underlying the stimulus material. This includes complete **familiarisation with all the diagrams** which you may need to support your answers.
5. **Know the number and structure of questions and time limit**. (Refer to specimen / past papers). Total time allowed: 2 hours. Total marks available: 60. Usually 7 compulsory questions drawing upon the pre-issued stimulus material.
6. **Know how you are to be assessed.** Ensure full familiarity with the levels of response mark scheme and the difference between knowledge, application, analysis and evaluation.
7. **Practice doing questions in a set time limit.** This is **absolutely essential.** Many candidates have the knowledge and ability to secure high grades but fail due to lack of time. DO NOT let this happen to you – PRACTICE MAKES PERFECT!

During the Examination

1. **Read** through the **entire question paper** at least **twice.**
2. With questions worth **10 or more** marks allow at least **3-4 minutes to plan**. Planning will help to keep your answers to the point, logical, and will help you to prioritise - all essential to secure high grades (refer to point 4 below).
3. Answer the question you find the **easiest first**. (This will help to build your confidence).
4. When answering questions (particularly those carrying high marks):

a. **Brainstorm** the **relevant points** and write these down in rough in the form of a spider diagram directly on your question paper. (The examiner will review any rough notes made if you run out of time).

b. **Prioritise** the order in which the above points will be discussed. Write a number next to each point in the order you intend to discuss them. The order should reflect their relative importance, and degree of analysis needed.

c. **Introduce** your answer - explain how you intend to answer the question, show that you have understood the question (2 to 3 sentences max).

d. **There are no marks for repeating what is in the stimulus material.** Quote from it, if helpful, and, of course, use it to develop your personal response.

e. Discuss the points you wish to raise. Include the possible **advantages** or **disadvantages** and / or the **implications / impact / effect** of current / proposed economic activities / your suggestions. Try to conclude each question by stating **what is particularly important / relevant / pertinent / the most appropriate option** and **why**. Consider the short-term and long-term wherever possible.

f. **Be ready to make assumptions**, if this facilitates analysis and evaluation. This will help to demonstrate your depth of understanding, as well as make it easier for you to explore issues fully.

g. Relate all answers to the **question set**. (Many candidates, once they start writing, stray from the original question and this wastes valuable time, as well as representing effort without reward).

5. **Keep within the time allowed** – if you start to run over time on one question stop and come back to it at the end. (Candidates usually gain the most marks in the first part of their answer).
6. **Regularly read through your work** (not just at the end) to check all points makes sense and directly relate to the question set, and to check for spelling, punctuation and grammatical areas.

BEST OF LUCK, BUT REMEMBER - FAIL TO PREPARE, PREPARE TO FAIL!