Diploma Programme
Programme du diplôme
Programa del Diploma

Economics
Standard level
Paper 2

Wednesday 3 May 2017 (morning)

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.

Relief as Kenya raises tariff for steel and iron imports

❶ Steel manufacturers in Kenya are set to benefit as the government moves to protect the local manufacturing industry from cheap steel and iron imports.

❷ In 2014 a government official announced an increased **tariff** on steel and iron imports. "Our steel mills are closing down due to unfair competition from cheaper imported iron and steel products," he explained. "To protect and create more jobs in the iron and steel industries, tariffs on a wide range of imported iron and steel products will be increased from 0 % and 10 % to 25 %," he said. The government official further stated that as well as protecting the local industries from cheaper imports, the protectionist measures would raise an additional 2.6 billion Kenyan shillings (Kenya's currency) annually in government revenue and support **economic growth**.

❸ The potential of local industries to expand and create jobs through trade has been held back by a number of administrative barriers. The government remains focused on improving the business environment. Over the past six months, the government has made it easier to register a company and trade across borders. The time taken to move goods out of the main harbour has fallen sharply; non-tariff barriers such as roadblocks have also been reduced. Importers of refined industrial sugar and wheat are also pleased after the government scrapped requirements to pay unnecessary administrative charges.

❹ However, there is a belief among manufacturers that there is a need for more deregulation to lower their costs of production and in effect reduce the cost of doing business.

Kenya sees gross domestic product (GDP) growth picking up but current account a concern

❺ Good economic growth rates in neighbouring countries like Uganda help to boost Kenyan exports, particularly for agriculture that makes up nearly a quarter of the Kenyan economy. The government suggests that the main risks to growth are the slow performance of developed economies that are key export markets for Kenyan goods and services, and Kenya's large and persistent current account deficit of over 10 % of gross domestic product (GDP) in the last three years. This is a major concern for sustained economic growth and the value of the Kenyan shilling.

[Sources: adapted from www.standardmedia.co.ke, 13 June 2014; www.af.reuters.com, 25 July 2014 and www.cnbcafrica.com, 25 November 2013]

(This question continues on the following page)

(Question 1 continued)

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

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

(b) Using an international trade diagram, explain the impact on the Kenyan government of implementing a tariff on steel imports. [4]

(c) Using an exchange rate diagram, explain why a deficit in the current account may result in downward pressure on the Kenyan shilling (Kenya's currency) (paragraph ❺). [4]

(d) Using information from the text/data and your knowledge of economics, evaluate the claim that trade protection measures will support economic growth in Kenya. [8]

Turn over

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

Australian economy feels the effects of falling iron ore price

❶ Iron ore is Australia's largest export and the double effect of slowing growth in China and higher levels of production in Australia has driven the price of iron ore lower. In addition, the Australian dollar (AU$) has experienced a 10% **depreciation** against the US dollar (US$). These two factors combined have caused a dramatic worsening in the **current account**.

❷ Australian mining companies are losing significant revenue from falling commodity prices and this is further worsened by the rapidly depreciating currency. The Australian dollar traded at US$0.7375 on Wednesday, nearly at a six-year low.

❸ Australia recorded a monthly balance of trade deficit of AU$2.61 billion in May 2015, compared with a deficit of AU$1.61 billion a year earlier. The increasing deficit in Australia's balance of trade is an indicator of potential declines in growth and employment, according to a foreign currency expert.

❹ The price of iron ore has fallen more than 67% between February 2013 and July 2015. In Australia, falling iron ore prices create downward pressure on economic growth. Australia's real gross domestic product (GDP) grew 2% in 2015, down from 2.5% in 2014. Some economists noted that falling commodity prices reduced Australia's export revenues by more than 2% of GDP in 2015.

❺ An expanding group of Australian-based economists argue that the central bank should further cut interest rates because of global economic uncertainty, falling commodity prices, weak consumer demand, and persistent weakness in non-mining sectors, such as tourism and education exports. Australia has been a popular destination for tourists and attracts many international students.

[Sources: *Sydney Morning Herald*: adapted from http://www.smh.com.au/business/markets/china-panic-feeds-into-australian-sharemarket-20150708-gi7nyk.html
Marketwatch: adapted from www.marketwatch.com, accessed 26 July 2015.

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

(ii) Define the term *current account* indicated in bold in the text (paragraph ❶). [2]

(b) Using an exchange rate diagram, explain why "slowing growth in China" may have caused a depreciation of the Australian dollar (paragraph ❶). [4]

(c) Using a demand and supply diagram, explain why "the double effect of slowing growth in China and higher levels of production in Australia has driven the price of iron ore lower" (paragraph ❶). [4]

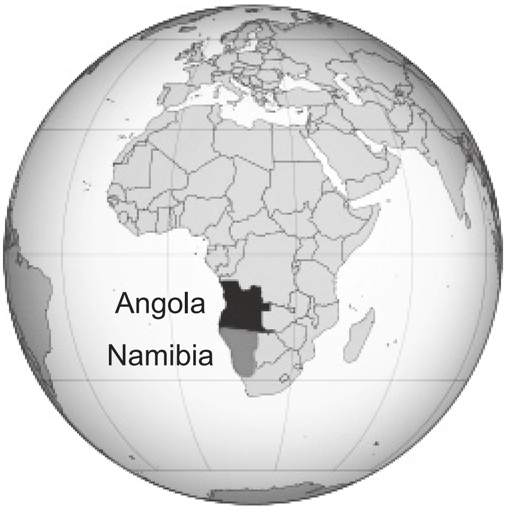
(d) Using information from the text/data and your knowledge of economics, discuss the possible consequences for the Australian economy of the fall in the value of the Australian dollar. [8]

Section B

Answer **one** question from this section.

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

Angola and Namibia



❶ Angola and Namibia are neighbouring countries on the west coast of Africa.

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(Question 3 continued)

Angola

❷ Angola's economy is driven by its oil sector. It is the second largest oil producer in Africa. Oil production and its supporting activities contribute about 50 % of gross domestic product (GDP), more than 70 % of government revenue and more than 90 % of the country's exports. Diamonds contribute an additional 5 % to exports. Subsistence agriculture provides the main livelihood for most people in Angola, but half of the country's food is still imported.

❸ Since 2005, the Angolan government has borrowed billions of US dollars from China, Brazil, Portugal, Germany, Spain and the European Union (EU) to help rebuild Angola's **infrastructure**. The global recession that started in 2008 slowed economic growth. In particular, lower prices for oil and diamonds during the global recession slowed GDP growth to 2.4 % in 2009, and many construction projects stopped.

❹ Falling oil prices and slower than expected growth in non-oil sectors have reduced growth prospects for 2015. Angola has responded by reducing government subsidies and by proposing import quotas and making it more difficult to import. Domestic fuel subsidies have been eliminated. Corruption, especially in the mining sector, is a major long-term challenge.

Namibia

❺ Namibia's economy is heavily dependent on the mining and processing of minerals for export. Mining accounts for 11.5 % of GDP, but provides more than 50 % of foreign exchange earnings. Namibia is a primary source for high-quality diamonds. In addition, Namibia is the world's fifth-largest producer of uranium, produces large quantities of zinc and is a smaller producer of gold and copper. The mining sector employs less than 2 % of the population. Namibia normally imports about 50 % of its grain requirements.

❻ A high per capita GDP, relative to the region, hides one of the world's most unequal income distributions. The Namibian economy is closely linked to South Africa with the Namibian dollar pegged one-to-one to the South African rand. Namibia receives 30 % to 40 % of its revenues from the countries in the Southern African **Customs Union** (SACU). Angola is not a member of the SACU.

❼ Namibia's economy remains vulnerable to world commodity price fluctuations and drought. The rising cost of mining diamonds, increasingly from the sea, has reduced profit margins. Namibian authorities recognize these issues and have emphasized the need for diversification.

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(Question 3 continued)

Figure 1: Selected economic data for Angola and Namibia (2014)

	Angola	**Namibia**
Human Development Index (HDI) rank	149	127
HDI value	0.526	0.626
Population (millions)	24.2	2.4
Land mass (kilometres squared)	1 246 700	825 615
Gross national income (GNI) per capita in purchasing power parity (PPP) terms (US$)	6540	8577
Real GDP growth rate (%)	4.2	5.3
Inflation rate (%)	7.3	5.3
Life expectancy at birth (years)	52	64
Expenditure on health, public (% of GDP)	3.8	7.7
Expenditure on education, public (% of GDP)	3.5	8.5
Gini coefficient	0.43	0.60
Population below poverty line (%)	40.5	27.8

[Sources: adapted from www.commons.wikimedia.org, 14 August 2014; *The World Factbook*, Country Reports, Central Intelligence Agency, 2015; www.databank.worldbank.org, accessed 13 August 2015 and www.cia.gov, accessed 13 August 2015]

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

(ii) Define the term *customs union* indicated in bold in the text (paragraph ❻). [2]

(b) Angola and Namibia have different Gini coefficient values. Using a Lorenz curve diagram, explain what this means (Figure 1). [4]

(c) Using a demand and supply diagram, explain the effect on the price and quantity of fuel consumed in Angola, caused by the elimination of domestic fuel subsidies (paragraph ❹). [4]

(d) Using information from the text/data and your knowledge of economics, compare and contrast factors that are likely to lead to economic development in Angola and Namibia. [8]

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

Sri Lanka's economic reforms

❶ After Sri Lanka's 25-year civil war ended in 2009 it became one of the world's fast-growing emerging markets, helped by billions of US dollars worth of infrastructure investment from China. Sri Lanka's new government plans to implement a range of market-oriented policies to open up its financial system, liberalize the Sri Lankan rupee (Sri Lanka's currency) and make new trade deals with both India and China.

❷ Sri Lankan economists and corporate leaders are urging "tough" economic decisions, reducing the bureaucracy and eliminating costly inefficiencies in state enterprises. 300 state-owned firms dominate the economy, and there is pressure for them to enhance their competitiveness. One realistic option is a policy of **privatization**. Another policy is the establishment of 46 economic zones across the country with low tax rates. This should encourage the private sector to invest in setting up these zones.

❸ Improving infrastructure is also a priority. Power supply is unreliable and broadband speeds are slow in rural areas.

❹ Another priority is to reduce controls on exchanging currency. Sri Lankans find it difficult to obtain foreign exchange, limiting tourism and business overseas. Improving access to foreign currencies would make people's lives easier and encourage more business.

❺ On a positive note, improved international relations has increased tourism. To take advantage of this, the government should now implement a strategy to further promote tourism.

❻ A major challenge for the government is that more than 25 % of the population lives below US$2.50 per day. This is caused largely by the fact that 30 % of the population is involved in agriculture, which contributes less than 10 % of gross domestic product. In addition, tackling youth unemployment and increasing household incomes are challenges.

❼ But perhaps the greatest problem confronting the government is the country's massive debt burden, which is equivalent to 700 % of its tax revenue. This creates a significant debt servicing problem, especially because much of the debt is foreign owned.

❽ Another problem is a current account crisis. Sri Lanka needs to replace its reliance on payments from Sri Lankans employed overseas with export revenues. And instead of relying on borrowing from overseas to finance its current account deficit, the country needs to attract foreign direct investment.

❾ There is also a need for the government to try to improve the ability for companies to do business, such as by reducing the time it takes to register a business and by improving access to credit for small companies, which would significantly stimulate the economy. Business confidence has to improve in order to stimulate new investments and economic growth.

[Sources: adapted from *Sunday Times*, Sri Lanka, www.sundaytimes.lk, 23 August 2015, and FT James Crabtree, 2015, Sri Lanka plans 'big bang' reforms, *Financial Times*, www.ft.com, 19 August.

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(Question 4 continued)

(a) (i) List **two** characteristics of an economically less developed country. [2]

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

(b) Using a production possibilities curve (PPC) diagram, explain how "billions of US dollars worth of infrastructure investment from China" may affect potential economic output (paragraph ❶). [4]

(c) Using a definition of the term opportunity cost **and** information from the text, explain how the servicing of debt has an opportunity cost that may affect economic development in Sri Lanka. [4]

(d) Using information from the text/data and your knowledge of economics, discuss the possible effects of the proposed market-oriented reforms on Sri Lanka's economic development. [8]