Economics
Standard level
Paper 2

Tuesday 3 May 2016 (afternoon)

1 hour 30 minutes

Instructions to candidates

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is **[40 marks]**.

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Section A

Answer **one** question from this section.

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

US steel

❶ With trans-Pacific and trans-Atlantic trade talks missing deadline after deadline, the United States (US) government is putting new tariffs on steel imports. This action will raise prices for many US firms, threaten domestic energy production, and upset trading partners worldwide.

❷ Last week, the US Department of Commerce imposed tariffs on hundreds of millions of US dollars worth of annual trade with South Korea and eight other countries, including India, Taiwan, Turkey and Vietnam. As punishment for allegedly **dumping** steel into the US market, South Korea's exporters will face tariffs of about 10 % to 16 %, while smaller producers from other countries face rates up to 118 %.

❸ In a preliminary review, the US International Trade Commission found a "reasonable indication" that US steel firms are being "injured" by foreign competitors' low prices.

❹ Low-priced steel from South Korea is good for American buyers but annoying for American producers who would rather have the market to themselves and charge higher prices.

❺ Spokespersons for US Steel Corporation complain that steel imports rose 113 % between 2010 and 2012, with South Korean products accounting for half the increase. They blame dumping, but the better explanation is related to America's energy revolution, where producers have taken advantage of two newly viable technologies: horizontal drilling and "fracking" to release gas and oil from rock formations. The resulting increase in energy production has been dramatic. Between 2007 and 2012, fracking generated an 18-fold increase in US production of what is known as light tight oil. This has created even more demand for steel, as steel products are needed in the gas energy market.

❻ The US steel tariffs will encourage other countries to raise trade barriers against American goods. The World Trade Organization (WTO) has already ruled against US tariffs imposed on Chinese steel and solar panels as well as Indian steel from 2007–2012. In the China case, the WTO ruled that the US had not provided enough evidence that the Chinese steel exporters received government subsidies.

❼ When the US imposes tariffs, it raises prices for many stakeholders to benefit the protected few.

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(Question 1 continued)

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

(ii) State **two** functions of the World Trade Organization (WTO) (paragraph ❻). [2]

(b) Using an international trade diagram, explain how the imposition of "tariffs of about 10 % to 16 %" will affect the revenues of foreign steel exporters in the US market (paragraph ❷). [4]

(c) Using a demand and supply diagram, explain how the tariffs will affect the gas energy market (paragraph ❺). [4]

(d) Using information from the text/data and your knowledge of economics, discuss the possible impact of the US steel tariffs on the different economic stakeholders. [8]

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

Tedious journey towards West African single currency

❶ The Economic Community of West African States (ECOWAS) has continued to push for a **monetary union**. Those involved in pursuing increased economic integration strongly believe that a common currency for the West African Monetary Zone (WAMZ) would increase trade in the region, increase competition (particularly in commodity markets) and stimulate economic growth.

❷ The proposed currency, the eco, will be initially introduced in the 14 member countries of WAMZ* which include The Gambia, Ghana and Nigeria.

❸ The proposal has been postponed four times, largely because of unequal progress among member countries in meeting the requirements to establish a monetary union by 2020.

❹ The main requirements for membership of the monetary union are:

- the budget deficit of each member country should not exceed 3 % of its gross domestic product (GDP)
- the average annual **inflation** of each country should be below 10 %
- each country must have enough foreign currency reserves to buy a minimum of three months' worth of imports
- the public debt to GDP ratio of each country should not be more than 70 %
- each country's exchange rate should be stable.

❺ Meeting the requirements for all countries by 2020 will be difficult, given that member countries have different economies with their own challenges. Nigeria is the only country which has met all requirements so far.

❻ For the monetary union to succeed there must be honesty among member countries. In addition, member countries would have to double their efforts in strengthening fiscal performance through improving tax revenue collection and reducing government expenditure on public services.

❼ Although a single currency in the region is likely to promote trade, it will mean that individual member countries will lose control over their own monetary policy, creating conflicts of interests. Research shows that the balance of trade of Nigeria, an oil exporter, tends to move in the opposite direction to its neighbours, who are largely importers of oil. Nigeria would push for higher interest rates in periods of high oil prices. That would be disastrous for other WAMZ economies which would be desperate for lower rates.

[Source: adapted from www.thisdaylive.com, 21 August 2014; www.channelstv.com, 21 August 2014 and www.economist.com, 3 October 2014]

* WAMZ: Ghana, Nigeria, Sierra Leone, The Gambia, Guinea, Liberia, Benin, Togo, Cote d'Ivoire, Niger, Mauritania, Senegal, Burkina Faso, and Mali.

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(Question 2 continued)

Figure 1 – 2015 projected economic data for selected members of WAMZ

	GDP (% change)	**Inflation (% change)**	**Net government debt (% of GDP)**
The Gambia	7	5	75
Ghana	5	11	67
Nigeria	7	7	18

[Source: adapted from www.imf.org, accessed 21 August 2014]

(a) (i) Define the term *monetary union* indicated in bold in the text (paragraph ❶). [2]

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

(b) Using an exchange rate diagram, explain how an increase in the West African Monetary Zone (WAMZ) interest rate would affect the value of the eco (paragraph ❼). [4]

(c) Using an AD/AS diagram, explain the impact on the macroeconomy of reducing government expenditure on public services (paragraph ❻). [4]

(d) Using information from the text/data and your knowledge of economics, discuss the possible advantages and disadvantages of a monetary union for members of the West African Monetary Zone (WAMZ). [8]

Section B

Answer **one** question from this section.

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

Singapore

❶ Singapore is a high-income economy in South-East Asia. The country provides the world's most business-friendly regulatory environment for local entrepreneurs and is ranked among the world's most competitive economies. Presently, the strong manufacturing and services sectors have become the main drivers of the Singapore economy. There is a wide range of businesses, with a particular focus on high value added goods and services.

Timor-Leste (East Timor)

❷ Timor-Leste (formerly known as East Timor) is a developing economy in South-East Asia. Timor-Leste gained independence from Indonesia in 2002. The country and families were torn apart by violence in the years before independence. Nearly 70 % of all buildings, homes and schools were destroyed. An estimated 75 % of the population were forced to move due to the violence.

❸ After serious challenges, Timor-Leste has progressed, particularly due to its endowment of natural resources, especially oil. With the petroleum revenue boom, **fiscal policy** has been expansionary and the economy has grown rapidly as a result of government spending, focusing on major **infrastructure**, development of skills, and other institutional changes. A main goal was to generate increased and sustainable private sector investment as a means to increased job opportunities and to reduce poverty. These developments are starting to contribute to poverty reduction and improved social outcomes.

[Source: adapted from *The World Bank – country reports*, 2013]

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(Question 3 continued)

Figure 1 – Selected economic data for Singapore and Timor-Leste – 2013

	Singapore	**Timor-Leste**
Human Development Index (HDI) data		
HDI rank	9	128
HDI value	0.901	0.62
Life expectancy at birth	82.32	67.54
Mean years of schooling	10.20	4.42
Expected years of schooling	15.40	11.70
Gross national income (GNI) per capita (2011 purchasing power parity (PPP) US$)	72 371.23	9673.61
Other selected data		
Population (millions)	5.41	1.13
Gross domestic product (GDP) per capita (2011 PPP US$)	71 474.89	11 814.79
Urban percentage of population	100.00	29.11
Foreign direct investment (FDI), net inflows (% of GDP)	20.62	4.31

[Source: adapted from *UNDP Human Development Reports*, www.hdr.undp.org, accessed August 2014]

(a) (i) Define the term *fiscal policy* indicated in bold in the text (paragraph ❸). [2]

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

(b) Using a production possibilities curve (PPC) diagram, explain the effects of the violence in Timor-Leste on production possibilities (potential output) (paragraph ❷). [4]

(c) Explain why the gross national income (GNI) per capita for Timor-Leste is lower than the gross domestic product (GDP) per capita (Figure 1). [4]

(d) Using information from the text/data and your knowledge of economics, compare and contrast the Human Development Index (HDI) data for Singapore and Timor-Leste in terms of their relevance for economic development. [8]

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

The Gambia

❶ The Gambia is the smallest country on the African mainland. Although small in size, The Gambia has a wealth of land, coastal, marine and wetland habitats and species of local, national, regional and global significance, making it an attractive tourist destination. Due to its unique geographic location it is also a centre for trade in the region, allowing it to benefit from regional economic integration. As a small, open economy, however, the country remains highly vulnerable to external shocks such as the global financial crisis given its relatively undiversified economy.

❷ The country has a population of 1.8 million with a fairly high population growth rate of 2.8% per year over the last decade. 57% of the population is concentrated around urban centres. The Gambia has maintained a reputation of relative stability and peace, although its neighbouring countries have been marked by recurring instability and conflict.

❸ The Gambia is facing serious challenges in achieving most of the Millennium Development Goals. It has achieved some of the targets, including the poverty reduction target, the targets related to gender equality in primary and secondary education, and the target of improved access to water sources. However, progress towards all other Millennium Development Goals is too slow. They will not be reached any time soon if current policies are continued and donor support remains low.

❹ The Gambia has had strong economic performance in recent years with **economic growth** of 5.3% in 2012 projected to accelerate to 6.4% in 2013. The Gambia benefitted from considerable multilateral debt relief from the International Monetary Fund (IMF), the World Bank and the African Development Fund after reaching the Highly Indebted Poor Countries (HIPC) completion point (a list of specific conditions) in December 2007. The total debt outstanding as a ratio to gross domestic product (GDP) declined from 143.2% in 2006 (pre-HIPC) to 55.1% in 2008; although it increased again to 68.4% in 2011.

❺ The negative effects of the global financial crisis of 2008 were reduced by favourable agricultural harvests in the same period, and by increased tourism revenue. Agriculture and tourism are the main exports of the country. Progress was made in the areas of fiscal management, civil service and justice reform and anti-corruption reform. Recent data show modest developments in health, notably in HIV/AIDS prevalence (which remains stable) and maternal mortality (which declined considerably). The government is committed to continuing these achievements while also funding poverty reduction programmes.

[Source: adapted from *The World Bank*, "Country Brief", September 2013]

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(Question 4 continued)

Figure 1 – Selected economic data for The Gambia – 2012

	The Gambia
Human development index (HDI) rank	172
HDI value	0.441
Gross national income (GNI) per capita in purchasing power parity (PPP) terms (US$)	1557.31
Foreign direct investment (FDI), net inflows (% of GDP)	4.01
Net official development assistance received (% of GNI)	15.58
Remittances, inflows (% of GDP)	10.09
Income Gini coefficient (1998) (%)	50.23
Income Gini coefficient (2012) (%)	47.28
Population living below US$1.25 PPP per day (%)	33.63

[Source: adapted from www.worldbank.org, 2012]

(a) (i) List **two** of the Millennium Development Goals (paragraph ❸). [2]

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

(b) Using a Lorenz curve diagram, explain what happened to income inequality in The Gambia between 1998 and 2012 (Figure 1). [4]

(c) Explain why the servicing of international debt may have an opportunity cost for economic development (paragraph ❹). [4]

(d) Using information from the text/data and your knowledge of economics, evaluate **two** trade strategies The Gambia might employ to achieve economic growth. [8]